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Free Trade Intervention and Political-Economic Intervention on Global Business Environment: Indonesian perspectives

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Abstract

As a developing country that adopted the open economy, Indonesia emphasizes the role of trade relations with other countries. However, the increasing trend of economy traffic has impacted Indonesia's national and economic development. The paper raises a simultaneous debate on free trade intervention policies from the global business environment and Indonesian perspectives. The results indicate that the Indonesian government adopted political-economic reasons into free trade intervention. The concluding part briefly discusses Indonesia's policies on an involvement in free trade agreements (FTAs), which have recently proliferated within Asia region. The result reveals that free trade with political intervention is positively correlated with economic growth based on Indonesian perspectives. Intervention is required to balance the impact of free trade, thus a limited intervention could be an opportunity for Indonesia to counter lagging of technological readiness and improve the labor market efficiency.

Keywords

Open economy; global business environment; Indonesia perspectives; free trade agreements

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Introduction

Alaedini (1997) defined government intervention as an effort to counter the free trade system in an unstable economy. Arguments behind the intervention have raised to a simultaneous debate (Abernathy & Chakravarthy, 1979). Politicians supported that political argument is the sole driver for intervention. However, Hill (2011) argues that both political and economic arguments are basically inseparable in reality.

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Indonesia took the opportunity of free trade for country's benefit and increased global prosperity. In 2016, Indonesia exported $164 Billion and imported $135 Billion, which resulted in a positive trade balance of $29.3 Billion. According to Gaulier and Zignago (2010), Indonesia becomes the 26th largest exporter in the world because of $164 Billion export value. The most export is led by Palm Oil and Coal Briquettes. The most recent export destinations of Indonesia are the United States, Japan, China, India, and Singapore. In compared to export value, Indonesia decreased its import value at an annualized rate of -4.9%, from $173 Billion in 2011 to $135 Billion in 2016. Top import origins such as China ($31 Billion), Japan ($12.1 Billion), Singapore ($15.1 Billion) and Malaysia ($7.17 Billion), which were mostly led by petroleum companies (Gaulier & Zignago, 2010). In addition, Indonesia's non-oil exports were developed into East Asia(26%), NAFTA(16%) and Japan(15%) in 2001. The number was doubled to 16% of the total non-oil exports due to the export to ASEAN countries (Soesastro & Basri, 2005).

In Indonesian perspectives, the economy market never follows the complete nature of the free market system. Consumer preferences, consumption flow, and business supply chain are the key sources for market equilibrium price (Editorial, 2018). The increased government intervention has led to thousands of complaint from business leaders. Meanwhile, the licensing bureaucracy towards business operations and start-ups have improved, the government has created an uncertain market intervention policy.

The discussion will be divided into four parts. First part justifies the political argument for free trade intervention. Second part balances the discussion with economic arguments. The third part shows the impact of government intervention and practical implications. Final part concludes that political-economy arguments are interrelated in the global business environment and basis of Indonesian perspectives.

Literature Review

As a newcomer in free trade, Soesastro and Basri (2005) argued that Indonesia is largely driven by the offers made by other countries to form FTA's with Indonesia instead of being pro-active to select free trade partners. It further argued the erosion of Indonesia's manufacturing sector competitiveness, which in turn to increase demand for protection. Indonesia's commitment to WTO and NAFTA and the creation of ASEAN Economic Community counterbalance the protectionist pressures. Furthermore, they explained that trade momentum and economic reform is the reason for Indonesia to form FTAs and PTAs (preferential trading arrangements). In addition, it found that regional FTAs help to promote domestic reforms. For example, US agreements tend to have the greatest effect on Indonesia's economic reform agenda in 2005. Meanwhile, APEC issued a similar understanding of best practices in forming FTAs and it becomes the guideline for East Asian countries. It concluded that FTAs have become an element of Indonesia's international economic diplomacy.

