UNIVERSITAS PELITA HARAPAN

CITI CENTER FOR INTERNATIONAL TRADE & INVESTMENT

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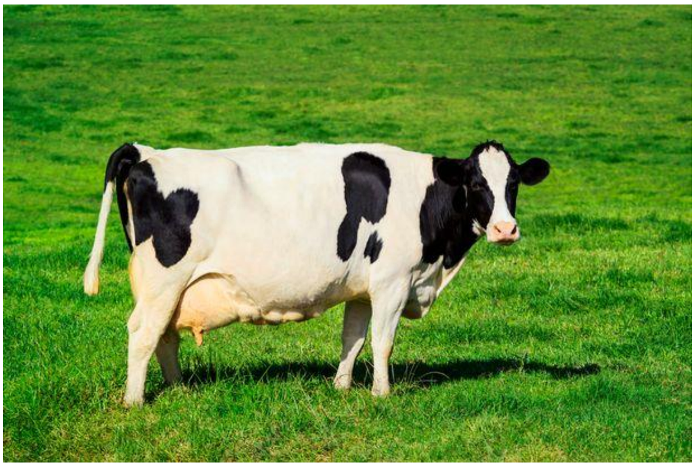
In This Issue

Local Content Requirements for Dairy Products

Between 1950s and 1980s Indonesian government was relentlessly promoting a nutrition slogan, '4 healthy 5 perfect'. The slogan referred to a concept that a meal is balanced if it comprises of the following components: (1) staple food, mainly carbs such as rice; (2) side dishes or the source of protein such as meat, fish, eggs; (3) vegetables; (4) fruit; and (5) water and milk. The slogan was deemed inapt in 1990s and has been updated ever since.

Although in 30 years of campaign milk was promoted as a 'perfect complement' to the '4 healthy' meals; the milk consumption in Indonesia during that period was very low as milk and its derivatives were not a traditional part of local diet. However, in the last decade, consumption of milk and other dairy products have increasing rapidly in parallel to a growing number of middle class and westernizing diets in Indonesia.

There is however a wide gap between the local dairy output and domestic consumption. The Livestock and Animal Health Services of Ministry of Agriculture statistics shows that Indonesia's dairy cattle population in 2015 was 518.649 head producing about 835.100 tonnes of milk (see: the Directorate General of Livestock and Animal Health Services, 'Bukti Nyata Dukungan Pemerintah Terhadap Peternak, Kementan Buat Regulasi Terkait Persusuan'). Meanwhile Indonesia's milk consumption in the same year was 3.838.215 tonnes or 14.3 liters per capita, still much lower than other ASEAN countries such as Philippines, Thailand and Malaysia which consume respectively 22.1, 33.7, and 50.9 liters (see: the USDA 'Indonesia 2016 Dairy Report and Products Annual Report'). This means that the local production of local milk can only meet 22% of the local demand. The production had a significant drop in between 2011 and 2013 when the previous administration set a beef self-sufficiency agenda through protectionist trade policies, as farmers took advantages of the soaring prices of beef and sold their cattle to slaughterhouses. Facing the domestic shortage, the bulk of milk is sourced from overseas mostly from New Zealand, Australia and the United States in the form of powders to cover 78% of the local demand.



To improve the capacity and competitiveness of local dairy farmers, the Indonesian Ministry of Agriculture issued a new regulation in July 2017 (MOA Regulation No. 26/2017) that requires business operators to establish a kind of partnership with local dairy farmers. The partnership can be in a form of procuring local fresh milk (for the milk processors) or promoting local milk consumption (for the non-milk processors such as importers). Other types of partnership can be in a form of providing a production support infrastructure, or production and/or capital/financial support. The local procurement requirement might not be a major concern for the milk processing companies as most of the local milk is absorbed as raw material by them.

The regulation, however, adds another layer of bureaucracy by requiring business operators to submit a partnership agreement and plan/proposal to the Director General of Livestock and Animal Health Services (DGLAHS). The DGLAHS will take these documents into consideration when issuing import recommendation. The regulation also contains sanctions including being prevented to obtain import recommendation for one year for business operators who fail to comply with the provisions on partnership and regular report.

