ANALYSIS

Trade protectionism in Indonesia: Bad times and bad policy

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EXECUTIVE SUMMARY

Difficult economic circumstances have historically led Indonesian leaders to enact economic reforms, leading some to argue that bad times have resulted in good policy. But as Indonesian growth has slowed over the past year, the government has departed from this pattern, and is instead ratcheting up protectionist measures in the form of a variety of non-tariff barriers. These measures are likely to drive up prices for Indonesian consumers at a time when their purchasing power is declining, and undermine the competitiveness and productivity of Indonesian firms.

A strong rupiah, anti-foreign sentiment, increased Chinese competition in the global supply chain, and the populist preferences of new Indonesian President Jokowi have all combined to push Indonesia toward protectionism. Despite the negative consequences for Indonesian consumers and firms, these measures are likely to continue under the Jokowi Administration.

Indonesia's recent decision to cut the quota for live cattle imports from Australia has been seen by some as yet another example of how the relationship between Australia and Indonesia is ebbing ever lower. The truth is, however, the decision has less to do with how Indonesia sees Australia than it does with the changing character of trade policy in Indonesia.

Indonesia's attitude to trade and investment in recent years has been characterised as "sitting on the fence."[1] On the one hand, the country is an active member in the G20, APEC, and ASEAN. Such participation has in the past encouraged domestic policy reforms that ensured Indonesia benefited from greater economic integration with other countries. Since taking office in October 2014, President Joko Widodo's government has taken advantage of the 2014 APEC summit in Beijing and the 2015 Asian–African Commemorative Conference in Jakarta to pitch Indonesian investment opportunities to the global investment community.

On the other hand, there is a growing trend towards protectionism. Most of the policies reflective of this trend are non-tariff measures, as tariffs are already very low. The introduction of a more restrictive cap on certain sectors, the ban on raw mineral exports, and the provision of greater authority for ministers to issue intervention and monitoring policies are just a few examples. This trend began during the tenure of former president Yudhoyono but is continuing under President Joko Widodo (Jokowi).

Economists have often characterised economic reform in Indonesia as a pattern that follows 'Sadli's Law', where bad times lead to good policies.[2] Certainly it has been like that in the past. Plunging oil revenue in the 1980s pushed the government to implement broad-based economic reforms that boosted industrial development in Indonesia. In the late 1990s, Indonesia introduced another package of economic reforms as part of an IMF program to make its way out of the Asian financial crisis.

But it is not clear that such a pattern will repeat itself in the near future. The economy is now facing declining investment, diminished job creation, and a fiscal shortfall, owing to lower prices of natural resources commodities and lower demand from China for Indonesia's exports. But the policies the government is pursuing in response to these are heavily protectionist in nature. This time, bad times are resulting in bad policy. This Analysis will outline Indonesia's drift towards more protectionist economic policy and explore some of the key reasons it is occurring.

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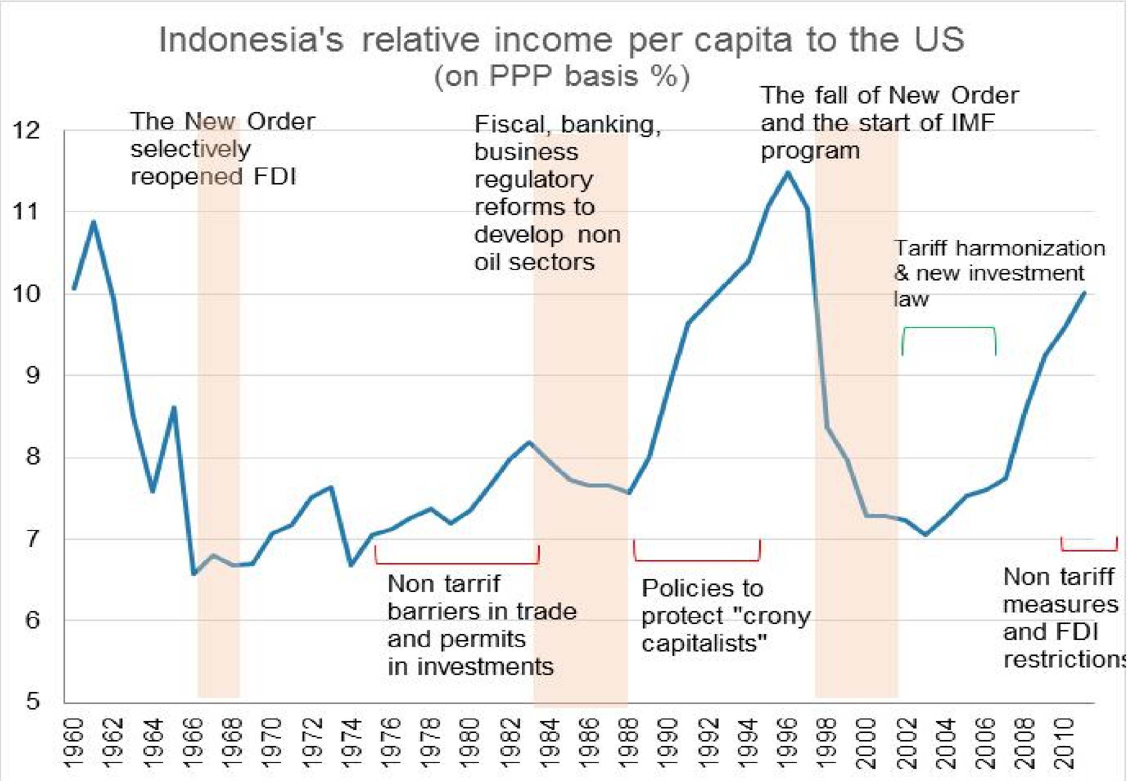
INDONESIA'S PATTERN OF REFORM

Like other economies, Indonesia is not immune from the cycle of boom and bust. Figure 1 shows GDP per capita on a Purchasing Power Parity (PPP) basis of Indonesia relative to the United States from 1960 to 2011, based on the Penn World Table. It underlines that the timing of major economic reforms in Indonesia have typically coincided with major economic crises. It also presents examples of protectionist policies implemented mostly during economic upturns.

Figure 1. Indonesia's income evolution and timing of key economic reforms



Source: Adapted from Basri, Rahardja, and Fitrania.[3]

The 'command socialism' of the late 1950s and early 1960s had collapsed by the middle of the 1960s, replaced by the dramatic reforms of the New Order. The 1967 Investment Law opened oil, the consumer sector, and heavy industries to foreign direct investment (FDI), which had previously been banned. Along with sharp increases in global energy and mineral prices in the 1970s and 1980s, the FDI reforms brought oil and mining multinationals to Indonesia, adding to the large influx of natural resources revenue.[4]

Reforms in the 1980s were triggered in large part by the collapse in global oil prices. The resulting contraction in the oil sector contributed to a slowing in the Indonesian economy. The government used the opportunity to launch a series of successful reform packages (*paket reformasi*) starting in 1983 and continuing into the early 1990s to stimulate non-oil industries, particularly those that were labour intensive. The economic reforms included measures to improve the mechanism for import fee refunds while encouraging exports; developing the capital market and banking sector; improving customs clearance procedures; reducing investment permit requirements; and relaxing ownership restrictions on foreign direct investment. These reforms helped accelerate economic growth and ushered in a new golden era for Indonesia.