Riswati and Warsito (2010) argue about the importance of free trade from the ASEAN China Free Trade Area (ACFTA) practice. It explains free trade as an opportunity to expand Indonesian products by increasing export volumes. The indication that Indonesia export values to China increased to a number that exceeded 30 million USD in 2009. Based on the position within the ASEAN region and the election of Indonesia as G20 members, Indonesia government considers of gaining big advantages from the involvement in the free trade. Indonesia-China trade balance was deficit since 2008; Indonesia's export to China was amounted to USD 11.6 billion, while imports from China reached USD 15.2 billion in 2008. In 2009, Indonesia–China trade deficit reached USD 1.7 billion due to a drop in exports, which implies Indonesian products difficulty in competing with Chinese products, which is cheaper and huge in quantities.

Indonesia saw an opportunity by the cooperation with China. Indonesia with its natural resources has big potential to increase its national income. Furthermore, China promised to accelerate a balanced and mutually beneficial on trade growth in order to improve competitiveness, such as encourage investment, infrastructure development, and credit facilities.

Meanwhile, it brings competition to the local. The impact can be potentially serious unless Indonesia could cope up with the competitiveness problem. Indonesia SMEs have lost large potential benefits due to lack of branding readiness. Positioning of Indonesia's export products no longer as a producer of low cost and low priced products. The existence of ACFTA makes it difficult for Indonesia 's product to build a position within China's products. If the competitiveness capability is high, non-tariff free trade agreement becomes effective, hence there will be a positive impact on economic growth and welfare.

(Brenton & Ikezuki, 2003) note that Indonesia has been quite successful in competing with developing countries. Its market share has increased throughout the last decade, thus making developing countries as important as Organization for Economic Co-operation and Development (OECD) countries to be the destination of Indonesia's exports. However, it contrasted China's trade pattern, where developed countries are becoming more important as the export destination. It suggested that Indonesia target its exports to developing economies. In this regards, Indonesia has much lower tariff than developing countries in general.

Within ASEAN Economic Community, Indonesia has the largest population with its largest economy. Indonesia accounts for almost 42% of the total population within the ASEAN market. However, Indonesia merely becomes consumer within ASEAN nations due to the high level of logistics costs (lack of quality infrastructure) and low quality of human resources. It implies that Indonesia is currently importing and consuming products and services from other ASEAN nations (Indonesia Investment, 2016).

In terms of competitiveness, Indonesia ranks 36th, in the World Economic Forum's Global Competitiveness Index 2017-2018, moving five places ahead compared to last year. The country is ranked below Singapore (3rd), Taiwan (15th), Malaysia (23rd) and Thailand (32nd), but above Vietnam (55th) and Cambodia (94th). Indonesia has improved its performance across the overall pillars. Its position is mainly driven by its robust macroeconomic environment and large market size. Furthermore, Indonesia ranks 31st and 32nd in innovation and business sophistication respectively to be the top innovators among the developing countries (Schwab, 2017). It shows that the competitiveness of Indonesian export products in international markets, which became a key measure of the readiness of Indonesia products to compete with other countries.

In contrast, the country is lagging quite far behind on labor market efficiency. The pillar is dragged down by the limited flexibility of wage determination, limited women representation in labor force and excessive redundancy costs. Another significant advance in the technological readiness, although there is a steady progress on the technological front over the last decade. It reflects on the low capacity of the Indonesian industry in global competition as a lack of capable human resources and technology in the International market of quality products from Indonesia.

Political Arguments for Intervention

Smith (1937) supported that political reason it the only explanation for government enthusiasm to free trade intervention. First, it can be due to protect jobs and industries. Practically, United States attempted to grow its coal industry to secure jobs from low-wage countries threat (Nank, 2012). The United States gained an advantage over coal being imported to Mexico and Canada by reducing trade barriers between them. It included the effort in facilitating investment, tax exemption policy and eliminating tariff and non-tariff products in the agreement (Caplin & Dysdale, 2010). Furthermore, the U.S. government fostered a grant of $22 million for education lobbying especially to local workers of Texas State (Walker, 1991). It resulted in a powerful network between U.S. and trade associations in the coal industry to prevent the threat from low-wage countries (Kaplun, 2009).