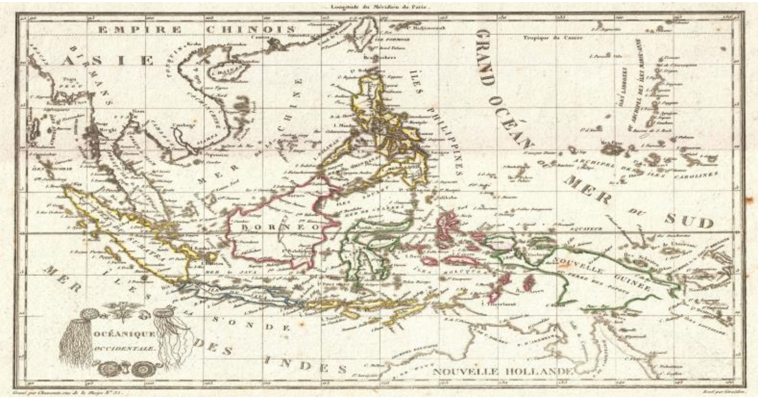
Local absorption and promotional requirements for dairy products in the MOA Regulation are quite similar to Indonesia's measure on domestic purchase requirement for beef that had been challenged by the United States and New Zealand in the WTO dispute settlement. The measure requires business operators that import large ruminant beef to absorb local beef when applying for an import recommendation. In this dispute, the panel found that the measure is akin to local content requirement and that the 'required increase of local content, either by purchasing from domestic producers or by developing local manufacture, [had] a direct limiting effect on importation, because the measure is designed to force the substitution of imports' (see panel report, Indonesia – Horticultural Products para 7.427). The panel also pointed out that the import substitution effect inherent to the measure has a limiting effect. For those reasons, the panel found the domestic purchase requirement for beef measure to be inconsistent with Article XI of the GATT as it constitutes a restriction having a limiting effect on importation.

Should Indonesia's 'local absorption and other requirements' measure for dairy products be challenged in the WTO dispute settlement, it is likely that the complainant will refer to this dispute and claim that such a measure constitutes a local content requirement that has a limiting effect on importation, and therefore it is inconsistent with Article XI of the GATT.

A Challenging Time for Retail Sector

Over the past few months, the retail sector has captured the media's attention. They reported that, in Jakarta, many retail outlets are struggling to survive or even have to close their business. Business operators tend to blame the stagnancy of economic growth as the main reason of their struggle. According to the Central Statistics Agency (BPS) data, Indonesia's economic growth is at 5.01% in the 2nd quarter of 2017, similar to the 1st quarter. This number is lower compared to the 2nd quarter of 2016, where it reached 5.18% (y-on-y). Claiming that the retail sector is struggling because of the lukewarm of economic performance is debatable. The economic growth of a country could fluctuate without necessarily spur new stores nor close them down. Furthermore, economic growth reflects the whole economy of a country, not only retail sector in particular. Should there an economy crisis, other sectors will also be affected.

There are various reasons why the retail sector is struggling as reported by the media, and a number of experts have provided their views on this phenomenon. Firstly, they refer to the weakening of Indonesians' purchasing power which automatically leads to the decreasing of aggregate demand. According to the Chairman of



Indonesian Retail Association (APRINDO), Mr. Roy N. Mandey, the industry is not able to absorb the workforce available in the market, which leaves many Indonesians who are in their productive age unemployed and spend less. Some observers also suggest that development in technology play a significant role in many job losses, as machineries replace human labors. They estimate that disruptive innovations in technology could replace 7.1 million manual jobs and generate only 2 million new jobs.

Secondly, they point out the rise of e-commerce which is changing the way people shop. Observers present two different arguments regarding this situation. On the one hand, some observers argue that the growth of e-commerce is insignificant to be considered as the record of online transaction only accounts for 1% of total retail transaction nationally. On the other hand, others view that there is a tendency for middle class to shop online. The goods purchased through online platform by middle class directly compete with those offered by brick and mortar businesses. The changing of consumption behavior indeed undermines the profit normally gained by the brick and mortar retailers.