In 1992, Indonesia strongly supported an ASEAN free trade area, and in 1994, Indonesia promoted the Bogor Declaration at APEC, which paved the way for greater regional economic integration. These reforms raised the productivity of Indonesia's manufacturing sector, as firms could now access inputs at prices closer to international levels.[5]

Unfortunately, the good economic times also attracted the attention of crony capitalists. Permits to perform economic activities (for example, automotive assembly, flour milling, forestry, cement production, petrochemicals, and clove trading) were given to certain business groups and state-owned enterprises (SOEs) without sufficient oversight or transparency. Several government projects, most notably in construction, were given to companies linked to President Suharto's family.[6] Combined with a lack of supervision in the banking sector and an underdeveloped capital market, these policies contributed to bad investments by local companies that eventually brought down the banking sector and the economy more broadly in 1997 and 1998.[7]

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As part of the economic rescue package agreement with the IMF following the crisis of 1998, Indonesia stripped the privileges of certain business groups and SOEs. Many import licences were abolished, and others simplified. Most notable was the removal of the authority of the national food agency, Bulog, to control imports of strategic food commodities such as rice and soybean. Between 2001 and 2002, rice trading was done largely by the private sector. Import tariffs were further reduced, bringing down the overall effective rate of protection. But the push for change in policy-making went much further when Indonesia decided to give significant budget planning and execution authority to district governments.

On the international front, Indonesia supported the establishment of the free trade agreement (FTA) between ASEAN countries and China in 2002 — a commitment that faced much domestic resistance after its implementation in 2010. Indonesia also negotiated and signed an FTA with Japan in 2008, the first bilateral FTA between Indonesia and its most important trading partner. The government's interest in free trade after the IMF reforms was short-lived, however. It resumed tight control over the import of rice and reinstated its mandate to procure paddy rice from farmers. Trade in agriculture products became subject to discretionary permits (letters of recommendation) or implicit quotas that were prone to corruption.[8]

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The return to protectionism continued during the second term of the Susilo Bambang Yudhoyono presidency, following the 2008 and 2009 global financial crisis. During this period, the government and the parliament passed new laws on mining, farming, and horticulture that had a serious impact on openness to trade and investment. Protectionism reached new heights after the Cabinet shake-up in 2012. The Ministry of Agriculture and the Ministry of Industry added new products to the list of those that require permits. The Ministry of Trade reinstated import licensing on a number of products and imposed tighter control over the distribution of imported goods. Meanwhile, dialogues on bilateral FTAs, such as with Australia, the European Union, and South Korea, were put on hold. In 2013, the government imposed a ban on exports of raw minerals to comply with the Mining Law and to promote domestic processing.

BAD TIMES AND BAD POLICY

The administration of President Joko Widodo (Jokowi) is continuing the trend towards greater protectionism. It is preparing increased local content requirements for telecommunication equipment (for example, smartphones and handheld devices) and for automotive parts. The Ministry of Trade has recently restricted retail sales of alcoholic beverages, while a draft law to completely ban alcohol consumption is being proposed to the Parliament.[9] The Ministry of Manpower also imposed tighter control on the use of foreign professionals in Indonesia.[10] Cabinet members talk openly about pushing back against the implementation of ASEAN Economic Community reforms and reviewing the usefulness of existing trade agreements.

As Table 1 shows, protection in Indonesia in terms of tariffs has decreased over time. While there has been a slight increase in the simple average tariff since 2011, and the Jokowi Administration has recently announced a further increase in tariffs affecting consumer goods, the weighted average tariff (taking trade volumes into account) has dropped below 5 per cent. However, tariff measures give only a partial picture of the level of protection. Marks and Rahardja calculated the actual level of trade protection in Indonesia using nominal and effective rates of protection (NRP and ERP).[11] They find that both measures increased between 1995 and 2008; for example, in the case of food crops, NRP and ERP increased from 11–17 per cent to 16–24 per cent. The fact that tariffs have decreased around the same period implies that non-tariff measures have increased.

Table 1. Indonesia's most-favoured nation (MFN) tariffs, 1995–2013

Tariff year	Simple average (%)	Weighted average (%)	Standard deviation
1995	15.34	10.89	14.89
1996	12.35	7.73	16.70
1999	11.19	6.05	16.61
2000	8.43	5.16	11.91
2001	6.89	4.31	11.29
2002	6.90	5.79	11.14
2003	6.90	5.22	11.13
2004	6.95	6.09	15.41
2005	6.96	6.07	15.41
2006	6.95	6.07	15.41
2007	6.91	5.01	12.62
2009	6.80	4.96	12.42
2010	6.70	5.19	7.00
2011	7.41	4.75	11.4
2013	7.23	4.67	11.4

Source: World Bank, World Integrated Trade Solution (WITS) data.

REGULATORY FRAMEWORK

Central to the proliferation of non-tariff measures in Indonesia in recent years has been a raft of new trade- and investment-related regulations. Appendix 1 highlights some recently passed laws and explains their impact. Most of these laws and their accompanying regulations are intended to restrict export or import, stabilise domestic prices, and foster linkages in the domestic economy. The 'linkage' policy (also known as 'downstreaming') was popular when developing countries were isolated from the rest of the global economy but it has been gaining popularity again, including in Indonesia. It is a type of industrial policy that aims to increase domestic value added by supporting an economic sector whose outputs are used heavily by another sector domestically, or which uses significant inputs from another domestic sector.[12] In today's globalised world, however, such an approach is no longer workable. In fact, as linkages between economic sectors weaken, export earnings as well as employment creation may actually increase. Enforcing artificial linkages might therefore reallocate resources at the cost of existing industries and potential industries.[13]

The new regulations also send contradictory messages. Take for example the Negative Investment List. The most recent list reduces foreign investment restrictions, allowing as much as 51 per cent foreign investment in advertising (previously 0 per cent) and 85 per cent in pharmaceutical manufacturing (previously 75 per cent). But at the same time, the list increases foreign ownership restriction in other areas, such as distribution (previously no restrictions, now 33 per cent) in an attempt to protect local producers.

Some of these new national regulations also conflict with local by-laws. For example, in the case of the sale of alcoholic beverages, the governor of Jakarta ruled that alcoholic beverages type A (0–5 per cent alcohol content) can be sold in minimarkets. But the minister of Trade issued a contradictory regulation, prohibiting all alcoholic beverages from being sold in minimarkets.[14] Another example is local by-laws on imports. Import policy comes under central government authority. However, there are regional governments like that of the Brebes district and East Java province that issue regulations requiring their permission for imports to enter their respective jurisdictions.[15]

NON-TARIFF MEASURES

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Although Indonesia may not be the worst offender in the region in imposing new trade-restrictive regulations, it is one of the worst when it comes to non-tariff measures. According to the Global Trade Alert (GTA) database, since 2009 Indonesia has implemented 25 non-tariff measures, compared with 12 by India and 1 by Thailand. Compared with China, Malaysia, India, and Thailand, Indonesia also issued more export taxes and restrictions.

The GTA classifies trade measures as ‘green’, ‘amber’, and ‘red’ to indicate their degree of ‘harmfulness’, with red being the most harmful. Table 2 presents the number of harmful measures (‘amber’ and ‘red’) implemented by Indonesia, as compared with China, Malaysia, Thailand, and India.

In its sixteenth report, the GTA listed Indonesia among the worst “offenders” for increasing protection since the global financial crisis.[16] According to its database, Indonesia has introduced 37 amber measures and 158 red measures since 2009. Furthermore, there are 746 tariff lines, 45 sectors, and 181 trading partners affected by the red measures.

