

PERSPECTIVE

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Rising Economic Nationalism in Indonesia: Will This Time be Different?

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EXECUTIVE SUMMARY

- Indonesian President Joko Widodo’s administration has advocated various protectionist measures in order to shield the Indonesian economy from heightened competition. This comes at a time of rising concerns over the state of the domestic economy in light of global uncertainties.
- After the 2009 Global Financial Crisis, Indonesia increasingly took to utilizing non-tariff protectionist measures such as import quota, import licensing, and local content policy, to support local industries and create jobs. In recent months, this trend is intensifying, driven by rising economic nationalism.
- Past experiences, however, show that such protectionist policies have little or no link to improvements in the capabilities of local industries. Likewise, the impact of these measures on employment is unclear.
- Furthermore, protectionist policies may also have negative effects on efficiency-seeking foreign direct investment.
- Inefficiency caused by protectionist policies in specific sectors can be expected to spill over to other sectors and eventually adversely affect the whole economy.



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- On the whole, therefore, rising economic nationalism in Indonesia may end up slowing down the pace of economic integration in the region.

INTRODUCTION

Has Indonesia become more protectionist? Indeed, a number of Indonesian economists believe that to be the case.² To be sure, the trend towards greater protectionism pre-dates the Joko Widodo administration and actually began during the second term of Susilo Bambang Yudhoyono (SBY). For example, a World Bank report in 2012 documented a sharp increase in the number of non-tariff measures (NTMs) taken to limit imports and exports after the 2009 global financial crisis.³ It stated clearly that Indonesia was among the large and emerging economies that used NTMs extensively in order to protect the domestic economy during those difficult times.⁴

Protectionism continued to rise over the last five years, fuelling worries that Indonesia is steadily becoming an inward-looking economy.⁵ In the past, economic crises forced Indonesia to implement what in the eyes of free trade advocates were ‘good’ policies.⁶ For example, after the end of the ‘oil boom’ era in 1982, Indonesia initiated a series of deregulation measures, including a series of trade reforms to reduce the highly protectionist trade regime.⁷ These reforms spurred the development of a more efficient and competitive private sector and increased Indonesia’s manufactured exports, reducing the country’s dependency on oil and gas exports in the process. As a result, Indonesia, together with Malaysia and Thailand, was classified as one of the three newly-industrializing economies (NIEs) by the World Bank.⁸

Today, things are different – Indonesia is undertaking ‘bad’ policies when in economic hardship by taking protectionist measures and introducing various inward-looking policies.⁹ Why the difference this time? This essay discusses some underlying factors behind Jokowi’s protectionist policies as well as possible consequences on the Indonesian economy. The next section examines some economic trends that inform Jokowi’s policy thinking to protect and revitalize the weakening economy. The third and fourth sections discuss some political and strategic motivations behind Indonesia’s increased protectionist policies. Following sections examine some possible consequences that Indonesia’s protectionist policies may have on the

² For an early warning about rising protectionism in Indonesia, see Titik Anas, "Indonesia's New Protectionist Trade Policies: A Blast From the Past", East Asia Forum, 18 June 2012, (<http://www.eastasiaforum.org/2012/06/18/indonesia-s-new-protectionist-trade-policies-a-blast-from-the-past/>). For a recent commentary, see Arianto A. Patunru and Sjamsu Rahardja, "Trade Protectionism in Indonesia: Bad Times and Bad Policy", *Lowy Institute Analysis*, July 2015, (http://www.lowyinstitute.org/files/patunru_and_rahardja_trade_protectionism_in_indonesia_0.pdf).

³ See Julia Oliver, "Rise of non-tariff protectionism amid global uncertainty", Growth and Crisis Blog, World Bank Institute. <http://blogs.worldbank.org/growth/rise-non-tariff-protectionism-amid-global-uncertainty>.

