
Trade Liberalization, Domestic Trade Policies and the Failure of Reducing Poverty: The Case of Indonesia

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Abstract

The existence of international trade has provided important benefits for reducing poverty. Many countries then have concluded trade agreements, to reach this goal by committing trade liberalization. The relatively high number of poverty has raised some concerns, questioning the effectiveness of trade liberalization. Putting Indonesia as a case study, this article weighs the role of trade liberalization and domestic trade policies in reducing poverty. This article argues that the existence of domestic trade policies is more significant than trade liberalization. The unfair practices, corruption, and the overwhelming spirit of national interest that colour domestic trade policies, contribute to the failure of reducing poverty instead of trade liberalization.

Keywords: Trade Liberalization, Domestic Trade Policies, Reducing Poverty, Indonesia

I. INTRODUCTION

The existence of international trade has provided important benefits, including alleviating poverty, increasing GDP¹, and reducing unemployment². Almost all trade agreements (both bilateral, regional, and multilateral) then put these goals in their primary objectives. The preamble of the World Trade Organization (WTO agreement) shows how the elimination of trade distortion is the prerequisite in reaching the objectives of intensifying ‘standards of living’ and safeguarding ‘full employment’³. In Australia-China FTA, the reduction of trade distortions, including investment flows will ‘create new opportunities for employment and to improve the living standards of their peoples’⁴.

The relatively high number of poverty has raised some concerns, questioning the contribution of trade liberalization across the globe. In 2015, United Nations Development Program (UNDP) denoted an inequality concerning human development⁵, particularly when most countries reached a medium level, Sub Saharan Africa still experienced with a low-level of human development⁶. In addition, 94 percent of the income of the world only is only circulated to 40 percent of world’s population⁷. Some experts then show their concerns, explaining that trade liberalization have negatively affected environment⁸ and cultural value, and heritage⁹.

Indonesia has been involving in the General Agreement on Tariffs and Trade (GATT) since 24 February 1950, and the WTO since 1 January 1995¹⁰. Indonesia was ardently joined in groups that encouraged specific trade issues during the WTO negotiations, such as the Cairns Group¹¹, the G-20¹², and the G-33¹³. In PTA, Indonesia has concluded agreements with other WTO members, such as Bulgaria (2004)¹⁴, and with non-WTO members, such as Uzbekistan (2008)¹⁵. On behalf of ASEAN, Indonesia has concluded PTAs with China (2002)¹⁶, India

(2003)¹⁷, Korea (2005)¹⁸, Japan (2008)¹⁹, and Australia and New Zealand (2009)²⁰.

However, there has been a continuous protest in Indonesia, doubting the contribution of trade liberalization for Indonesia's growth and development. While Indonesia (Bali) became a host of WTO annual meeting in Bali, activists showed their disagreement in the implementation of trade liberalization. They insisted that Bali Package had no benefits for Indonesia, and only marginalised farmers, professionals, and civil servants, putting Indonesia as a victim of trade policies²¹.

In 2018, when Indonesia hosted World Bank and IMF annual meeting, the issues are somewhat similar. Indonesia's opposition criticized this event as it spends lavish amount of money while Indonesia is still in crisis²². Furthermore, the event will have no contribution for reducing poverty, promoting labour rights, and promoting environment²³.

This article aims to weigh the role of trade liberalization and domestic trade policies in reducing poverty. This article argues that the existence of domestic trade policies is more significant than trade liberalization, particularly in reducing poverty.

To begin with, this article answers the problem related to whether trade liberalisation under agreements really fails to reduce poverty. Then, it will analyse the contribution of domestic trade-related laws and policies in impeding trade agreements' goals. Putting Indonesia as a case study, this article explains the past and existing domestic trade-related laws and policies, and how they have been contributed to the poverty issue in Indonesia.

II. DISCUSSION

Does Trade Liberalisation Really Fail to Reduce Poverty?