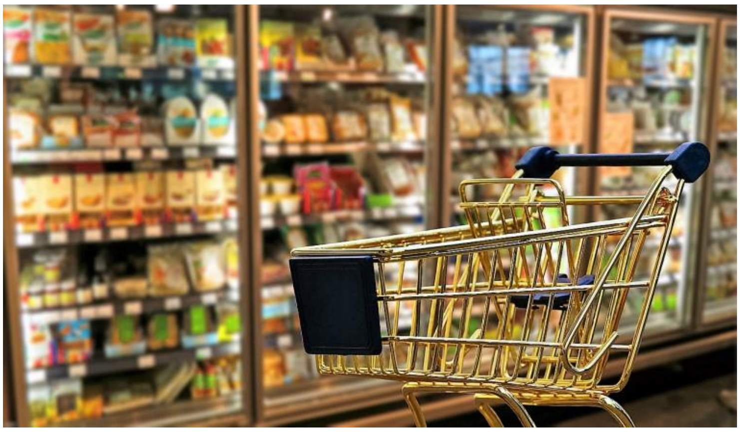
This article offers other explanations to why retailers are now struggling to survive, such as inflation and the mushrooming of shopping centers. In simple terms, inflation can be understood as a persistent, ongoing rise across a broad spectrum of prices. If inflation is not compensated by increases of income, the value of income earned by the workforce is decreasing. Accordingly, people will be reluctant to spend their wages on secondary or luxurious goods which most retailers sell as they will prioritize to fulfill their primary needs such as food and electricity first. From January 2017 until April 2017, the subsidy for electricity was gradually reduced. The removal of subsidy has increased the price electricity for households around 75%, from IDR 587/kwh in January to 1,023/kwh in April. Additionally, Indonesia food inflation was at 4.33% in May 2017 – the highest in 14 months. If the cost of these primary needs goes up, people have less money to spend on secondary and tertiary needs/goods.

The boom of property business has triggered the mushrooming of new shopping centers. In Jakarta, most of the residential areas have its own shopping center, which lead to the dispersion of consumers. Few years ago, consumers had to reach out to certain trade center in Jakarta to shop, but now they can do it with the comfort of geographical proximity. In turn, the outlets which were concentrated in 'traditional' trade centers now facing competition from these close-to-home shopping centers.

From a bigger perspective, the struggle of brick and mortar retailers is also experienced by the retail sector in other countries. Singapore is one example for this similar issue. The Urban Redevelopment Authority's retail rental index for the first quarter of this year is into its ninth quarter of consecutive decline. Singapore's national vacancy stock reached 5 million square feet or 7.7 per cent nationally. Retailers in Australia are also seeing its sales slumped. The share price of Myer – one of the largest department store chain in Australia, is even halved between September 2016 to September 2017. Toys R Us – a US-based toy chain with more than 1,600 stores worldwide is filing for a bankruptcy due to its faltering performance. Thus, it can be said that there is a similar trend/problem facing by the brick and mortar retailers across the globe.

"…technology , especially the rapid growth of e-commerce is one of the main reasons behind the struggle of traditional retailers."

Undeniably, technology, especially the rapid growth of e-commerce is one of the main reasons behind the struggle of traditional retailers. The survey by BPS demonstrates that the consumers now tend to buy certain goods online instead of shopping traditionally at the shopping centers. The record today may show that e-commerce contributes merely 1% of total trade in retail in Indonesia. However, this number is likely to be inaccurate considering there is no proper mechanism in place to record the online transactions. Installing an appropriate recording mechanism is important, not only to get the statistics right, but also for the tax purposes.



Whatever the reasons that cause this phenomenon, it certainly indicates that traditional way of doing business is no longer applicable in today's world. Brick and mortar retailers need to keep up with the pace, innovate and embrace technology. The simplest way is to integrate the business with e-commerce. Some retailers also innovate by combining the concept of retail and café to offer consumers a unique experience.

President Joko Widodo in one occasion said, consumers behaviors in this digital era are changing. In the past, people consume the goods, while now people tend to seek or consume experience. Christine Li – the Director and Head of Research of Cushman & Wakefield Singapore, noted that physical stores are no longer a point of sales, rather it is a point of experience. Physical stores will remain competitive as long as they evolve to stay relevant and be an integral part of customer's experience. Indeed, it is a challenging time for retail business, but it is not the end of the game.

It is not Safeguard Measure, WTO Panel Decision on *Indonesia – Iron and Steel Products*

On 18 August 2017, WTO Panel issued its ruling on a dispute brought by Chinese Taipei and Viet Nam against additional specific duty imposed by Indonesia on certain steel products (galvalume). The specific duty was adopted for a period of three years pursuant to Regulation No. 137.1/PMK.011/2014 of the Minister of Finance of the Republic of Indonesia, which entered into force on 22 July 2014. Indonesia imposed the additional tariff for galvalume as a safeguard measure following the result of investigation by *Komite Pengamanan Perdagangan Indonesia* (KPPI).