⁴ Other economies include Argentina, Brazil, China, India and Russia. Together they accounted for almost half of all the new NTMs imposed by countries world-wide. See Julia Oliver, "Rise of non-tariff protectionism amid global uncertainty", Growth and Crisis Blog, World Bank Institute. <http://blogs.worldbank.org/growth/rise-non-tariff-protectionism-amid-global-uncertainty>.

⁵ Lili Yan Ing, Mari Elka Pangestu and Sjamsu Rahardja, "Managing Indonesia’s Trade Policy: How to remove the agenda?", in Anwar Nasution (ed), *Macroeconomic Policies in Indonesia: Indonesia economy since the Asian financial crisis of 1997*, 2015, Routledge: 224-44.

⁶ 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.

⁷ Thee Kian Wie, 2012, *Indonesia’s Economy since Independence*, ISEAS, Singapore: 72-4.

⁸ World Bank, 1993, *The East Asian Economic Miracle: Economic Growth and Public Policy*, Oxford University Press, New York.

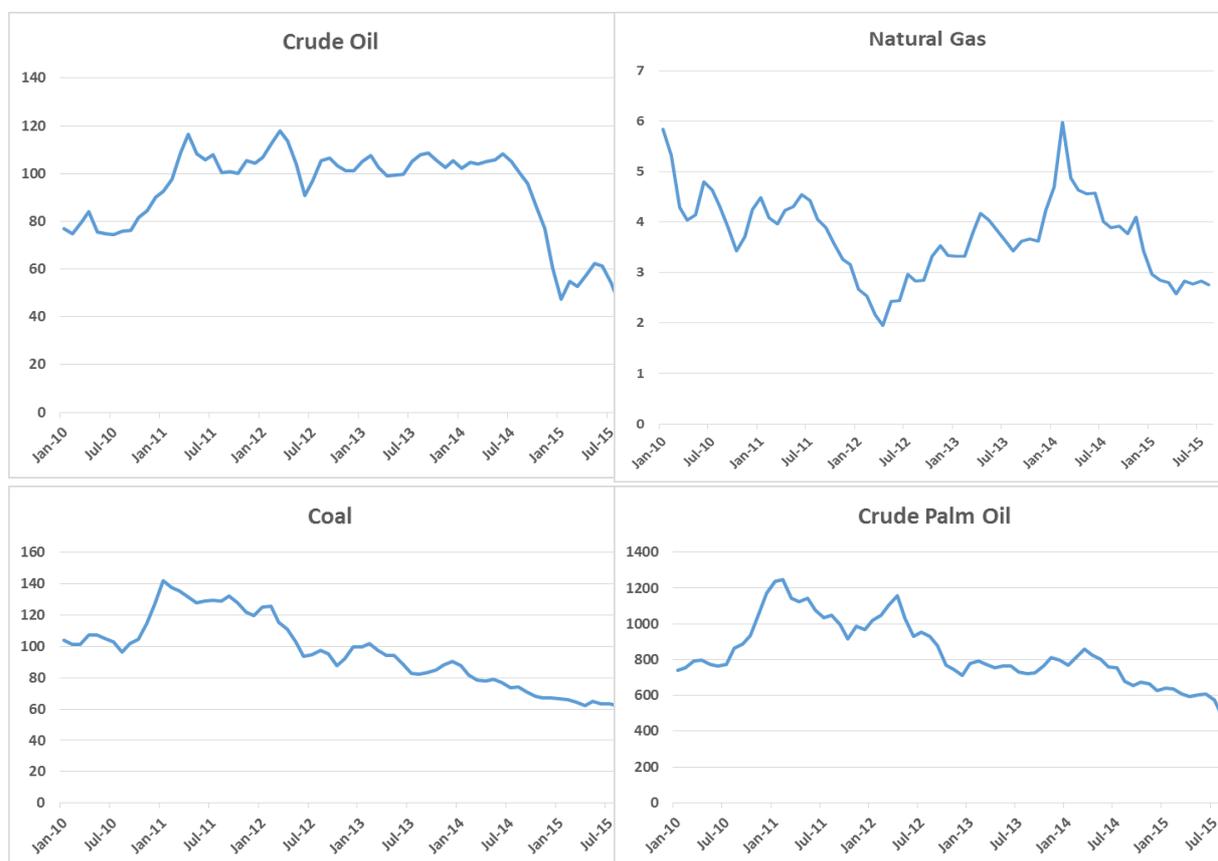
⁹ See Arianto A. Patunru and Sjamsu Rahardja, "Trade Protectionism in Indonesia: Bad Times and Bad Policy", *Lowy Institute Analysis*, July 2015