Appendix 2 lists some non-tariff measures imposed by Indonesia since 2009, mostly by the minister of Trade. These include measures such as licence and permit requirements, pre-shipment inspections, and new labelling requirements. Some measures re-enforce previous ones, with increased strictness. Others include complicated cross-bureaucracy between ministries.

Appendix 3 lists other measures Indonesia has used to promote domestic industries, including local content requirements and export restrictions.[17] Export restrictions are also intended to ensure a sufficient domestic supply. These measures are sometimes taken in tandem, making the business environment more complicated and cumbersome.

Table 2. 'Harmful' trade measures

Number of harmful measures implemented by specified jurisdiction, by type of measure	Total measures				
	Indonesia	China	Malaysia	Thailand	India
Bail-out / state aid measure	6	6	1	1	19
Competitive devaluation	0	0	0	0	0
Consumption subsidy	0	1	0	0	0
Export subsidy	3	11	2	1	25
Export taxes or restriction	18	10	1	2	14
Import ban	6	3	1	0	6
Import subsidy	0	0	1	1	2
Intellectual property protection	0	2	0	0	0
Investment measure	13	17	4	3	12
Local content requirement	15	9	4	0	107
Migration measure	2	1	2	1	2
Non-tariff barrier (not otherwise specified)	25	9	3	1	12
Other service-sector measure	4	3	0	0	1
Public procurement	9	7	0	0	13
Quota (including tariff-rate quotas)	5	7	0	0	2
Sanitary and phytosanitary measure	4	0	0	0	0
State trading enterprise	0	0	0	0	0
State-controlled company	2	1	0	0	1
Sub-national government measure	0	2	0	0	1
Tariff measure	12	15	3	1	37
Technical barrier to trade	3	1	0	0	0
Trade defence measure (anti-dumping, countervailing duties, safeguard)	17	45	7	14	135
Trade finance	1	1	2	0	95
Total	115	131	18	22	356

Source: http://www.globaltradealert.org, accessed 13 May 2015.

THE POLITICAL ECONOMY OF TRADE PROTECTIONISM

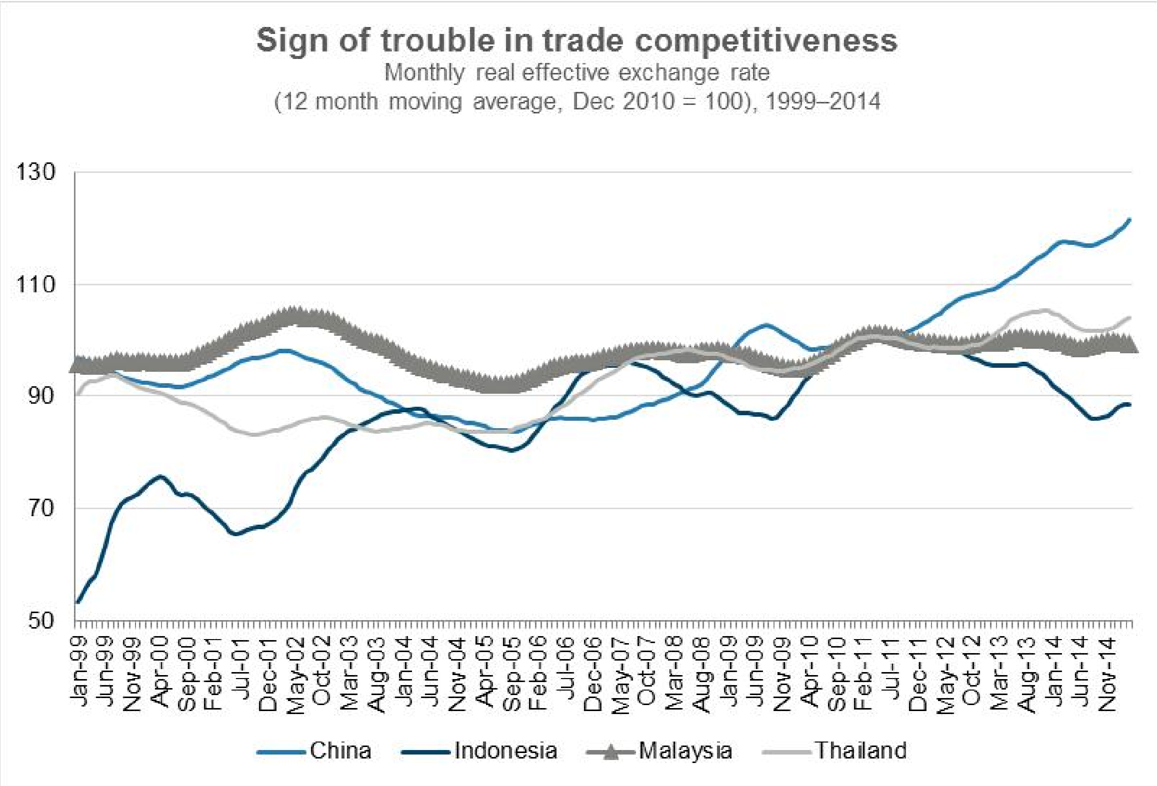
A number of factors have played a role in the re-emergence of protectionism in Indonesia. One of these has been exchange rate movements. Exchange rate movements often drive protectionist tendencies.[18] When the real exchange rate appreciates, export becomes more expensive. To compensate for reduced demand, the sectors that produce traded goods often ask government for protection in the form of tariff- or non-tariff measures.[19] In part this seems to explain, for example, the rise in protectionist measures around the local rice industry.

Nevertheless, movements in the exchange rate do not on their own explain why the government often protects a small group of businesses at the cost of the rest of the population. The answer often lies in the ability of small concentrated interests like rice traders to lobby more effectively than the larger population. Corruption also plays a role in this regard.

Four more recent factors also help to explain the re-emergence of protectionism in Indonesia. First, a drop in Indonesia's competitiveness. Figure 2 depicts Indonesia's competitiveness as represented by the real effective exchange rate.[20] There was a strong appreciation after the

Asian financial crisis of 1998 before it reversed in 2013. The appreciation was due to a commodity boom, as more than half of Indonesia's non-oil and gas exports were contributed by commodities. Indeed, the value of Indonesia's exports nearly tripled during the period between 2004 and 2011, from $US71 billion to $US201 billion. But this was mainly due to the significant increase in the price of commodity exports, rather than in the quantity. As the boom ended, Indonesia's competitiveness also dropped.

