UNIVERSITAS PELITA HARAPAN

CITI CENTER FOR INTERNATIONAL TRADE & INVESTMENT

Indonesian Trade and Investment Quarterly

4th Quarter 2016

In This Issue

The rise of machines, trade and inclusive growth: Time for equality?*

Michelle Limenta

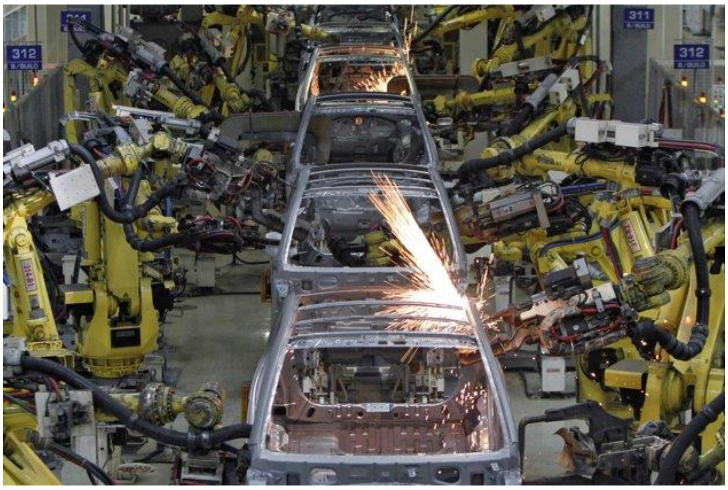
Economic growth is the most powerful tool to reduce poverty. China's share of global trade, for example, has tripled since the country joined the World Trade Organization (WTO) in 2001, helping cut its poverty rate from 36 percent at the end of the 1990s to 6 percent in 2011, said the World Bank Group's president, Jim Yong Kim, at the Opening Plenary of the WTO's 5th Global Review of Aid for Trade last year.

However, another study by the World Bank in 2005 entitled "Pro-Poor Growth in the 1990: The Lessons and Insights from 14 Countries" highlights increased inequality in countries with economic growth and trade liberalization, although they achieved an absolute reduction in poverty. Indonesia also struggles with the issue of inequality. According to a World Bank report entitled "Indonesia's Rising Divide", Indonesia has one of the fastest rising rates of inequality in the East Asia region, with a Gini coefficient climbing from 30 in 2000 to 41 in 2014.

Despite the economic growth and poverty reduction (the poverty rate fell from 24 percent in 1999 to 12 percent in 2012), national disparities in income and consumption have widened over the past decades. Indonesia's wealthiest 20 percent have enjoyed higher growth in income and consumption, while its poorest 40 percent remain vulnerable. Rural-urban as well as regional disparities have contributed to inequality. Eastern Indonesia appears to lag far behind other parts of the country.

Does trade contribute to the rising inequality?

*A version of this article appeared in the Jakarta Post (op ed.) on 25/10/16, available online: http://www.thejakartapost.com/news/2016/10/25/the-rise-machines-trade-and-inclusive-growth-time-equality.html



There is no dispute that trade stimulates economic growth and development. However, trade creates not only winners but also losers. In today's globalized world, trade liberalization has delivered benefits and opportunities for many people, but at the same time it has produced challenges and vulnerabilities for others. Free trade opponents argue that trade agreements kill jobs. They claim that imports destroy jobs, local factories are closed and industries in the region disappear.

Even many people in advanced countries see free trade with low-wage countries as impoverishing low-skilled and mid-level workers in their countries, particularly in the manufacturing sector, because those job opportunities will be sent overseas, where workers' wages are much lower. Often, displaced workers cannot find equally well-paying jobs and remain unemployed.

Indeed, trade can cause displacement in the labor market. But, to put the blame entirely on trade seems unfair. The problem of inequality entails various factors, and international trade is a relatively minor factor.