Munthe and Silviana (2018) shows Indonesia's efforts to protect farmers from imports. Indonesia's government stepped into salt import quotas although The Indonesia Food and Beverage Association faced shortages of salt. In fact, Indonesia has over than 31,000 miles of coastline surrounded by salt water, but it spends ten of millions of dollars to import salts annually because the incompetence to produce high-grade salt. Thus, it takes years to increase quality and output in the local salt industry. In the presidency of Widodo in 2014, he delayed imports of beef and cattle from Australia as well as other foods to stimulate domestic production. However, prices went shot up in 2016, his government scrambled to find beef from different sources, including buffalo meat from India. In another case, Indonesia' domestic rice prices were 60% higher than international prices due to policy interventions. According to World Bank data, food security is also politically sensitive in Indonesia where more than 160 million people, around 60% of the population, live on $5.50 a day or less.

Second, government could intervene due to national security issue. Practically, U.S. intervened in wheat and rice market which is the main resources for Tanzania state (Gerrard & Roe, 1983). The U.S. government purposely separated domestic market for food grains from the international market by increasing tariff and non-tariff barriers. In result, it maintained self-sufficiency for Tanzania in agricultural sector. Recently, Tanzania had been promoted as the top maize producer internationally (Economic and Social Research Foundation, 2008).

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Rahardja (2015) shows that Indonesia abolished import licenses due to rescue package agreement with IMF following the crisis of 1998. The government removed the authority of national food agency to control imports of strategic food commodities such as rice and soybean. Rice trading was done largely by the private sector in 2001 and 2002. Meanwhile, the import tariffs were reduced, bringing down the overall protection effective rate.

Third, Dickinson (1993) supported that protecting consumers could trigger the intervention activities. Recently, China lifted a ban on importing the poison milk formula from Australia into Chinese infant industry. The poison milk formula was issued to contain pesticide 1080 which is used for the agriculture sector. Thus, it was an effort to improve the effectiveness of food safety for consumers. In result, China consistently blocked the infant industry from Australia even though it was a hoax (BBC News, 2015).

The Food and Drug Supervisory Agency (BPOM) ordered producers and distributors of processed sardine food products to be withdrawn from circulation throughout Indonesia (Paramaesti & Widyastuti, 2018). The reason for the withdrawal was due to the findings of parasitic in sardine cans from three brands. A withdrawal warrant was given to distributors as well as a summon letter to the importers of the three brands such as Farmer Hack, Hoki and IO discovery of worming sardines in Pekanbaru, Riau Islands. It impacted imported products that are not spared from BPOM testing. It is that consumers check the packaging, label, marketing permit, and expiration date.

Fourth, retaliation threat has been considered as one of the factors for political reasons. Practically, European Union (EU) raised the tariffs due to retaliation threat from United States (King & Tejada, 2003). EU limited list of imported product for the U.S. with heavy tariffs at $2.1 billion (Winestock & King, 2002). To some extent, it affected Harley-Davidson motorcycles, textiles and steel products. In result, it caused EU flood of steel imports from the U.S. market.

Retaliation threat from the European Union because of disrecognizing biofuel as the renewable energy source is terribly high for Indonesia as the biggest players in the US$ 39 billion palm oil industry (Hutton, 2018). Indonesia and Malaysia are the world's two biggest producers of the crop used in almost everything from cosmetics to cookies. Indonesia accounts for 90 percent of global production of palm oil, which is expected to clock in at about 65 million tons. The retaliation threat from EU had caused Widodo administration to give an assurance that there would be no trade reprisals unless there was evidence the EU was discriminating against palm oil.

In Indonesia, the industry employs 6 million workers and generates US$20 billion in export earnings annually from planting oil palm. Indonesia's palm plantations cover an area of 12 million hectares, triple the area in 2000. The intervention was due to protectionism against small-scale farmers reliable income. European parliament would cut the biofuel portion of renewables to be cut to zero within three years. Luhut Pandjaitan, coordinating minister for maritime affairs warned retaliation if the government sensed the EU, the second largest importer of palm oil, was cracking down on the commodity in favor its won crops. Meanwhile, trade minister Enggartiasto Lukita has put Norway on notice by threatening to ban fish imports after its parliament voted to exclude biofuels from government procurements.