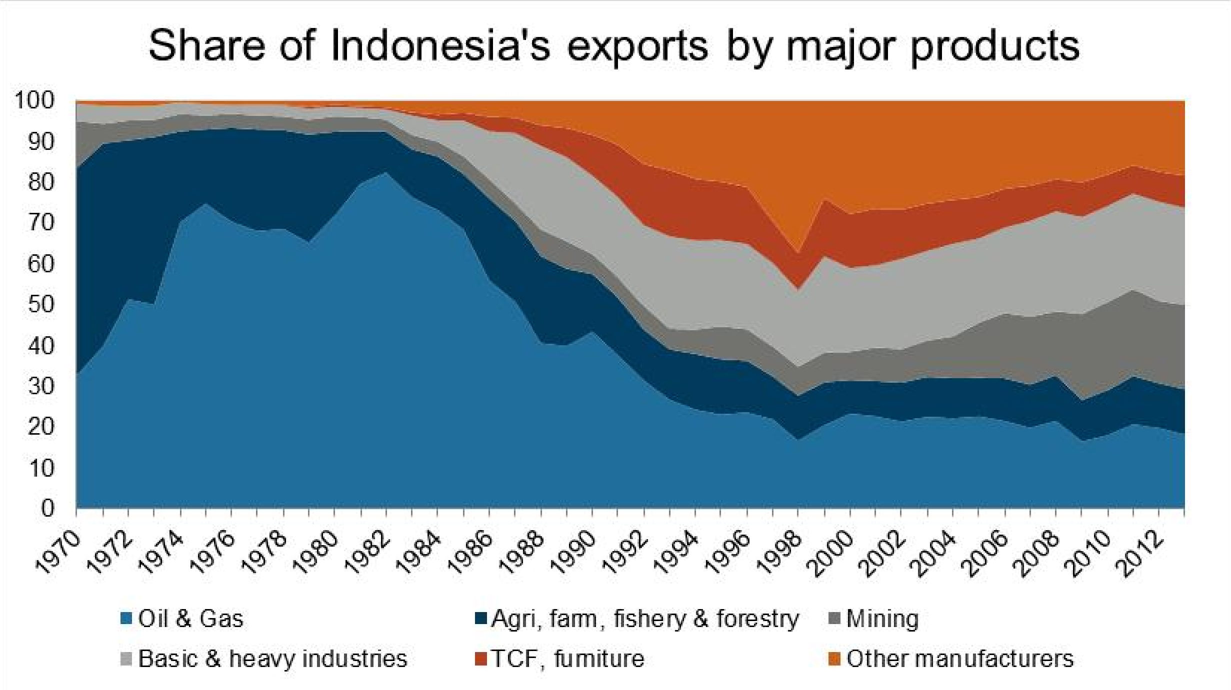
Figure 2. Indonesia's trade competitiveness



Source: Authors' calculation from BIS database, http://www.bis.org/stats.

At the same time, like in other countries, Indonesia's manufacturing sector came under threat with China's accession to the WTO. China's entrance into the global trading system quickly changed the competitive equation for Indonesia, as it competes directly with China on labour-intensive products such as footwear, garments, and other light manufacturing. Meanwhile, Indonesia's aspiration to move up the value chain in manufacturing and to develop heavy industries was immediately challenged by the rapid expansion of Chinese exports in the global marketplace. This and the commodity boom meant that Indonesia's manufacturing exports, especially labour-intensive products such as textiles, clothing, and footwear (TCF), and leather products and furniture (Figure 3), comprised a declining share of its total exports. Finally, changes in wages and increased uncertainty in the regulatory environment after the Asian crisis weakened the link between output growth and jobs generated in manufacturing, and reduced the likelihood of medium-size firms expanding.[21]

Figure 3. Share of Indonesia's exports by major products



Source: Authors' calculation from UN-COMTRADE based on SITC rev 2.

The second factor in the re-emergence of protectionism in Indonesia is related to the trauma of Indonesia's experience with the IMF in the wake of the Asian financial crisis of 1997–98. Many observers (for example, Ito 2004 and Grenville 2004) have demonstrated that the IMF's economic prescriptions for Indonesia were misplaced and did damage to the Indonesian economy. One consequence of this was that it created an 'IMF stigma'.[22] There remains today in Indonesia a strong sentiment "to avoid even thinking about asking financial assistance from the IMF."[23] But this sentiment is not just anti-IMF: populist commentators portray increased FDI and financing by international financial institutions as signs that Indonesia is once again bowing to the demands of foreigners instead of its own people.[24] Such stereotypes were reinforced by Indonesia's strong performance during the global financial crisis of 2008–09. Many argued that Indonesia escaped the worst of the crisis

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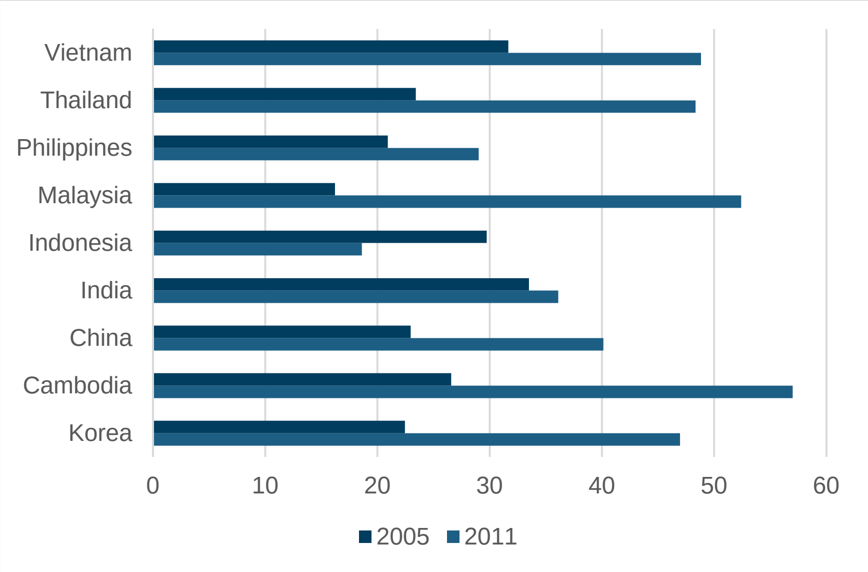
because it was more domestically oriented, and less engaged in foreign trade. Partly as a consequence, an inward-looking economic strategy is once again gaining appeal.[25]

The anti-foreign attitude also helps explain why Indonesia has been less enthusiastic about the global production network. The data on 'trade in value added' from the OECD reveals that the share of foreign value added in Indonesia's exports has declined from 30 per cent in 2005 to 19 per cent in 2011 (Figure 4).[26] This is in contrast to other successful manufacturing exporters in the region, which have increased the foreign value added component of their exports. One reason for this is that Indonesia's exports were increasingly dominated by commodities and natural resources. Another reason was the measures introduced by Indonesia that discriminate against imports. Rather than seeing this as a matter of concern, the nationalist policy-makers and populist commentators celebrate the fact. They portray higher foreign content in export or domestic production as a sign of weakness. Such a view is, however, short-sighted. It is precisely participation in global or regional production networks that has been a key factor in driving exports and investments in manufacturing in neighbouring countries.

Figure 4. Indonesia's declining import content in exports: is this a good sign?



Source: OECD TiVa database, http://stats.oecd.org, accessed 11 June 2015.

The third factor relates to the character of the new president, Jokowi. As the mayor of the city of Solo, Central Java, Jokowi was a success.[27] He came from a business background, so he understood the challenges faced by the private sector. He adopted an unusual approach to improving the investment climate in Solo. This included his famous impromptu visits to local merchants, traders, and other business players. He relied on ad hoc policies, often drafted after talks with business-people and meetings in the field. But he was successful, and given numerous awards.

He then became the governor of Jakarta. During his short, two-year governorship, he tried to implement the same approach he had applied in Solo. With its very large population (10 million, compared with Solo's half a million) he faced far bigger challenges in Jakarta than he had in Solo. Nevertheless, he emerged as the 'people's favourite leader', and not just in Solo and Jakarta; he became popular elsewhere too.