Many commentators have highlighted the role of technology (or automation) as another explanation for increased inequality. In his speech at the joint IMF-World Bank-WTO seminar in October, WTO head Roberto Azevêdo said that over 80 percent of job losses in advanced economies were not due to trade, but to increased productivity through technology and innovation.

Some jobs are at high risk because of automation. The postal service cut down their mail services and staff due to the force of the internet. ATMs have reduced the number of bank teller jobs. Online shopping is threating retail stores. The role of travel agents has been diminished as passengers book their tickets online.

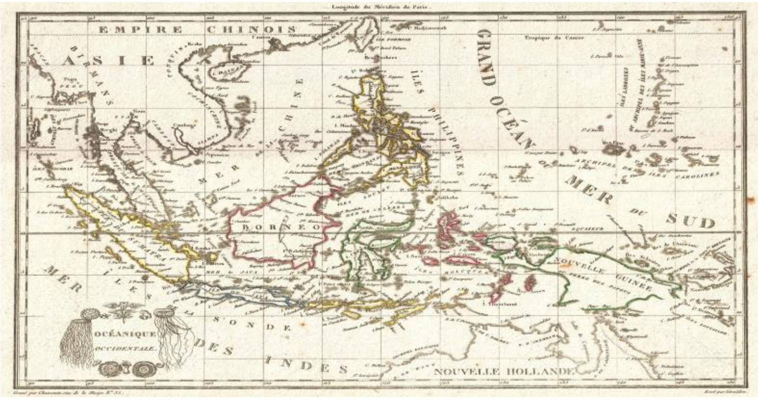
In Indonesia, the presence of ride-hailing apps introduced by a local company called Go-Jek pose a threat to traditional motorcycle taxis, known as *ojek*. Recently, Google and Uber have tested their own driverless cars on public roads. Driverless vehicles will bring huge opportunities to technology and software companies, but they will endanger driver jobs.

Other commentators, however, argue that automation redefines jobs rather than destroying them. Bank employee's routine work has been replaced by ATMs, but this allows banks to reallocate their human resources to do other things that cannot be done by machines, like sales and customer services. Driverless vehicles may open up other types of jobs, such as for programming, car fleet maintenance and emergency operations. Automation increases efficiency and the value of tasks that can be performed by humans. But, it indeed requires them to learn new skills. Whether replacement or reallocation, we need policies suitable for dealing with such events.

"The problem of inequality entails various factors, and international trade is a relatively minor factor… the role of technology (or automation) as another explanation for increased inequality."

Inequality has prevented many Indonesians from reaping the fruits of economic growth. However, building up walls of trade protection is not the solution to the inequality problem. Trade protection would do little to ease the job woes of unskilled or less skilled workers, but at the same time it would hit hard producers and consumers.

To reduce inequality, we need policies that focus on promoting 'inclusive growth'. To be inclusive, growth should benefit all segments of society in terms of access to opportunities and participation in growth. According to the Asia-Pacific Trade and Investment Report 2013, inclusivity touches on multidimensional aspects of development comprising productivity, poverty and inequality reduction, the creation of decently paid jobs, integration of specific groups (women, young, unskilled) in the labor force, enhanced entrepreneurship, improved consumption choices and the quality of life. Policies and strategies promoting inclusive growth will play an important role in charting a way forward for the country.



Trade will be inclusive if it is in line with the spirit of inclusive growth. Trade facilitation at the domestic level, for example, can reduce trade costs due to administrative barriers or red tape and can directly benefit individuals and households by reducing the prices of goods and services. International trade that enables efficiency and makes available goods or services that are not available or more expensive domestically will improve local production and consumption.

Trade is an important driving force for inclusive growth, but trade alone is insufficient; it must be accompanied by complimentary policies and supportive institutions with genuine political commitments. The government, for example, needs to issue labor market policies that enable appropriate responses to worker displacement due to technological progress and provide necessary support to the unemployed.

Training, reskilling, capacity-building and labor adjustment programs are indispensable. Infrastructure also plays an important role in supporting inclusive growth. Infrastructure development creates jobs and generates economic activities, reduces production costs through improved connectivity and access to facilities, and opens up markets domestically and internationally.