domestic economy and on regional economic integration. The last section emphasizes the need for Indonesia to ensure that it remains committed to ASEAN integration.

A DETERIORATING DOMESTIC ECONOMY

Part of the reason why Indonesia chooses to tighten economic protection is due to deteriorating domestic economic condition. When Jokowi started his presidential term in late October 2014, the full impact of the global economic slowdown had already hit Indonesia's economy. China's reduced demand for global commodities had led to a sharp fall in prices, and since Indonesia is a major exporter of coal, natural gas and oil-palm, falling prices (see Figure 1), have had a significant negative effect on its current account balance. Table 1 shows that Indonesia's export growth has been falling since 2012 and has become negative in the last two quarters.

Figure 1: Commodity Price Development of Select Indonesia's Key Exports



Note: Crude Oil (petroleum) Monthly Price - US Dollars per Barrel; Natural Gas Monthly Price - US Dollars per Million Metric British Thermal Unit; Thermal Coal Monthly Price - US Dollars per Metric Ton; Palm oil Monthly Price - US Dollars per Metric Ton.

Source: Index Mundi. <http://www.indexmundi.com/commodities/>

Table 1: The Growth of GDP and its Components in Indonesia (%)

	2011	2012	2013	2014	2015 (Q1)	2015 (Q2)
Private consumption	5.1	5.5	5.4	5.0	5.01	4.97
Govt consumption	5.5	4.5	6.9	2.2	2.71	2.28
Investment	8.9	9.1	5.3	4.2	4.29	3.55
Export	14.8	1.6	4.2	1.3	-0.85	-0.13
Import	15	8	1.9	2.2	-2.27	-6.85
Total GDP	6.5	6	5.6	5.0	4.72	4.67

Source: Badan Pusat Statistik (BPS) various edition of Berita Resmi Statistik

In addition to the drop in exports, household consumption, traditionally the key driver of economic growth, is also weakening due to weak consumer confidence. In the last quarter of 2015, private consumption grew below 5%, the slowest growth rate since 2011. Weak consumer confidence is partly caused by the rupiah's steep depreciation. In fact, the rupiah has depreciated by around 13% since October 2014, making it the worst performing currency in the region (see Figure 2).

However, the clearest indicator of economic decline in Indonesia is seen in the steep fall of investment growth. In Q2-2015, private investment only grew by 3.5%, much slower than investment growth rates in 2011 and 2012, when Indonesia still grew by 6% each year (see Table 1). This trend indicates declining investor confidence in the Indonesian economy.

Figure 2: The Rupiah's Steep Depreciation Against the US\$



Source: Oanda (accessed on 10 September 2015)

In response to the deteriorating domestic economy, Jokowi's administration increased tariff and non-tariff measures in order to reduce imports.¹⁰ There are two objectives for this: First, reduce the use of its limited foreign reserves; and second, protect domestic industries from heightened competition from imported goods.