Given his previous experience, especially in Solo, some may have expected that Jokowi would pursue market-friendly economic policies. However, to date, he has pursued more interventionist policies. Such an approach might arguably be the result of Jokowi's promise during the election days to be more supportive to domestic industries' needs. For example, during the campaign, Jokowi famously promised to achieve self-sufficiency in beef within a few years; in July 2015 his administration cut the quota for imports of Australian live cattle by 80 per cent.

The fourth factor has been the use of active industrial policies in many emerging East Asian countries, which may have prompted Indonesia to follow suit.[28] The state-supported domestic firms that helped China to become "leading dragon" and Taiwan to become a major innovator in electronics in the region are just a few examples of these policies.[29] The new Indonesian government has signalled its willingness to support domestic private investment in sectors deemed to be strategic priorities.

Once again, pursuing protectionist policies is likely to prove counter-productive. Given that the Indonesian economy is still suffering from other chronic deficiencies, including its poor energy infrastructure, its poor logistics, its underdeveloped services sector, and deficiencies in the predictability of economic rules and regulations, protectionism is unlikely to significantly improve the ability of domestic industries to compete in the global marketplace. On the contrary, excessive protectionism, through the creation of barriers to trade and FDI, can further undermine the competitiveness and productivity of Indonesian firms, as such measures limit access to inputs and technology.[30]

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POLICY CHALLENGES AND OPPORTUNITIES

Looking ahead, there are few indications that President Jokowi is going to abandon the protectionist trend in Indonesian economic policy. In January 2015, the President signed into law his national medium-term development program (RPJMN). The trade section in the RPJMN is very broad and deals with both domestic trade and foreign trade. The domestic trade policy aims are ambitious. Among other things it seeks to: cut logistics costs from 24 per cent of GDP in 2015 to 19 per cent in 2019; cut average dwelling time at the ports from five to six days in 2015 to three to four days in 2019; increase the growth rate of the retail and wholesale trade sectors in GDP from 5 per cent in 2015 to 8 per cent in 2019; keep the coefficient of variation of the prices of “essential”[31] goods across regions from a maximum of 14 per cent in 2015 to a maximum of 13 per cent in 2019; and revitalise 1000 ‘people’s markets’ every year.

The section on foreign trade aims to: increase the growth rate of non-oil exports from 8 per cent in 2015 to 14 per cent in 2019; increase service exports from 2.7 per cent of GDP in 2015 to 3.5 per cent of GDP in 2019; and increase the share of manufacturing in total exports from 44 per cent in 2015 to 65 per cent in 2019.

Domestic trade strategies, as stipulated by the planning document, focus on the improvement of infrastructure and logistics and on the increase of economic activities and efficiency of cross-regional trade in Indonesia. Foreign trade strategies, on the other hand, include linkage policy, trade facilitation, and the re-evaluation of existing free trade agreements. Considering the existing regulatory framework, policies, and the level of protection in Indonesia, these goals will be difficult to meet.

Although promoting domestic industry is well intentioned, relying only on protectionist policy may lead to industries that are forced to rely heavily on the domestic market. Indonesia’s market is the largest in Southeast Asia; however, limiting industry only to domestic growth risks missing the benefits of being part of global production chains. Using quarterly data since 2000, we studied the relationship between the share of manufacturing in total exports, the share of FDI in the manufacturing sector, and the real effective exchange rate.[32] FDI was included because net FDI inflow to Indonesia continues to increase, and there is a strong assumption that foreign investment has been playing a key role in driving Indonesia’s manufacturing exports.[33] The results suggest that the manufacturing share of total exports has not responded to increased FDI in manufacturing, and vice versa.[34] This supports the argument that in recent years the manufacturing industry in Indonesia has become more inward-oriented.

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Another cause of concern is that interventionist policy may lead to a wasteful allocation of resources. Governments often subsidise the private sector’s inputs or investments even when the private sector itself is willing to spend at the prevailing market rate and risk. This might lead to overinvestment by the government or poor spending decisions by the private sector which could be more productive for other purposes.[35] In such situations, firms would have less incentive to push for greater efficiency and, on the contrary, will likely continue asking for government support. Indonesia should know this well because this type of protection has led to cronyism and bad investments decisions in the past.

These more protectionist policies also risk Indonesia's leadership position in ASEAN and its involvement in the World Trade Organization and the G20. Indonesia has struggled to maintain a good posture in these forums, as a member of and a leader in an integrating world. Inward-looking policies run counter to this objective.

CONCLUSION

Protectionism is still on the rise in Indonesia, mostly in the form of non-tariff measures. These are accompanied by policies typical of a developmentalist state, such as indiscriminate measures to increase domestic processing, despite the fact that global production networks increasingly shape every country's trade with the world.

Declining commodity prices, prolonged sluggish growth in the global economy, and tough competition with other low-cost producers are likely to add pressure on Indonesia to introduce interventionist policies. In addition, past reforms that have lowered tariffs and increased FDI might have further pressured the government to support domestic entrepreneurs to develop industries. While state intervention through public support for industrialisation is not uncommon in East Asia, the worry for Indonesia is that it will repeat the mistakes it has made before: prolonging protection and life support for industries that are not economically viable.

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Increasing protectionism is likely to prove immensely counterproductive for the Indonesian economy. Rather than pursuing interventionist policies the Indonesian government needs to return to the basics: infrastructure, logistics, and consistency of rules and regulations. Unfortunately, for the immediate future, that seems very unlikely.

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APPENDIX 1. HIGHLIGHTS OF THE TRADE-RELATED LAWS

Law 4/2009 on Mineral and Coal Mining

This law replaced Law 11/1967 on Basic Mining Provision. The main new feature is the forbidding of the export of unprocessed minerals and coal within five years of the law's inception (hence by 2014). The minerals include bauxite, nickel ore, and copper ore, as well as tin, chromium, gold, and silver. According to Howes and Davies (2014), this restriction affects about $US5.5–6 billion of Indonesia's exports — or about 3 per cent of the total in 2014. The export ban is intended to oblige miners to process and refine their minerals domestically. This law has been very controversial, as many big miners with a long history in Indonesia claim it is uneconomical to build their own smelters, while the smaller miners lack the funds to do so.

Different ministries issued different implementing regulations. For example, the Minister of Energy and Mineral Resources Regulation 1/2014 stipulates that miners have to build their own smelters and refineries so as to increase domestic value added of mining products. The Minister of Trade Regulation 4/2014 rules that only mining products that have reached a certain threshold of domestic processing are allowed for exports. The Minister of Finance 153/2014 is the least interventionist among these regulations, as it offers some 'price mechanisms' to 'incentivise' miners to build refineries and smelters in Indonesia. According to this regulation, the government will impose a 7.5 per cent export tariff if construction (of smelters) reaches 7.5 per cent completion, a 5 per cent export tariff if progress is between 7.5 per cent and 30 per cent, and 0 per cent when construction is 30 per cent complete or above by January 2017.

Law 13/2010 on Horticulture

According to this law, every person engaging in horticulture business should prioritise domestic goods and services (Article 71). Export of horticultural products is allowed after fulfilling the needs of national consumption (Article 87). On the other hand, import of horticulture products is allowed if permitted by the minister of Trade under recommendation from the minister of Agriculture (Article 88), but only via designated points of entry (Article 33). The process to import is particularly cumbersome, as in order to get a recommendation from the minister of Agriculture, an approval from a provincial office is required (which in turn requires a regency or municipal's recommendation).