This section will show current studies, explaining some criticisms of the existence of trade liberalization in alleviating poverty. Almost all trade agreements eventually issue schedule of commitment to accelerate trade liberalization. They have primary objectives to realise world's prosperity through poverty reduction. Specifically, The WTO obviously states in its preamble 'a view to raising standards of living, ensuring full employment'²⁴. Furthermore, North-American Free Trade Agreement (NAFTA) has a primary goal to reach 'new employment opportunities and improve working conditions and living standards in their respective territories'²⁵.

There are disagreements to the perspective that trade liberalisation is always positive. Muhammad Yunus, the winner of the Nobel Peace Prize, explained that income inequality was a notorious fact of trade liberalisation, showing 40 percent of world's population dominated 94 percent of the world income while 60 percent people enjoyed only six percent of the income²⁶.

Stiglitz then analysed that the acceleration of trade liberalization without providing any 'safety nets, with insufficient reciprocity and assistance on the part of developed countries, can contribute to an increase in poverty'²⁷. Likewise, using the theory of the second best, Krugman and Obstfeld concluded that free trade can only work 'if all other markets are working properly'²⁸. If not, it requires the intervention of government to anticipate market failure's effect²⁹.

Some empirical studies have shown how poverty and inequality are still serious impediments to embody the prosperity. Specifically, the wage inequality remains unsolved in countries such as Colombia³⁰, India³¹, and Indonesia³². Equally, UNDP in 2015 denoted, between 1990 and 2015, when the global prevalence of extreme poverty decreased from 47 to 14 percent, the extreme poverty in Sub-Saharan Africa only slightly decreased from 57 to 41 percent³³.

World Bank then analysed the poverty rate in Central Asia and Europe to Africa³⁴. It showed that from 272.4 million total population with 0.7 percent population growth, only less than 2 percent population living below \$1.25 per day in Central Asia and Europe³⁵. Meanwhile, in Africa, from 936.3 million total population with 2.7 percent population growth, 46.8 percent Population living below \$1.25 per day³⁶.

Do Domestic Trade Policies Contribute to the Failure of Trade Liberalisation?

Instead of blaming trade liberalisation, the following scholars will show how the existence of

domestic trade policies determines the extent to which a country is success (or failure) to gain benefit from trade liberalization under trade agreements. Hernando De Soto (2000) analysed that inefficiencies and formalities of laws and policies in developing countries have made them fail to gain the benefits of capitalism³⁷. Trubek (2006) then explained how legal cultures of developing countries were highly 'formalist', causing to inconsistent enforcement, incongruous rules, and low legitimacy³⁸.

Dee and Findlay (2009) and Abeysinghe (2014) then pointed out how domestic laws are more influential than international laws in trade in services. Trade in services' agreements predominantly focusses on 'behind the border' regulatory distortions, while those on trade in goods predominantly deal with 'at the border barriers' for instance tariffs³⁹. Specifically, instead of tariffs, host country can impose discriminatory limitations on the movement of capital (such as limitations on foreign ownership), and a difference of domestic policies, including licensing, technical standards, and qualification compulsion⁴⁰.

The Case of Indonesia

Problems on the domestic policies in Indonesia have been scrutinized by international organizations and leading scholars. World Bank (2009) revealed that the lack of coordination across different branches of government, covering the central and local level, and across different ministries at the national level in formulating and implementing laws and policies has impeded the effectiveness of the government in realising its development program⁴¹.

World Justice Project (2015) then raised three contributing factors for the shortcoming of law in Indonesia, namely "defective investigations, an ineffective correctional system, and violations to due process of law"⁴². In Addition, the World Economic Forum (WEF)'s Global Competitiveness Report 2016-2017 stated that the most troublesome factors for conducting business in Indonesia were corruption and inefficiency in the bureaucracy of Indonesia⁴³.