President Joko "Jokowi" Widodo has made infrastructure development, particularly outside Java, the hallmark of his administration. This is a part of his strong commitment to reduce inequality and disparity in the prices of goods. That said, problems still hamper his administration's infrastructure plans.

Making growth inclusive is not an easy task. But, as President Jokowi put it, let us "move together to work, work and work".

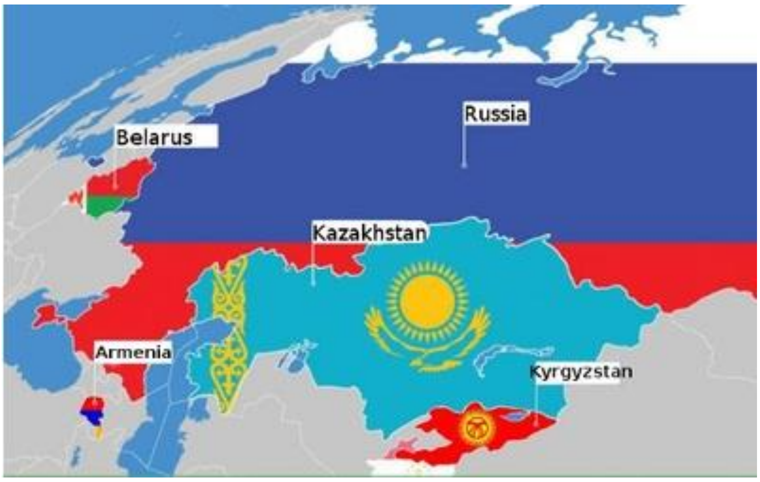
Toward Deeper Trade Relationship with the Eurasian Economic Union, a Hot Potato: Can Indonesia Make FTA with Non-WTO Members?

Michelle Limenta

In May 2016 following the Russian-Indonesian bilateral talks, Indonesian President Joko 'Jokowi' Widodo and Russian President Vladimir Putin issued joint press statements. In their statements, both leaders confirmed their commitment to improve trade and economic relations between two countries. In that spirit, they discussed the idea of creating a free trade area between Indonesia and the Eurasian Economic Union (EAEU).

The EAEU officially came into existence since 1 January 2015. In the same year, it signed a FTA with Viet-Nam. The organisation currently consists of five members: Armenia, Belarus, Kazakhstan, Kyrgyzstan, and Russia.

According to a document entitled 'Eurasian Economic Integration: Facts and Figures' published by the Eurasian Economic Commission, the EAEU, in terms of its territorial size and population, includes over 182 million people and covers more than 15% of the world's surface (20 million km^2). In terms of its economy and trade, the EAEU



generates a combined GDP of US$2411.2 billion and US$932.9 million in foreign trade turnover, and is capable of industrial output worth US$1.5 trillion. Unsurprisingly, Russia is the EAEU's heart of economic and demographic gravity. It accounts for over four fifths of the EAEU's entire GDP, population size and geographical surface.

Looking at their potential, a number of commentators urge Indonesian government to pursue this non-traditional market. The interesting question then arises as to whether Indonesia will breach its most favoured nation (MFN) obligation under World Trade Organization (WTO) law by concluding a FTA with non-WTO members? Unlike the European Union, the EAEU and Belarus, one of its Members, are not yet the member of the WTO.

Under the MFN treatment obligation, an advantage or favour (such as lower customs duty rate) granted to any country (either WTO or non-WTO member) by a WTO member should be accorded to other WTO members. Some exceptions to this obligation are allowed. For example, WTO members can establish a FTA or custom union that applies only to goods and/or services traded within the group. In other words, WTO law ensures the validity of exclusive exchange of FTA benefits. This assurance can be found in Article XXIV of GATT and Article V of GATS which are designed as an exception to the MFN obligation regarding trade in goods and services.