This law was the basis of the five-year 'blueprint' of the Ministry of Agriculture for 2010–14 which, among other things, targets self-sufficiency in five commodities: rice, sugar, soybean, beef, and corn. Indonesia failed to reach this target for most of these, yet carried the aim forward in the next period's blueprint. Due to its highly protectionist approach, objections to this law were lodged by the European Union, the United States, and New Zealand.

Law 18/2012 on Food

This law authorises the government to regulate trade in food through price and quantity stabilisation, food reserves management, and the development of a good investment climate for the food business (Article 51). The government is obliged to stabilise the supply and the price of staple foods at both the producer and consumer levels. Such stabilisation is intended to protect “the income and purchasing power of farmers, fishermen, small and micro food enterprises, as well as consumers’ welfare” (Article 55).

Furthermore, the law stipulates that food sources should come from domestic food production and national food reserves. Imports are allowed only if these supplies are insufficient (Article 14 and Article 36). Therefore, the government should prioritise domestic food production in meeting domestic demand (Article 15). The export of staple food is allowed only after domestic needs and national food reserves are fulfilled.

Law 19/2013 on Protection and Empowerment of Farmers

This law lays out strategies to protect farmers (Article 7). These include the “elimination of the practice of high-cost economy.” The elucidation explains vaguely that this “is intended to ensure the implementation of farming activity in an effective and efficient manner.”

Furthermore, the government is obliged to prioritise domestic agriculture products to meet domestic needs. This is to be done through import regulations (Article 15). Every person is also prohibited from importing agriculture commodities when the domestic supply is “sufficient” (Article 30), as stipulated by the minister of Agriculture. The case of rice illustrates why implementing these articles can be very inconsistent. Even when the government itself has stated that domestic supply is not enough, the import of rice has still been banned.[36]

The government is also obliged to create conditions that lead to favourable agriculture commodity prices for farmers by stipulating duty tariffs, points of entry designation, quality standards, and price stabilisation policy (Article 25).

These interventionist stances extend to marketing. In particular, every person who manages a modern store (as opposed to traditional market) is obliged to prioritise sales of domestic agriculture commodities (Article 50).

Law 3/2014 on Industry

This law takes an interventionist approach to promote industry, and shows the government's belief in a linkages policy that forces the creation of domestic value added chains and discourages the use of imported inputs in production. Article 31, for example, states that in order to increase value added to natural resources, the government will promote domestic processing industries. Article 32 is similar: in order to increase industry value added, the government may restrict the export of natural resources. Article 33 continues, stating that central and local governments are to ensure the availability and distribution of natural resources for domestic industries. Finally, Article 85 says that to empower domestic industries, the government will increase the use of domestic products or components. In the elucidation of this article, it is stated that the export of raw materials is allowed only if the needs of domestic industries have been met.

Law 7/2014 on Trade

Two features of this law stand out: its mercantile tone and its anti-consumer stance. Firstly, there is an inherent phobia towards imports that is evident in the law's approach to the problem of trade balance. Article 54 states that the government may restrict the import of goods to maintain the balance of trade.[37] This implies a perception that the problem of trade is more about imports than exports. The latter is subject to restriction, however, when the domestic supply is deemed insufficient or when the government is determined to increase the domestic value added (Article 54).

Secondly, there is strong bias towards producers and against consumers in the foreign trade part of the law. Article 70 states that if the price of an imported good is lower than the "normal price" and causes a loss or potential loss to relevant domestic manufacturers, the government is obliged to take anti-dumping measures. While this practice is allowed by the WTO, it requires strong evidence as well as effective consultation. The article is also rather confusing, as there is no explanation of what "normal price" means.

Law 20/2014 on Standardisation and Conformity Assessment

This law is to support the implementation of the Indonesian National Standard (SNI). This includes technical regulations, certifications, and laboratory testing procedures, which are imposed on industries in addition to the existing international standards enforced by regulatory agencies. While the objective is to ensure conformity of products with a nationally recognised standard, in practise it may add unnecessary costs for the producers and deprive local consumers of cheaper, imported goods. By January 2015, more than 10 000 SNIs have been developed, 270 of which are mandatory.

APPENDIX 2. SELECTED LIST OF NON-TARIFF MEASURES IMPOSED BY INDONESIA SINCE 2009

Date of issuance	Name	Nature of restriction	Notes/highlights
18/02/2009	MOT Regulation 8/2009	New procedures for the import of steel and iron products.	
19/11/2009	MOT Regulation 27/2009	Stricter regulation on fruit and vegetable imports.	Certification letters that products do not contain dangerous chemicals as regulated by FAO.
26/01/2010	MOT Regulation 2/2010	Verification of foreign raw materials in textiles.	Textiles produced in Bonded Zones made completely out of Indonesian raw materials exempted from technical inspection.
15/03/2010	MOT Regulation 11/2010	Tighter regulation on the import of machines, tools, and ingredients for disc production.	Importer needs a special licence as Registered Importers of Optic Discs, renewable every 4 years.
13/12/2011	MOT Regulation 40/2011	Pre-shipment inspection requirement on tyre imports.	
29/12/2011	MOT Regulation 48/2011	Import regulation for used capital goods.	Every importation must obtain approval from MOT, with recommendation from MOI. No imports allowed for used goods older than 20 years.
6/02/2012	MOA Regulation 5/2012	Import provisions on seeds.	Each importer must obtain permission from MOA, then import has to be concluded within 2 years.
21/11/2012	MOT Regulation 59/2012	Restriction for importers of more than one product group.	Each importer must have importer identification number (API) for each good in different classification system, e.g. a car component importer has to obtain different APIs for seats and windows.
27/12/2012	MOT Regulation 82/2012	Stricter import regulation on mobile phones and tablets.	Intended to support the industrialisation in mobile phones and computers in the future.
29/12/2012	MOT Regulation 83/2012	Imposition of additional requirements for imports of certain products.	Requirements include licences, pre-shipment inspection, and limited access to seaports and airports.

28/05/2013	BPOM Regulation 27/2013 and 28/2013	Supervision of the importation of drug ingredients, traditional drug ingredients, health supplement ingredients, and food materials.	Importers should obtain a distribution license and import statement letter.
28/08/2013	MOA Regulation 84/2013	Import restriction on carcass, meat, offal, and/or their derivatives.	Reference price system. Labelling imposed.
30/08/2013	MOT Regulation 46/2013	Import restriction for meat, offal, and processed meat.	Reference price system. Labelling imposed. Import volumes are determined for each import permit individually.
28/03/2014	MOT Regulation 19/2014	Import and export provision of rice.	Import is allowed only: 1) for rice with 25 per cent broken quality, 2) conducted by Bulog (national logistics agency), 3) outside the period 1 month before to 2 months after harvest season.
11/04/2014	MOT Regulation 20/2014	Controlling and monitoring of alcoholic beverages.	Additional certification: registered importer of alcoholic beverages (ITMB, renewable every 3 years), in addition to business permit (SIUP), company registration letter (TDP), custom identity number (NIK), importer identity number (AIP), and import permit. Also required: copies of contracts with at least 20 manufacturing companies from at least 5 different countries of at least 3000 cartons per brand per year, certified by public notary or trade attaché in the respective countries.
2/06/2014	MOT Decree 28/2014	Restriction on import licensing for steel alloy.	
24/06/2013	MOT Regulation 29/2013	Restriction for exports of crude palm oil and its derivatives.	