Fifth, political arguments can be extended to humanitarian intervention (Sarkin, 2009). Practically, the United States limited the supply quantity of nuclear weapons to India (BBC News, 2007). The purpose is to control the number of weapons due to the human rights issue. Thus, the nuclear trade agreement was made for United States congressman to reject agreements that fall off within the human right issue. In fact, Edwards (American public supports UN, Washington out of touch L poll; Nuclear opinions differ, 2007) argues that nuclear weapon intervention was to protect its credibility in protecting human rights.

Indonesian labor market is highly regulated. Post Soeharto governments totally revamped the regulatory framework governing conditions of work, social protection, worker rights, and industrial relations. It includes the regulations in three areas deserve special mention in the content of labor market flexibility, standards, and job creation. The intervention into minimum wage, severance pay, and new regulations stand in contrast to international trends, which moved in the direction of improving labor market flexibility from the 1990s. Tight labor regulations with slower rates of economic growth and the job creation that provide the context for the discussion of export performance and employment.

Aswicahyono, Hill, and Ardiyanto (2011) perceive rising labor costs from the intervention could discourage investment. The intervention of stringent labor regulations and less flexible labor market rather than a demand-induced wage growth. Compared with neighboring countries, the Indonesian government intervenes in job creation, missing out in connecting to the PRC locomotive, which has driven much of East Asian trade since the Asian crisis (Athukorala, 2006).

Sixth, political reasons have been extended to furthering foreign policy goals of the country. Practically, U.S. and Colombia entered into Colombia Free Trade Agreement (FTA) to build stronger relations. Both U.S. and Colombia have maintained a 10 years collaborations for $8 billion plan. Colombian products had accessed to U.S. market while American farmers faced an effective tariff rate of 14% which is lower than average tariff rate. In result, Colombia FTA increased U.S. exports to more than $1 billion annually. In long-term, recent involvement of Colombia in trade agreements with Asia may not be able to secure U.S. advantage (Baucus & Kerry, 2015).

Damuri (2014) shows that Indonesia could increase its attractiveness as an investment destination by joining the Trans-Pacific Partnership (TPP). A low border barrier that reduces the cost of production by allowing investors to source capital and intermediate goods efficiently. The greater market access means that investors can see their products in partner markets easily, not merely for domestic consumption. With foreign direct investment which is less than 3% of the gross domestic product, implies that Indonesia has to draw more investment from abroad.

It is not surprising that Indonesia shows little interest in trade deals, a comprehensive and advanced trade agreement, Trans-Pacific Partnership (TPP) covers many economic issues that are not in Indonesia interests. Joining the trade pact is expected to be costly to the economy and would likely to reduce competitiveness even further. Meanwhile, the potential trade diversion effect would be serious if China, Thailand, and Philippines were joining the trade deal, but is not such the case with current TPP members, which are mostly high and high middle-income countries. In fact, improving competitiveness and economic integration are not mutually exclusive to reinforce each other when the country is not ready for a more open economy. When the country is ready, then the trade agreements could function to maximum, including expanding the opportunities for local producers and market base.

Political – Economic Arguments for Intervention

Hill (2011) argues that economic arguments for free trade intervention are inseparable from political arguments. First, it could be due to protect emerging industries from international competition until it could be globally competitive. Practically, Akyuwen (2011) remarks that the Indonesian government had protected its early airline industry from external competition. In result, the industry achieved substantial growth due to limited competition. Currently, the Indonesian government consistently prevent strong competitors such as Singapore Airlines from entering the market even though it has passed the development phase (Akyuwen, 2011). Thus, it could be a disadvantage for Indonesian airline industry in long-term.