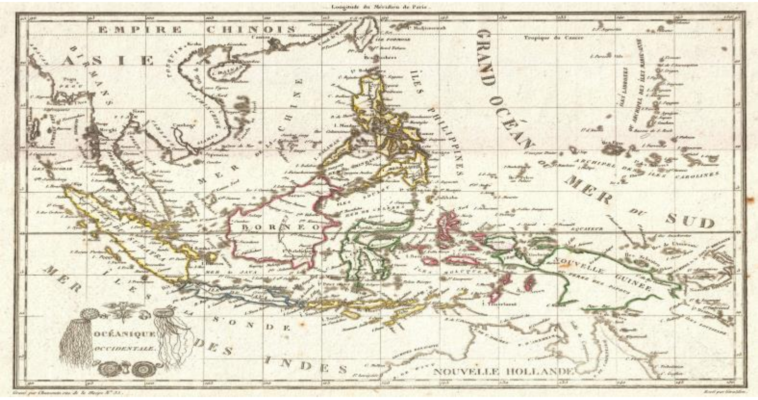
During the request for consultation, Indonesia's Most-Favored Nations (MFN) tariff for galvalume was 12.5% ad valorem. However, Indonesia applied 0% preferential tariff for ASEAN Members under the framework of ASEAN Trade in Goods Agreement (ATIGA), and 10% tariff for South Korea under the framework of ASEAN-Korea Free Trade Agreement (AKFTA). The specific duty adopted by Indonesia will be imposed in addition to this existed applied tariff. It is important to note that Indonesia has no binding tariff commitment for galvalume in the WTO, and in applying the safeguard measure, Indonesia excluded 120 developing countries listed in the Annex of the Minister of Finance's Regulation. The basis of this exemption is unclear, but it is apparent that they are not major steel producer or exporter countries.

The co-complainants argued that the imposition of Indonesia's safeguard measure was inconsistent with a number of provisions under the Safeguard Agreement, safeguard provision in GATT Article XIX (a), as well as the MFN provision found in GATT Article I:1. The co-complainants also made a stand-alone claim based on the non-discrimination principle under Article I:1 of the GATT because Indonesia excluded certain countries from the application of its safeguard measure.

Despite of the fact that the parties to the dispute viewed the additional duty as safeguard, the Panel ruled otherwise. The Panel noted that under Article 1 of the Agreement on Safeguards the 'safeguard measures' should be understood as 'those measures provided for in Article XIX of GATT 1994'. Accordingly, the panel referred to Article XIX:1(a) of the GATT and stated that 'measures provided for' in Article XIX:1(a) are measures that suspend in whole or in part or withdraw or modify a GATT concession/obligation.

The Panel found that since Indonesia has no binding tariff commitment with regards to imports of galvalume, Indonesia did not suspend or withdraw or modify its obligation under Article II of the GATT 1994. In other words, the additional duty imposed by Indonesia for importation of galvalume did not constitute a safeguard measure.

Indonesia asserted that its commitments in AKFTA and ATIGA prevented Indonesia from increasing its tariff on imports of galvalume originating in its regional trade agreement (RTA) partners. Therefore, Indonesia argued that imposition of specific duty suspended its GATT obligations under Article XXIV of the GATT 1994 (the provision



concerning Customs Unions and Free-trade Areas). The Panel was not persuaded with this argument. They viewed that Article XXIV of the GATT 1994 is a permissive provision and does not impose an obligation on Indonesia to apply a particular duty rate on imports of galvalume from its RTA partners. The obligation to accord preferential tariff derives from the FTAs and not from the GATT.

Panel's ruling with regards to Article XXIV of the GATT implies that Indonesia's measure is irrelevant with Indonesia's obligation under the GATT. However, the measure could be found as a safeguard measure and considered to be inconsistent with Indonesia's obligation under the relevant FTAs. Put differently, the co-complainants in particular Viet Nam could bring a claim against Indonesia's allegedly safeguard measures to the relevant FTA dispute settlement.

"…since Indonesia has no binding tariff commitment … the additional duty imposed by Indonesia for importation of galvalume did not constitute a safeguard measure."

Indonesia also argued that the imposition of specific duty suspended its obligations to apply the measure on a non-discriminatory basis under Article I:1 of the GATT. Indonesia asserted that it is legally required by Article 9.1 of the Agreement on Safeguards to provide special and differential treatment (S&D) for qualified developing countries. The Panel recalled that they have found that Indonesia's measure is not a safeguard measure, and thus, there is no basis for Indonesia's assertion that it was legally required to apply the specific duty in the manner required by Article 9.1. For the reasons mentioned above, the Panel dismissed the entirety of the claim of the complainants with regards to safeguard.