17/09/2014	MOT Regulation 56/2014	Local content requirements for traditional markets, modern stores, and shopping centres.	Local content at least 80 per cent of goods sold. Exempted if: 1) requiring uniformity from a global supply chain, 2) having a brand that is world famous and yet to have a production base in Indonesia, and 3) products from certain countries being sold to meet the needs of their citizens living in Indonesia.
26/11/2013	MOT Regulation 67/2013	Requirement that all imported goods be labelled in Indonesian language.	
15/07/2014	MOT Regulation 39/2014	Export restriction for coal and coal-linked products.	Producers should register with MOT before being allowed to export for 3 years, then they should apply for extension.
14/10/2014	Government Regulation 76/2014	Public procurement in defence industry.	
24/12/2014	MOT Regulation 97/2014	Export restriction for industrial forestry products.	
16/01/2015	MOT Regulation 6/2015	Restriction on the sale of alcoholic beverages.	No alcohol allowed for sale in minimarkets — only in supermarkets and hypermarkets, with required permits.

Notes: MOT, MOA, MOI, BPOM are Ministry of Trade, Ministry of Agriculture, Ministry of Industry, Food and Drug Monitoring Agency. Source: GTA, accessed 13 May 2015.

APPENDIX 3. SELECTED LIST OF LOCAL CONTENT REQUIREMENT MEASURES TAKEN BY INDONESIA SINCE 2009

Date of issuance	Name	Nature of restriction	Notes/highlights
16/11/2009	MOF Regulation 176/2009	Import tariff exempts for inputs to locally produced machinery.	
19/04/2010	MOI Regulation 48/2010	Local content requirements for power plants.	
14/12/2012	MOI Regulation 15/2012	Increased local content requirements in textiles, clothing, and footwear industry.	
21/05/2012	MOF Regulation 76/2012	Local content promotion scheme via input tariffs on goods, machinery, and materials used in the assembly of motorised vehicles.	At least 30 per cent of total value of machines used must have been locally produced.
5/10/2012	Law 16/2012	Local content requirements in defence industry.	
15/10/2012	Government Regulation 82/2012	Local content requirements for electronic system operator in public services.	Required to establish data centre in Indonesia.
29/10/2012	MOT Regulation 68/2012	Strict regulation in franchising in retail business.	Locally produced goods should take at least 80 per cent of goods being sold.
11/02/2012	MOT Regulation 7/2013	Local content requirements in food and beverages industry.	
22/02/2013	MOEMR Regulation 15/2013	Increased local content requirements in oil and natural gas industry.	
13/01/2014	MOI Regulation 2/2014	Public procurement restriction for foreign companies.	Obligatory use of domestic products in government procurement.
12/12/2013	MOT Regulation 70/2013	Local content requirements for traditional markets, modern stores, and shopping centres.	
14/10/2013	Government Regulation 76/2014	Local content requirements in defence industry.	
24/11/2014	MOI Regulation 80/2014	Local content requirements in automotive industry.	To be conducted in Indonesia: welding, paintings, assembling of the motorised vehicles, and quality control.

Notes: MOT, MOF, MOI, MOEMR are Ministry of Trade, Ministry of Finance, Ministry of Industry, Ministry of Energy and Mineral Resources. Source: GTA, accessed 13 May 2015.

APPENDIX 4. SELECTED LIST OF EXPORT MEASURES TAKEN BY INDONESIA SINCE 2009

Date of issuance	Name	Nature of restriction	Notes/highlights
31/12/2009	MOEMR Regulation 34/2009	Revitalisation program for small and medium enterprises in textiles and leather.	
6/05/2012	MOEMR Regulation 7/2012	Export ban on 14 mineral ores.	
16/05/2012	MOF Regulation 75/2012	Additional export tax on palm oil, cocoa beans, wood, and leather products.	
18/05/2012	MOF Regulation 29/2012	Export tax of up to 40 per cent on 65 products, including the 14 mineral ores previously banned and an additional 51 products.	Intended to promote the production and export of 'high value' finished goods instead of export of raw materials.
22/10/2012	MOT Regulation 65/2012	Restriction on export of timber products.	
23/01/2013	MOT Regulation 4/2013	Increased export duty and reference price for crude palm oil and decreased reference price for cocoa beans.	
24/06/2013	MOT Regulation 29/2013	Technical restriction for export of crude palm oil.	
12/12/2013	MOT Regulation 73/2013	Revised export cap list for fertiliser.	
11/01/2014	MOF Regulation 6/2014	Increased export tax for certain mineral ores.	Export tax for metal concentrates to increase gradually until 2016.
28/03/2014	MOT Regulation 19/2014	Import and export provisions of rice.	
25/07/2014	MOF Regulation 153/2014	Conditional export tax exemptions for unrefined mineral exports.	Gradual cut of tariff in line with progress in smelter building.
15/07/2014	MOT Regulation 39/2014	Required registration for coal exporters.	
24/07/2014	MOT Regulation 44/2014	Technical restriction for tin exports.	
24/12/2014	MOT Regulation 97/2014	Licensing requirements for exports of industrial forestry products.	

Notes: MOT, MOF, MOEMR are Ministry of Trade, Ministry of Finance, Ministry of Energy and Mineral Resources. Source: GTA, accessed 13 May 2015.

NOTES

[1] M. Chatib Basri, "Indonesia's Role in the World Economy: Sitting on the Fence," in *Indonesia Rising: The Repositioning of Asia's Third Giant*, ed. Anthony Reid. (Singapore: Institute of Southeast Asian Studies, 2012), 28–48.

[2] Hal Hill and Thee Kian Wie, "Moh. Sadli (1922–2008): Economist, Minister, and Public Intellectual," *Bulletin of Indonesian Economic Studies* 44, no. 1 (2008): 151–6; Ian Coxhead, Thee Kian Wie, and Arief Anshori Yusuf, "Twenty-First-Century Challenges for Southeast Asian Economies', in *Routledge Handbook of Southeast Asian Economies*, ed. Ian Coxhead. (London: Routledge, 2015), 408–21.

[3] M. Chatib Basri, Sjamsu Rahardja, and Syarifah N. Fitrania, "Not a Middle-Income Trap but a Slow Transition in Indonesia?" (paper presented at the Asian Economic Panel Meeting, Kualalumpur, 23–24 March 2015).

[4] Hal Hill, *The Indonesian Economy Since 1966: Southeast Asia's Emerging Giant* (Cambridge: Cambridge University Press, 1996).

[5] Mary Amiti and Jozef Konings, "Trade Liberalization, Intermediate Inputs, and Productivity: Evidence from Indonesia," *American Economic Review* 97 no. 5 (2007): 1611–38.

[6] The role of crony capitalists was closely associated with the rise of the New Order government. See Richard Robison, *Indonesia: the Rise of Capital* (Southeast Asia Program Publications, Cornell University: 1988).

[7] Hal Hill, *The Indonesian Economy* (Cambridge: Cambridge University Press, 2000).

[8] In 2013, a corruption scandal on the management of beef imports broke out and implicated the chairman of the Justice and Welfare Party (PKS).

[9] In addition, the Ministry of Trade also revoked 2266 licences due to alleged breaches of licence terms. The affected industries include electronics, apparel, food and beverages, cosmetics and homecare, toys, medicine and food supplements, and footwear.