Top management of State oil company Pertamina, which has virtually monopolized fuel distribution and in 2021 will become Indonesia' largest oil and gas producer (Editorial Board, 2018). The Pertamina infused with government's social safety net programs assessing the performance as a corporate entity not as the commercial and social entity. The intervention made that the management changes transparently and with the highest standards of good governance, assessment and selection of the best managerial talents have always been vulnerable to the short-term political interest of the incumber government (Editorial, 2018).

Previously, it is set as monopoly competition due to fixing fuel prices. Jokowi government announced no fuel distributors, including foreign oil firms allowed to float fuel prices according to international market quotations. The government maintains the prices of subsidized all fuels except octane gasoline and diesel to help the poor despite the constant growth of oil price in the international market. In long term, it sets out the right direction for the government's long-term energy policy.

Second, it could be due to counter dumping practices from international competition with anti-dumping policies (Harpaz, 2011). Practically, the Foreign Trade Association (FTA) set an anti-dumping tariff to assure European customers and retailers have the ability to buy ceramic kitchenware and tableware (Asia News, 2013). EU Commission set the anti-dumping duties to protect their market from imports of Chinese ceramic kitchenware and tableware. In result, it successfully prevented Chinese ceramic ware from spoiling market rate in Europe (Eckhardt, 2011).

Indonesia has established an anti-dumping committee. Indonesia urges the significance of discipline in the use of anti-dumping as contingency protection. It is worth that anti-dumping measures are relatively new to Indonesia, which has applied in the case of wheat flour. Indonesian Committee on Anti Dumping (KADI) found that flour was being sold in Indonesia at lower prices than in any exporting countries. KADI proposed that government applied import duties, ranging from 5.96% to 35.93%. Finance rejected the proposal and imposed a 5% tariff on all wheat flour imports (Rodrik, 2002).

Third, the source of capital – resource transfer effect - provide a valid explanation for free trade intervention. Practically, China reduced the tariff for dairy export could offer plenty of capital resources for both China and Australia who are known for the land of milk. The tariff on dairy exports has been reduced to the range between 10-15% which is under the average tariff rates. In result, Australian exports of dairy reached the amount of USD 450 million in 2013 (Evans, 2015).

Bilateral trade relations between Indonesia and China have grown rapidly after signing the Strategic Partnership between Indonesia and China in 2005 and the early harvest program. Indonesia-China trade rose from 4.8 billion US$ (2000) to 49 billion US$ in 2011.

Fourth, resource transfer effect and spillover effect are significantly related to the act of intervention. Practically, South Korea government intervened the light and heavy industries in order to obtain adequate technological capabilities – the source of technology - for its research and development. In addition to this particular industry, only selected trade exporters will be granted free access to imported intermediate products. The government was contingent to protect local firms with its exclusive local market (Alaedini, 1997).

Indonesian government made an agreement of cooperation with China due to the consideration that Indonesia is rich in natural raw materials. When compared with Chinese batik, Indonesian batik has its own advantages ad high material quality as well as representing the rich cultural diversity of Indonesia. It makes batik Indonesia remains as a choice although the price is slightly higher.

Low-Quality human resources must be supported by technology and human resource development. It is required to support the linkages and interlinkages between domestic industries. Hence, in order to solve the problem that threatens the economic integration process of the country efficiently, the fundamental weaknesses in production capacity could be obtained from collaboration with China. Thus, China owns the technology and professionals in terms of transfer effect while Indonesia owns the natural resources.

In addition, regionalization is another form of multinational intervention due to geographic region. Practically, the collaboration between ASEAN and EU showed a mutually beneficial relationship in the geographical context (Howse, 2003). ASEAN enjoyed tariff concessions exports to EU. To an extent, EU contributed to the achievement of ASEAN free trade area goals. In fact, the geographical trading has slowly moved away from the global free trade system.

Practical Impact of Government Intervention

A country's intervention to an excessive degree is negative from a business point of view. It is associated with higher uncertainty in international planning and higher intervention costs. Practically, the UK government implemented the industrial restructuring policy on French steel plant industry (Betts, 2008). Due to the de-industrialized policy, French companies was invoked to adopt higher adapting costs instead of preparing labor base for necessary changes. Thus, the UK government is suggested to create new jobs by taking advantage of the 1.9% economic growth instead of restructuring the steel plant industry (Betts, 2008).