Daniel S. Lev (1990) revealed that harsh criticisms of the law in Indonesia have begun since 1960, especially when social injustice began to occur⁴⁴. Alkostar (2000) then argued the cause of this situation because of the misuses of law enforcement⁴⁵. Samekto (2008) argued that the legal crisis in Indonesia has taken place because the legal enforcement apparatus treated the law as tradable activities, as if the justice belongs only to a certain group of people so called "justice (not) for all"⁴⁶.

Analysing the legal loopholes in Indonesia, Butt (2009) found one of the reasons why the government was difficult to enforce judicial decisions⁴⁷. The existence of 'surat sakti' (magic memos) has severely impeded the rule of law in Indonesia⁴⁸. The Chief Justice of the Supreme Court issued these memos, instructing a lower court that a particular decision cannot be enforced⁴⁹.

The regional autonomy governance is also far from perfect. Aspinall and Fealy (2003) indicated that some elements of regional autonomy had degraded the quality of governance, pointing out the lack of capacity at the regional level, the inequality between the rich and poor regions, and the massive corruption⁵⁰. Furthermore, World Bank (2009) argued that the process of regional autonomy had been coloured by the overlapping responsibilities between central and local governments and the lack of transparency⁵¹.

From those explanations, it can be concluded that domestic policies have a more influential role instead of trade liberalization. What makes the goals of trade liberalization fail is the existence of domestic policies. However, there is a possibility if trade liberalization may also contribute to that failure, particularly if the commitment of trade liberalization that has been concluded under trade agreements, haphazardly transforms into domestic policies. Juwana (2006) revealed that some policies were not realistic because the government issued these policies to follow an order of foreign countries and international financial institutions instead of people's demand⁵². For example, the political elite may determine that the government enacted legislation in order that Indonesia has comparable legislations to the developed country⁵³. Besides, a foreign country or an international organisation may request Indonesia to enact a particular policy as a prerequisite before granting financial aid⁵⁴.

Indonesia's Domestic Trade-Related Laws and Policies: Past Experience

This section will explain how the past domestic trade policies have contributed to the failure of trade liberalization in reducing poverty in Indonesia. In old order under Sukarno Administration, Indonesia was reluctant in joining trade agreements. The overwhelm spirit of national interest became the main

reason. The government conducted tariff reform to secure domestic businesses⁵⁵. Further, Indonesia only approved to the decrease of tariff and non-tariff barriers executed upon export products of interest of Indonesia⁵⁶.

However, the decision to protect national interest was coloured by the corruption practice in the implementation phase. The most popular one was a corruption in the export-import licenses⁵⁷. Many politicians acted business cohorts of licensees where the license was coming from discriminatory measure for prioritizing indigenous businesses⁵⁸. However, this measure changed into ‘behind-the-scenes kickbacks paid by Chinese businessmen’⁵⁹. Another practice related to the fact that state-owned companies were granted a monopoly on the import of primary commodities, which was supported by state credit⁶⁰. However, private companies (indigenous and Chinese firms) did not enjoy those measures and facilities⁶¹.

In New Order under Soeharto Administration, there were many types of corruption and collusion in the implementation of domestic trade policies. Kenward then elaborated these practices, including the national car project (Timor) that involved Soeharto’s youngest son where the government discriminatory waived some car taxes for this project; the privatisation of excise tax collection in Bali; the bail-out of failing banks by the central bank; and the monopoly for purchasing and distributing the cloves needed by cigarette industry in Indonesia⁶². Almost all illegal practices occurred as a result from the strong alliances of Suharto’s children and leading conglomerates, supported by strong military and political regimes⁶³.

In this period, Indonesia was also not active in trade agreements. Only in Uruguay Round Indonesia seemed to produce trade liberalisation’s commitment. In market access in goods, 95 per cent of all of Indonesia’s tariff-lines, accounting 92 per cent of total imports, were bound at 40 per cent⁶⁴. However, due to the average tariff line was already around 15 per cent in 1994, Indonesia’s commitment had minor impact on actual trade liberalisation⁶⁵.