[10] Since January 2015, the Ministry of Manpower has issued five regulations restricting expatriates from taking certain positions in different sectors. See http://www.hukumpedia.com/adi_abaw/perizinan-tenaga-kerja-asing-diperketat.

[11] Steven Marks and Sjamsu Rahardja, "Effective Rates of Protection Revisited for Indonesia," *Bulletin of Indonesian Economic Studies* 48 no. 1 (2012), 57–84; NRP refers to the percentage difference between domestic producer price and border price, and ERP is the proportion by which value added per unit of output with distortive policies exceeds the level under free trade.

[12] Albert O. Hirschman, *The Strategy of Economic Development* (New Haven: Yale University Press, 1958).

[13] Arianto A. Patunru and Listyowati Lestari, "Assessing the 'Downstreaming' Policy in Indonesia," (paper presented at the Indonesian Regional Science Association Conference, Denpasar, 3–4 August 2015).

[14] A minimarket is a marketplace between 100 and 999 square metres, a supermarket between 1000 and 4999 square metres, or a hypermarket larger than 5000 square metres.

[15] Steven V. Marks, "Indonesian Horticultural Imports and Policy Responses: An Assessment," (report submitted to USAID-SEADI, 2012).

[16] Simon J. Evenett, *The Global Trade Disorder: The 16th GTA Report* (London: CEPR Press, 2014).

[17] The local content requirements have been on the rise again. Some argue that such an approach is appropriate only in a relatively isolated economy (see for example Prema-chandra Athukorala and Bambang H. Santosa, "Gains from Indonesian Export Growth: Do Linkages Matter?," *Bulletin of Indonesian Economic Studies*, 33 no. 2 (1997): 73–95). But relatively open economies such as Malaysia and China are now using similar measures; for example, in the oil and gas industry and the wind turbine industry respectively.

[18] Max W. Corden, *Trade Policy and Economic Welfare* (OUP Catalogue, 1997).

[19] In the case of depreciation, it is the sectors that rely on imports (e.g. those with heavy import content in their production) that would seek protection.

[20] The value of the Indonesian rupiah against a weighted average of several foreign currencies, divided by price deflator.

[21] Haryo Aswicahyono, Hal Hill, and Donisius Narjoko, "Industrialisation after a Deep Economic Crisis: Indonesia," *Journal of Development Studies*, 46 no. 6 (2009): 1084–108; Swati Ghosh, Sjamsu Rahardja, and Gonzalo Varela, "How the Macroeconomic Environment and Investment Climate Have Affected the Manufacturing Sector." The World Bank Policy Note no. 3, http://siteresources.worldbank.org/EASTASIAPACIFICEXT/Resources/226300-1349835451376/Full-PN3-Manufacturing.pdf.

[22] For example, Takatoshi Ito, "Exchange Rate Regimes and Monetary Cooperation: Lessons from East Asia and Latin America," *Japanese Economic Review* 55 no. 3 (2004): 240-66; Stephen Grenville, "The IMF and the Indonesian Crisis," *Bulletin of Indonesian Economic Studies*, 40 no. 1 (2004): 77–94. A similar stigma is also evident in the other two recipients of IMF loans and packages during the Asian financial crisis: Thailand and Korea.

[23] Takatoshi Ito, "Can Asia Overcome the IMF Stigma?," *American Economic Review: Papers & Proceedings* 102 no. 3 (2012): 198–202.

[24] For an example of populist writing by commentators, see http://m.inilah.com/news/detail/93879/investor-asing-harus-diminimalisir.

[25] Despite its many limitations, the IMF was actually successful in pushing unilateral trade liberalisation in Indonesia in the aftermath of the Asian financial crisis. As mentioned above, many trade barriers were torn down in conjunction with IMF recommendations for structural adjustment. However, the trade reform was short-lived. Since 2001, protectionism has begun to creep back (see M. Chatib Basri and Arianto A. Patunru, "How to Keep Trade Policy Open: The Case of Indonesia', *Bulletin of Indonesian Economic Studies* 48 no. 2 (2012): 191–208).

[26] Trade in value added refers to trade flow as measured by the allocation of value added by different companies (perhaps from different countries) involved in the manufacture of the final export. This approach is in contrast to traditional

trade statistics that record gross flows of goods and services every time they cross a border. The latter is prone to the problem of double or multiple counting (see the OECD explanation at http://www.oecd.org/sti/ind/whatcantivadatabasetellus.htm).

[27] Arianto A. Patunru, Neil McCulloch, and Christian von Luebke, "A Tale of Two Cities: The Political Economy of Local Investment Climates in Indonesia," *Journal of Development Studies* 48 no. 7 (2012): 799–816.

[28] One view has it that in this region, the predominant story of growth is about continuous productivity improvement and technological progress where countries are catching up in "flying geese" formation to close the gap with the innovation leader (see Justin Yifu Lin, "From Flying Geese to Leading Dragons: New Opportunities and Strategies for Structural Transformation in Developing Countries," *World Bank Working Paper Series* No. 5702 (2011)).

[29] For China see Lin, "From Flying Geese to Leading Dragons"; for Taiwan see Ya-Hwei Yang, "Government Policies and Strategic Industries: the Case of Taiwan," *Trade and Protectionism*, ed. Takatoshi Ito and Anne O. Krueger (Chicago: University of Chicago Press, 1993): 387–412. State support is also present in Malaysia and Korea through the establishment of various government agencies and programs to support SMEs and link them with the global value chain. Recently, Narendra Modi's government also launched the "Made in India" policy campaign to help expand India's manufacturing sector.

[30] Victor Duggan, Sjamsu Rahardja, and Gonzalo J. Varela, "Service Sector Reform and Manufacturing Productivity: Evidence from Indonesia," *World Bank Policy Research Working Paper* No. 6349 (2013).

[31] Essential goods include rice, red onions, chicken, beef, sugar, corn, soybean, egg, chili, milk, cooking oil, and flour.

[32] We also included the global non-energy price index as an additional exogenous variable.

[33] FDI-acquired firms tend to engage more on exports (see Jens Mathias Arnold and Beata Javorcik, "Gifted Kids or Pushy Parents? Foreign Direct Investment and Plant Productivity in Indonesia," *Journal of International Economics*, 79 no. 1 (2009): 42–53). Thee confirmed that FDI had a significant role in the emergence of export-oriented manufacturing industry in Indonesia (Thee Kian Wie, "Indonesia's Economy Since Independence" (Singapore: Institute of South East Asian Studies, 2012).

[34] Detailed results are available upon request.

[35] Neary and Leahy developed a theoretical model for strategic trade and industrial policy that characterises the interaction between the government's decision to commit to subsidies and a firm's decision to commit to invest in capacity. Their model suggests that the optimal intervention (to subsidise or tax) depends on the firm's behavior, which is largely unobserved (Peter J. Neary and Dermot Leahy, "Strategic Trade and Industrial Policy Towards Dynamic Oligopolies," *The Economic Journal*, 110 no. 463 (2012): 484–508).

[36] For example, http://thejakartaglobe.beritasatu.com/business/rice-imports-hold-ministry-waits-indonesian-harvest-yields/.

[37] Article 67 stipulates that the government will establish trade security and safety policies that include, for example, defence measures for exports, anti-

dumping measures, and measures to overcome import surges. While these are important measures to be implemented by the Ministry of Trade and are in fact in line with WTO, their effectiveness lies in the capacity of the Anti-Dumping Committee.

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