INCREASED POLITICAL PRESSURE FOR PROTECTION

The protectionist policies was also in answer to rising nationalism driven by various political parties and business groups. Economic decline has triggered increased political pressure for Jokowi to support local industries and to keep jobs for millions of Indonesian workers. And given his 'weak' power base both in Parliament and within his own party (PDI-P), it is difficult for him to ignore these pressures.¹¹

Domestically, Jokowi has to accommodate various interest groups; including his own party, his broader coalition, a complex bureaucracy, local governments, business associations, and trade unions. There is definitely strong pressure from trade unions for Jokowi's administration to avoid major layoffs.¹² Sectors that absorb many workers, such as garment, shoes, electronics and coal mining, have been struggling to maintain their production and avoid layoffs.¹³ Local workers also worry about increased job competition, aggravated by the 'rumour' of influx of foreign workers.¹⁴ In early September 2015, a big demonstration was held by trade unions demanding better conditions and higher salaries, and rejecting the government's policy to ease requirements for foreign employees seeking jobs in Indonesia.¹⁵

In addition to pressure from trade unions, business groups are demanding government protection against foreign competition.¹⁶ These groups have already successfully lobbied the government to increase tariff and non-tariff measures to help locally made products compete against foreign goods. They claim that many jobs can be saved that way for Indonesian workers.

¹⁰ Wahyudi Soeriaatmadja, "Jakarta raises import taxes for more than 1,000 items", The Strait times, 24 July 2015. (<http://www.straitstimes.com/asia/se-asia/jakarta-raises-import-taxes-for-more-than-1000-items>)

¹¹ Amalinda Savirani, "Commentary: Why Jokowi's Supporters Start to Doubt the 'Indonesian Obama'", (<http://jakartaglobe.beritasatu.com/opinion/why-jokowis-supporters-start-to-doubt-the-indonesian-obama/>).

¹² Kompas, "Ada Potensi PHK 100.000 Tenaga Kerja" (100,000 workers potentially lose their jobs), 2 September 2015,

(<http://bisniskeuangan.kompas.com/read/2015/09/02/070712926/.Ada.Potensi.PHK.100.000.Tenaga.Kerja>).

¹³ The Jakarta Post, "43,085 workers laid off since early 2015", 28 September 2015,

(<http://www.thejakartapost.com/news/2015/09/28/43085-workers-laid-early-2015.html>)

¹⁴ In fact the number of foreign worker in Indonesia is relatively small, only around 70,000, according to the Ministry of Manpower. (<http://www.thejakartapost.com/news/2015/08/29/number-foreign-workers-very-small-minister.html>)

¹⁵ Agus Maryono, "Hundreds of workers in Cilacap reject foreign employees", The Jakarta Post, 1 September 2015, (<http://www.thejakartapost.com/news/2015/09/01/hundreds-workers-cilacap-reject-foreign-employees.html>)

¹⁶ Linda Yulisman and Grace D. Amianti, "Import tariff hike applauded", The Jakarta Post, 24 July 2015, (<http://www.thejakartapost.com/news/2015/07/24/import-tariff-hike-applauded.html>).

ACCELERATING ECONOMIC TRANSFORMATION

Besides the economic and political factors mentioned above, Indonesia also has a longer-term strategic motivation that may explain the protectionist trend. As stated in its Masterplan for Acceleration and Expansion of Indonesia Economic Development 2011-25 (MP3EI),¹⁷ Indonesia is envisioned to transform its economy from a resource-based economy into a high value-added one driven by innovation and technology. In line with this long term development goal, Indonesia has identified several strategic sectors, considered as high in value added, labour intensive, export-oriented and import-substitution industries, and has designed various policy interventions to steer their direction. For example, to reduce dependency on mineral exports and to move up the industry value chain, Indonesia has implemented Law No 4/2009 on mineral and coal mining that prohibits mining companies from exporting unprocessed minerals and that obliges them to build local smelters. Despite the government's self-proclaimed statement that its mining ban policy has triggered significant foreign direct investment (FDI) into the smelter projects and pushed miners to add value to their products,¹⁸ there is no clear economic calculation available about the net impact of the policy.