However, when a FTA involves WTO members and non-WTO members, will this exception apply?

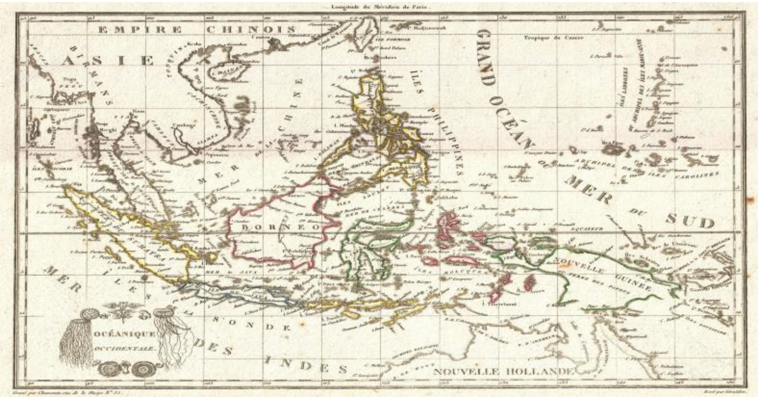
While GATT Article XXIV:5 justifies FTAs among WTO members, Article XXIV:10 establishes a procedural aspect if WTO members conclude FTAs with non-WTO members. The provision of Article XXIV:10 states that 'The CONTRACTING PARTIES may by a two-thirds majority approve proposals which do not fully comply with the requirements of paragraph 5 to 9 inclusive, provided that such proposals lead to the formation of a customs union or a free-trade area in the sense of this Article.' By referring to the drafting history, the GATT panel in *EEC – Bananas II* noted that paragraph 10 was included in the GATT to allow the contracting parties to establish a customs union and FTA that would include non-contracting parties.

"The interesting question then arises as to whether Indonesia will breach its most favoured nation (MFN) obligation under World Trade Organization (WTO) law by concluding a FTA with non-WTO members?"

In practice, the procedure stipulated in Article XXIV:10 has been to date invoked twice, for the Nicaragua – El Salvador FTA and the Nicaragua – Central American FTA. Louise Eva Mossner in a journal article entitled 'The WTO and Regional Trade: A Family Business? The WTO Compatibility of Regional Trade Agreements with Non-WTO-Members' says that the contracting parties had practically abandoned the paragraph 10 procedure since 1960s and to this day no more approval procedure have taken place. Won-Mog Choi in 'Legal Problems of Making Regional Trade Agreements with Non-WTO-Member States' explains why this mechanism had started becoming insignificant. According to him, in 1960s reaching a FTA with non-GATT parties had become a widespread practice, thus there were an increased number of countries that were reluctant to go through the strict approval procedure of paragraph 10. Another reason is also based on the fact that the number of WTO members has been constantly increasing. When the WTO Committee on Regional Trade Agreements evaluated the FTAs between the European Communities and Estonia, Latvia and Lithuania in 1997, the non-WTO member status of Estonia, Latvia and Lithuania was not the issue in the evaluation process. Much of the discussion focused on the quality of the agreement.

Interestingly, the approval procedure stated in GATT Article XXIV:10 is absent in the GATS. The wording of Article V:1 of GATS justifies a MFN violation by WTO members arising from FTAs on services with non-WTO members. But, the provision clearly does not state any required approval process. Additionally, Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), unlike GATT and GATS, does not provide any provision regarding FTAs.

In sum, Indonesia as a WTO member is allowed to conclude FTAs with non-WTO members. The existing practice demonstrates that WTO members have rarely recourse to the approval procedure stipulated in GATT Article XXIV:10. So, it is expected that Armenia, Kazakhstan, Kyrgyzstan, Russia and Viet-Nam will not invoke the paragraph 10 procedure as regards the establishment of FTA among them.