Reformation Order and Domestic Trade Policies.

In reformation order, the better domestic trade policies have contributed to the reduction of poverty. Under the WTO negotiations, Indonesia sustained to decrease its tariff. While in 1995 the typical tariff rate was 15.6 per cent, the typical tariff rate had lessened to 7.2 per cent in 2003⁶⁶. In 2004, a tariff harmonisation program was publicized, introducing a tariff reduction (up to below 10 percent) schedule between 2004 and 2010⁶⁷. According to this schedule, 94 per cent of tariff lines would have rates at or below 10 per cent by 2010⁶⁸.

In 2012, the Government issued Indonesian Custom Tariff Book (‘BTKI’), according to the World Custom Organization HS2012 nomenclature and the ASEAN Harmonized Tariff Nomenclature (‘AHTN’)⁶⁹. This policy had resulted in a 10 per cent reduction in the total number of most favoured nation (‘MFN’) applied tariff lines⁷⁰.

The implementation of trade liberalisation does not mean without any controversy. In 2011, a group of non-governmental organization (NGO) filled a complaint to the Constitutional Court of Indonesia, arguing that the Law Number 38 of 2008 on the Ratification of Charter of the Association of Southeast Asian Nations had conflicted with Indonesia’s constitution. The ratification would harm the economic rights of Indonesian and it was alleged as the new colonialism and imperialism. The constitutional court, through the decision No. 33/PUU-IX/2011 finally refused the NGO’s claim⁷¹.

In 2014, the government enacted Law Number 3 of 2014 on Industry. The spirit of national interest is reflected in some articles. Article 32 explains that the government may limit the export of natural resources for enhancing the value added of domestic industry⁷². In Law Number 7 of 2014 on Trade, article 85 explains that subject to consent of House of Representatives, the government may re-examine and withdraw international trade agreements’ approval on the ground of national interest⁷³. The law, however, did not further clarify what the meaning of cancellation, and what constitute a national interest. Therefore, this law may contravene with the provision on the termination in the Vienna Convention on the Law of Treaties of 1969⁷⁴.

Some empirical studies have shown the positive impact of trade liberalisation in Indonesia. Robilliard and Park et al (2008) analysed how ASEAN-China FTA would benefit Indonesia through

greater productivity, competition, and lower consumer prices⁷⁵. A study from the Ministry of Trade of Indonesia (2011) showed how a trade agreement increased a competitiveness of Indonesian products⁷⁶. By using Constant Market Share Analysis (CMSA), this study examined the competitiveness of Indonesian manufacturing products after the implementation of Indonesia- Japan FTA⁷⁷. The result revealed the increase of competitiveness in the following products: fish products, cocoa, garments, and furniture⁷⁸. Nevertheless, the competitiveness of shrimp and plastic products has decreased after the implementation of this bilateral agreement⁷⁹. However, ILO (2013) showed that high unemployment still occurred in Indonesia, particularly among women, the educated workforce and youth, denoting the benefits of trade liberalisation are not always equal among age, gender and groups⁸⁰.

III.CONCLUSION

The existence of international trade has provided important benefits for alleviating poverty and inequality. Countries then have concluded trade agreements, to reach those goals by committing trade liberalization. The relatively high number of inequality and poverty has raised some concerns, questioning the effectiveness of trade liberalization. Putting Indonesia as a case study, this article weighs the role of trade liberalization and domestic trade policies in reducing poverty. This article argues that the existence of domestic trade policies is more significant than trade liberalization. International organizations and leading scholars have scrutinized problems on the domestic policies in Indonesia, particularly related to policy making process, the implementation of policy, and policy enforcement. From previous experience, it can be concluded that the unfair practices, corruption, and the overwhelming spirit of national interest that colour domestic trade policies, contribute to the failure of reducing poverty instead of trade liberalization.

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