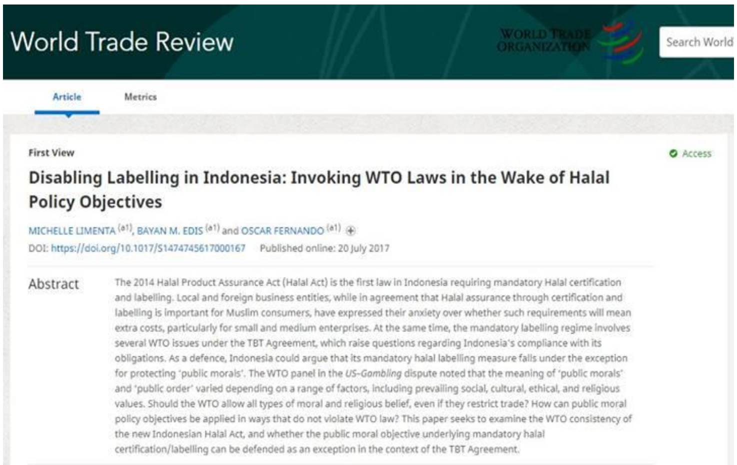
The co-complainants, however, also pursued a stand-alone claim that Indonesia's measure is inconsistent with the MFN principle under Article I:1 of the GATT. Indonesia did not contest the discriminatory nature of its measure, but it referred to the S&D provision under Article 9.1 of the Safeguard Agreement to justify its action. The Panel rejected Indonesia's argument because the Panel has found that the measure at issue is not a safeguard measure, therefore this provision does not apply. As Indonesia failed to justify its discriminatory measure, the Panel found that such a measure is inconsistent with Article I:1 of the GATT.

Finally, safeguard measure must be temporary, and based on the Indonesian Minister of Finance regulation, Indonesia's safeguard measure on steel was supposed to be expired in July 2017, prior to the Panel's ruling on this dispute. Should Indonesia government wish to apply a safeguard measure on galvalume, government could consider other available forms of action.

For example, instead of imposing additional specific duty, Indonesia could consider imposing a safeguard measure in the form of quantitative import restrictions. The measure would be likely to qualified as a safeguard under Article XIX:1(a) because it suspends Indonesia's obligation under Article XI:1 of the GATT. Should Indonesia opt for adopting this form of measure, it should provide justification for its measure and the measure should be consistent with WTO provisions on safeguard.

Indonesia could also increase its applied tariff as it has no binding tariff commitment with regards to galvalume in the WTO. However, it would escalate a concern whether the measure is inconsistent with Indonesia's commitments under FTAs.

CITI regularly hosts and participates in seminars, workshops, and conferences related to international trade and investment.



World Trade Review

Article Metrics

First View

Disabling Labelling in Indonesia: Invoking WTO Laws in the Wake of Halal Policy Objectives

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Abstract The 2014 Halal Product Assurance Act (Halal Act) is the first law in Indonesia requiring mandatory Halal certification and labelling. Local and foreign business entities, while in agreement that Halal assurance through certification and labelling is important for Muslim consumers, have expressed their anxiety over whether such requirements will mean extra costs, particularly for small and medium enterprises. At the same time, the mandatory labelling regime involves several WTO issues under the TBT Agreement, which raise questions regarding Indonesia's compliance with its obligations. As a defence, Indonesia could argue that its mandatory halal labelling measure falls under the exception for protecting 'public morals'. The WTO panel in the *US-Gambling* dispute noted that the meaning of 'public morals' and 'public order' varied depending on a range of factors, including prevailing social, cultural, ethical, and religious values. Should the WTO allow all types of moral and religious belief, even if they restrict trade? How can public moral policy objectives be applied in ways that do not violate WTO law? This paper seeks to examine the WTO consistency of the new Indonesian Halal Act, and whether the public moral objective underlying mandatory halal certification/labelling can be defended as an exception in the context of the TBT Agreement.