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Trumponomics: Popular but Problematic

Oscar Fernando

Americans have spoken. In few weeks, President-elect Donald Trump will be sworn as the 45th President of the United States. Mr. Trump's victory had caught many by surprise and raised curiosity among immigrants, businesses and scholars. This is common, as people will always wonder during a transition from one administration to another. The curiosity will find its answer when Mr. Trump translates his promises during the campaign into concrete policies. However, some statements from Mr. Trump and the appointment of some cabinet members can signify his future policies.

During his campaign, Mr. Trump highlighted his plan to remove burdensome regulations, cut income and corporate taxes and boost spending on infrastructure. He will also use carrot and stick approach to persuade American companies to bring back their assets. For example, Mr. Trump promised to incentivize domestic companies who retain their business at home, while threatened to impose tariff on products imported from American companies who produce abroad. He believes this approach will benefit Americans and bring abroad jobs back to the United States.

Another notion put forward by Mr. Trump is to take strong action against China's alleged practice of currency manipulation. The 'weak' Yuan has been blamed by Mr. Trump as the main cause of the trade deficit suffered by the United States in the last decade. As the response, Mr. Trump is planning to impose steep tariffs on importation of Chinese products.

In late November, Mr. Trump announced that he will appoint Wilbur Ross – a strong supporter during the campaign as Secretary of Commerce. Sharing the same view with Mr. Trump, Mr. Ross is not fond of free-trade, dislike multilateral trade agreement and ultimately also an opponent of Obama's administration's Trans-Pacific Partnership. In the past, Mr. Ross dealt a lot with steel and coal industry, two industries that usually enjoy protections from government. Based on these facts, it is expected that Mr. Trump's administration will adopt inward-looking economic policies.

> "While some industries and labor force in the US strongly favor Mr. Trump's mercantilist view, industries that rely on global value chain disfavor the view equally strong."

This inward-looking strategy can be working in the short-term and benefits the United States for a while. At least, the market has responded well and the US Dollar has risen sharply in early December, stood 40% above its lows in 2011. However, in the long term, strong currency does not always mean good, as it can widen trade deficit. Strong currency will make imports cheaper and exports more expensive. In other words, strong USD will squeeze exports and sucks in imports.

But, does this mercantilist view is what really make United States as great as today? Globalization is a fact of life, and the United States has championed the global competition. While some industries and labor force in the US strongly favor Mr. Trump's mercantilist view, industries that rely on global value chain disfavor the view equally strong. IP-intensive industry for example, has reaped the benefits of complexity in global value chain. Companies in this category such as Apple, General Electric and Pfizer are definitely harvesting the benefits from their efficient world-based production. US Department of Commerce recorded IP-intensive

industries contributed 38.2% of the US GDP in 2014. The IP-intensive industries thus responsible directly and indirectly for 30% of employment in the United States. Imposing inward-looking policies might upset these companies.

Mr. Trump might be successful to bring back jobs into the United States, but at the same time he will also isolate the United States from the global value chain. This can be bad for American in the end. One of the reasons companies now rely on global value chain is to save logistics cost, since raw materials needed for production are mainly located outside the United States. Forcing the businesses to produce in the United States can increase the cost of production as they have to spend more resources to transport the raw materials into the United States. As the result, although Americans get their job back, their purchasing power will be weaker as the products becoming more expensive.

A gloomy day for Indonesia?

Stronger US Dollars can be bad for emerging markets, including Indonesia. Beside the sophisticated financial calculations, one certain implication is companies have to dig deeper into their pockets to pay for foreign debts. The central bank of Indonesia noted that Indonesian private foreign debt amounted up to $165.2 billion USD in April 2016. When the dollar rises, the cost to service those debts will increase as well.

With regards to trade, the United States has been one of the main trading partners for Indonesia. Based on Indonesian Statistic Agency's data, the US was the 4th export destination in 2014 accounted for 9.4% of Indonesia's exports. Although the value of Indonesian export to the US increased in the last 5 years, but the share declined to around 8%. In other words, Indonesia's export value to other countries increased more significantly compared to the US. Another main destination for Indonesia's export is China, which ranked 2nd in 2014, sharing more than 10% of Indonesia's exports. Having said that, China's economy is more influential to Indonesia compared to the US's economy. Many commentators have predicted that Indonesia will not be directly affected by Mr. Trump's policies. However, unfortunately, Indonesia's 2nd export destination is a clear target of Mr. Trump's policies.