Pertamina is a case study in how not to manage one's natural resources. The industries are supposed to be cash engines to build a better economy for society. In fact, endless internal disputes due to political interventions will only lead to losses to the company and state (Tempo, 2018). There is the potential capital injection of 32 billion US Dollars (416 trillion Indonesian rupiah), however, too much government intervention in the changing Pertamina's board of directors may cause crucial projects delays and ruin the long-term plans of the company. Thus, it leads to higher intervention costs (Muna, 2018).

Practically, free trade could be the main source of innovation. For example, Japan protected its mining, coal, steel, and food manufacturing industries from foreign competition (New York Times, 1993). Its regulation protected Japan from foreign competition. In fact, those unprotected industries in Japan has grown rapidly than those protected industries in terms of innovation. Thus, protectionism tends to limit productivity by preserving industries that fail in competition (Ford & Suyker, 1990).

Methodology

Data utilized in the paper were secondary data research. The data were collected through various sources namely World Bank, researches, articles and case studies for an in-depth analysis from Indonesian perspectives.

The methodology used is an analysis technique based on data and mostly used are case studies based analysis. Strengths of case studies based analysis includes (1) Conducts data examination within the situation in which activity takes place; (2) Captures the unforeseen information on how they behave, not only based on daily activity; (3) Gains a highly specific data from implicit behavior of the object study (Yin, 1984).

However, there are several flaws from case studies based analysis. It includes (1) Case studies are often accused to lack of rigor; (2) Provides the little basis for scientific generalization since the subject number is small or some conducted with only one subject; (3) Difficult to reach a generalize conclusion since it depends on single case exploration. Therefore, the article made serve the purpose for further researches in the future.

Conclusion

The political argument could be justified for intervention into the free trade agreement.

The number of factors plays a role in Indonesia's protectionism against free trade. The six main political factors imply that the re-emergence of government protectionism in Indonesia is a drop in Indonesia's competitiveness. Commodities contributed to over than 50% of Indonesia's non-oil and gas export. Thus the increasing exports value was due to the significant increase in commodity prices rather than quantities.

Other than developing a relationship with free trade country members, Indonesia adopted lower involvement when the issues covered within agreements are not in Indonesia's interests. The main factor is that government believe it could increase its attractiveness as an investment destination. Thus, it could incur the higher economic cost as well when joining the trade pact.

Reality shows that both political and economic arguments are positively correlated with each other. It implies that the political reason could significantly impact economic growth. Indonesian economy never follows the complete nature of the free market system and created an uncertain deep market intervention policy. Often government deems free trade as an opportunity to increase its export, in which turns to global prosperity. In fact, by being open to free trade, Indonesia's in competitiveness faced the issue of deficit trade balance. It implies that Indonesia merely becomes the consumer in free trade organizations. It is mainly driven by the factor of lacking capable human resources and supporting technology for a better product quality.

In order to counter the shortages, Indonesia often exchanges its natural raw materials in free trade for resource transfer effect, market access and finally to the source of capital. In recent years, the trade relation between Indonesia and China has increased sharply due to its professionals and advanced technology.

In fact, the government attempt to improve its competitiveness and economic integration are not mutually exclusive. Indonesia has to ensure its readiness to open up the economy, especially from reciprocal trade agreements although it could expand the market base and opportunities for local producers. On the other hand, Indonesia's SMEs face a big problem in accordance with the openness in intervening free trade agreements. The government should be able to ensure SMEs to create the power on branding. Branding readiness could help Indonesia to boost up export products as a low cost and low priced products within the global market and increase the competitiveness indirectly. Before intervene, Indonesia should put their competitiveness capability as a consideration, hence the non-tariff trade agreement becomes effective. In result to the positive impact on economic growth and global business environment.

In addition, government intervention to an excessive degree may lead to higher expenses in-country expenditure. Furthermore, political intervention often leads to internal disputes and losses to the country. Corruption plays a role in this regard.

Notes on Contributor

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