"Disabling Labelling in Indonesia: Invoking WTO Laws in the Wake of Halal Policy Objectives" Article Publication in the World Trade Review Journal

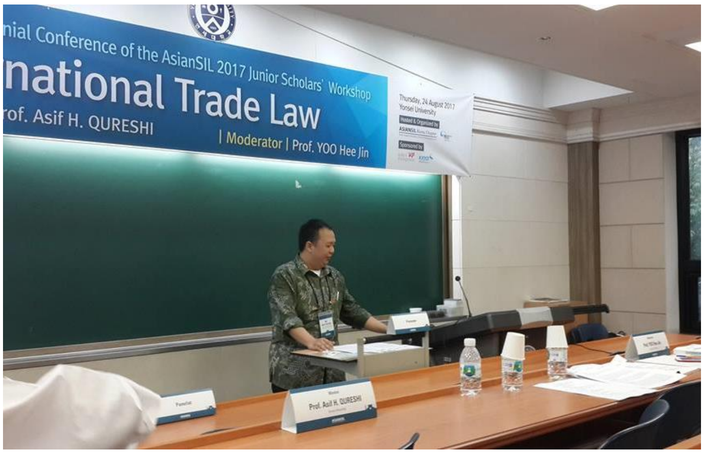
20 July 2017

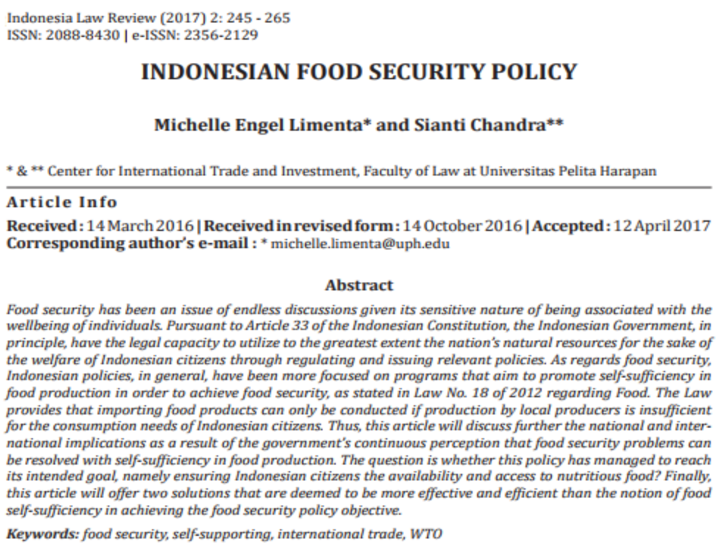
The article written by UPH-CITI's researchers has been published in the World Trade Review Journal. The journal was established at the initiative of the World Trade Organization Secretariat in close cooperation with Cambridge University Press.

UPH CITI's Research Associate Presented at Junior Scholars Workshop of the 6th Biennial Asian Society of International Law Conference

Seoul, 24 August 2017

Oscar Fernando won a competitive scholarship granted by the Asian Society of International Law (AsianSIL) and presented his paper entitled "Trump's Unilateral Action: The End of an Era?" at the 'Junior Scholars Workshop'. The conference was held in South Korea for 3 days. Hundreds of scholars, lawyers and practitioners from more than 50 countries attended the conference.





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INDONESIAN FOOD SECURITY POLICY

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Abstract

Food security has been an issue of endless discussions given its sensitive nature of being associated with the wellbeing of individuals. Pursuant to Article 33 of the Indonesian Constitution, the Indonesian Government, in principle, have the legal capacity to utilize to the greatest extent the nation's natural resources for the sake of the welfare of Indonesian citizens through regulating and issuing relevant policies. As regards food security, Indonesian policies, in general, have been more focused on programs that aim to promote self-sufficiency in food production in order to achieve food security, as stated in Law No. 18 of 2012 regarding Food. The Law provides that importing food products can only be conducted if production by local producers is insufficient for the consumption needs of Indonesian citizens. Thus, this article will discuss further the national and international implications as a result of the government's continuous perception that food security problems can be resolved with self-sufficiency in food production. The question is whether this policy has managed to reach its intended goal, namely ensuring Indonesian citizens the availability and access to nutritious food? Finally, this article will offer two solutions that are deemed to be more effective and efficient than the notion of food self-sufficiency in achieving the food security policy objective.