In many occasions, Mr. Trump stated that he will label China as currency manipulator since his first day in office and other actions are being prepared towards China. If Mr. Trump brings his promises into action, it will hit China hard. World Bank data shows that the United States is the top China's export destination, accounted for 18% of its total exports. Due to the large proportion of Chinese exports to the US, China will be adversely affected by Mr. Trump's policies.

America's hit on China will be felt indirectly by Indonesia after Mr. Trump's policies take effect in the Chinese economy. This indirect implication is probably more significant for Indonesia compared to the direct implications of sudden change in the US economic policy. Apart from all of this, Trumponomics will change the global economic order.

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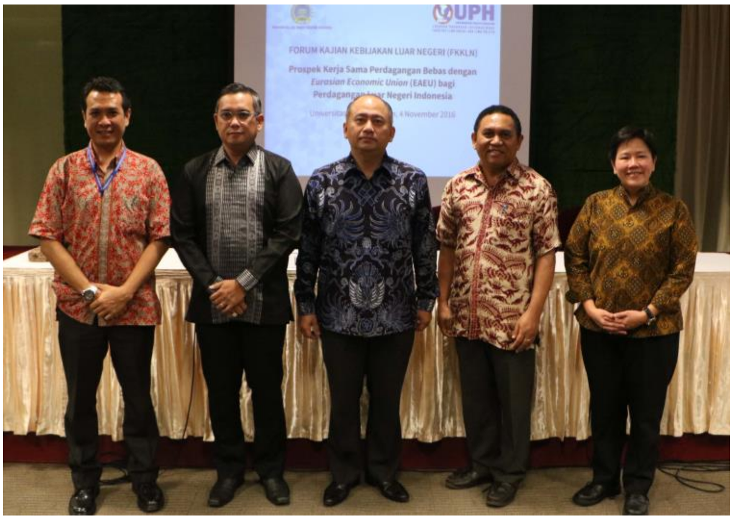
CITI regularly hosts and participates in seminars, workshops, and conferences related to international trade and investment.

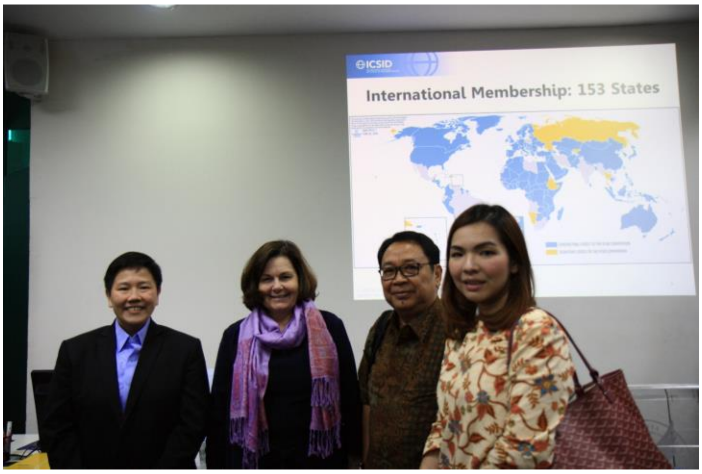


Foreign Policy Discussion Forum: Potential Cooperation between Indonesia and Eurasian Economic Union (EAEU)
Jakarta, 4 November 2016

Indonesian Ministry of Foreign Affairs and UPH's International Relations Department hosted a foreign policy discussion forum to explore the potential cooperation between Indonesia and the Eurasian Economic Unian (EAEU). Michelle Limenta, Ph.D. of UPH-CITI was invited to present her view.

Public Lecture by Meg Kinnear - Secretary General of International Centre for Settlement of Investment Disputes (ICSID)
Jakarta, 18 November 2016

UPH-CITI had the privilege to host a public lecture by Meg Kinnear – Secretary General of International Centre for Settlement of Investment Disputes (ICSID). The public lecture was entitled "How International Investors and States Resolve (Many of) Their Disputes – An Overview of the International Centre for Settlement of Investment Disputes". There were more than 80 participants who attended the public lecture coming from different backgrounds, including law firms, embassies, businesses, researchers and students.

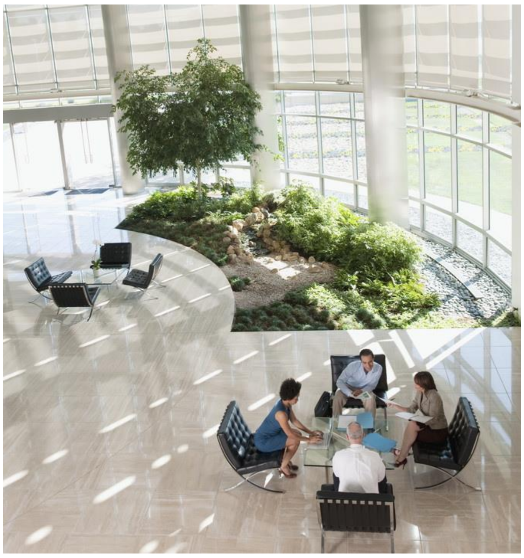


In this end of the year, more than ever, our thoughts turn gratefully to your supports and cooperation which have made our progress possible.
And in this spirit we say, simply but sincerely...

Thank You!

We wish you a Merry Christmas and a Wonderful New Year!

Season's Greetings



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

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.

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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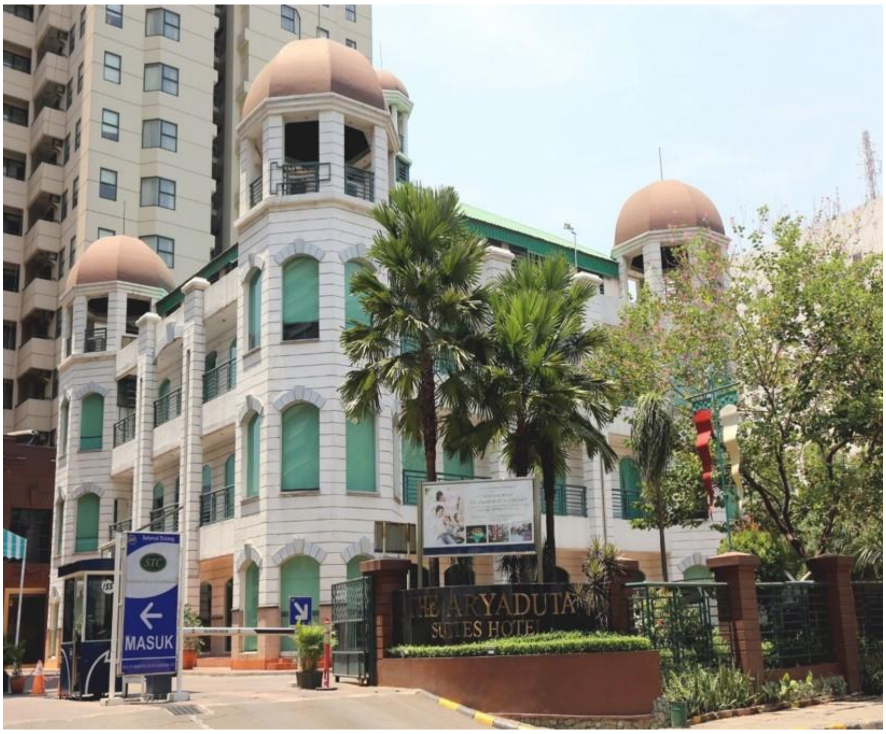

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