Keywords: *food security, self-supporting, international trade, WTO*

"Indonesian Food Security Policy" Article Publication in the Indonesia Law Review Journal

August 2017

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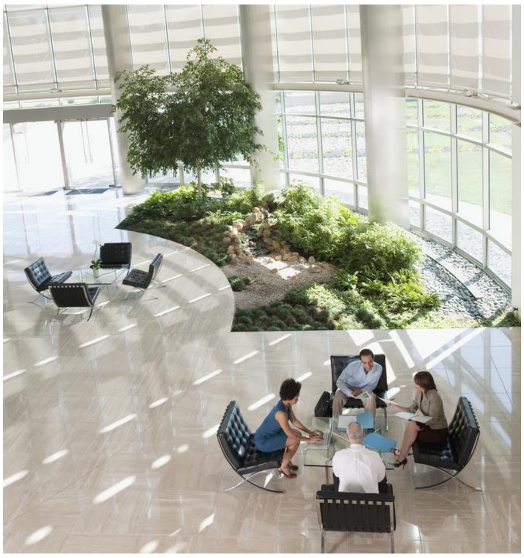

Universitas Pelita Harapan - UPH

Founded in 1994 with the vision of educating a new generation of leaders for Indonesia and the wider ASEAN region, Universitas Pelita Harapan is the number one private university in Indonesia according to the QS World University Ranking 2013. UPH was the first University in Indonesia to introduce programs entirely taught in English, the first to offer a liberal arts curriculum, and the first to introduce a multi-disciplinary approach to its programs. While consistently underlining the vision of "knowledge, faith and character", UPH, in cooperation with overseas partner universities, has developed a very rich curriculum in many areas of study, ensuring that its graduates are respected globally and appreciated by modern business and industry.

The Center for Trade and Investment - CITI

Established in September 2014, CITI's objective is to raise awareness in Indonesia of the importance of an outward-looking and liberal trade and investment policy, so as to ensure the country's continued commercial competitiveness and support its economic development goals. CITI runs a number of research, education and outreach initiatives with the generous support of the Swiss State Secretariat for Economic Affairs (SECO) and the World Trade Institute (WTI), Switzerland.

Our goal: To be the preeminent center for thought leadership and expertise on trade and investment policy and law in Indonesia

This quarterly newsletter seeks to provide updates, insights and analysis on current developments in trade and investment law and policy in Indonesia. Constructive feedback and comments are always welcome.

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Disclaimer: The articles are representative of the author's view, not necessarily the general view of the Center

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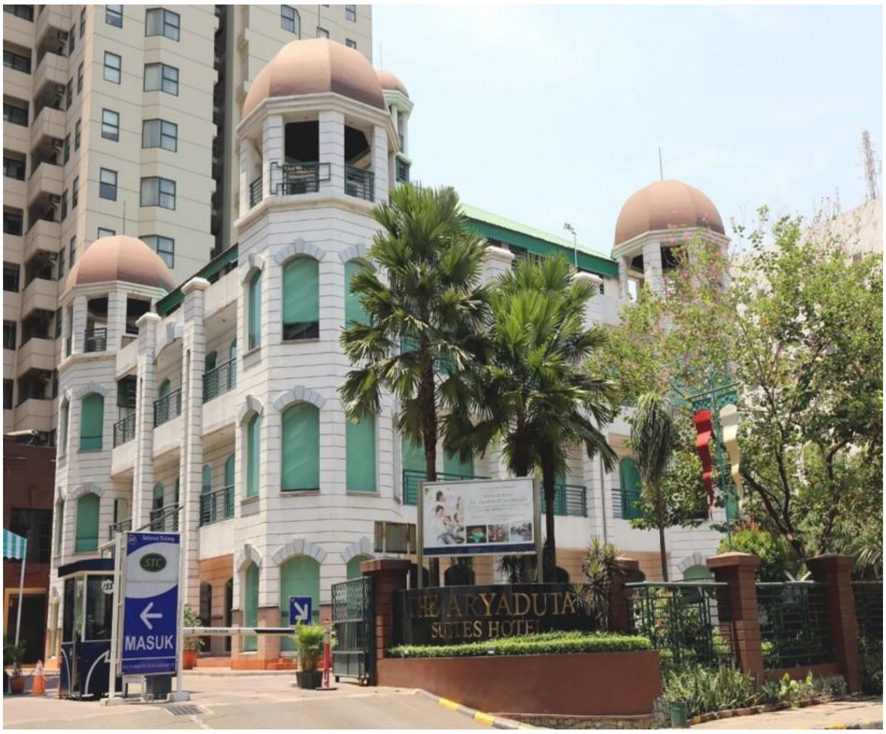

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