Like his predecessor, Jokowi's trade and investment policies will also be driven by Indonesia's long-term strategic development objective to move local industries up the value chain. Presently, Indonesia is likely to be increasingly more selective in opening up sectors to foreign investments. For example, in power plant investment, in which local players have neither the required knowledge nor technology, the government allows foreign ownership to maximize at 95 %. Meanwhile a sector like fishing, in which local players already have the business capability, will be totally closed to FDI. Moreover, to accelerate economic transformation upwards, Indonesia is also offering various incentives to boost investment in certain strategic sectors, such as machineries, petrochemicals, papers, textiles, mining, agriculture processing, marine infrastructure, and special economic zones.¹⁹

DOMESTIC CONSEQUENCES

During a crisis, it is natural for every government to prioritize its domestic economy and protect the groups that are adversely affected by competition from imports. However, Indonesia should consider the fact that these policies, especially when poorly-targeted, lacking in transparency and monitoring, and imposed for too long, may make matters worse.

Protectionist measures cause economic distortion and inefficiency.²⁰ Protecting some sectors may also hurt the competitiveness of other successful private players in the industry. Non-tariff protectionist measures, in particular, prevent consumers and producers from buying from the most efficient foreign suppliers. A common and misguided view is to see exports as good and

¹⁷ This masterplan was initiated by the former president Susilo Bambang Yudhoyono.

http://www.kemlu.go.id/rome/Documents/MP3EI_PDF.pdf

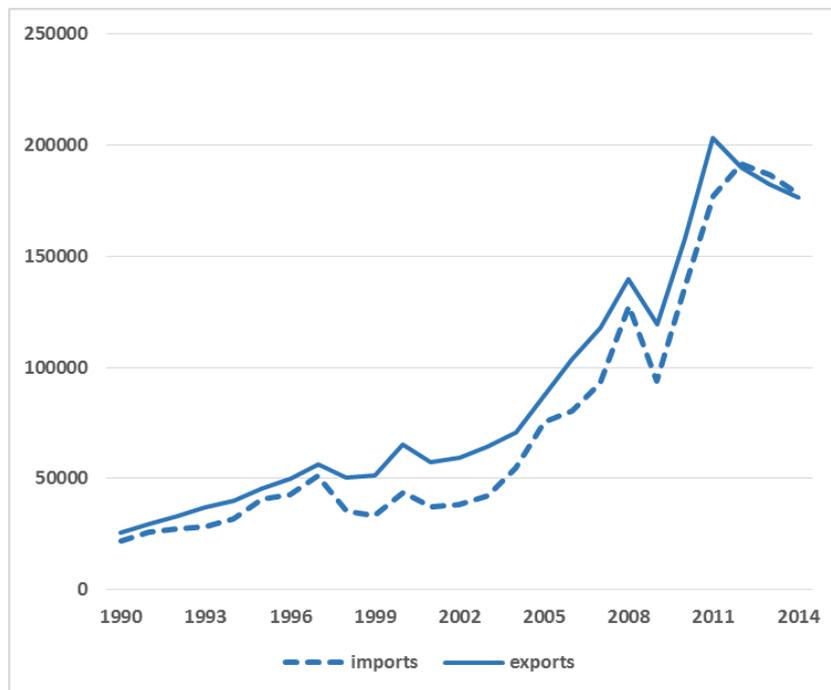
¹⁸ Satria Sambijantoro, "Mining Law boosts foreign investment", The Jakarta Post, 25 July 2015, (<http://www.thejakartapost.com/news/2014/07/25/mining-law-boosts-foreign-investment.html>).

¹⁹ Satria Sambijantoro, "New tax holiday will lure foreign investors: Govt", The Jakarta Post, 4 August 2015, (<http://www.thejakartapost.com/news/2015/08/04/new-tax-holiday-will-lure-foreign-investors-govt.html>)

²⁰ See Julia Oliver, "Rise of non-tariff protectionism amid global uncertainty", Growth and Crisis Blog, World Bank Institute. <http://blogs.worldbank.org/growth/rise-non-tariff-protectionism-amid-global-uncertainty>

imports as bad.²¹ However, Figure 3 clearly shows that Indonesia's exports are strongly and positively correlated to its imports. When imports increase, Indonesia's exports increase, and vice versa.

Figure 3: Indonesia's Export and Import Values, 1990-2014 (million US\$)



Source: UNCTAD. Author's calculation.

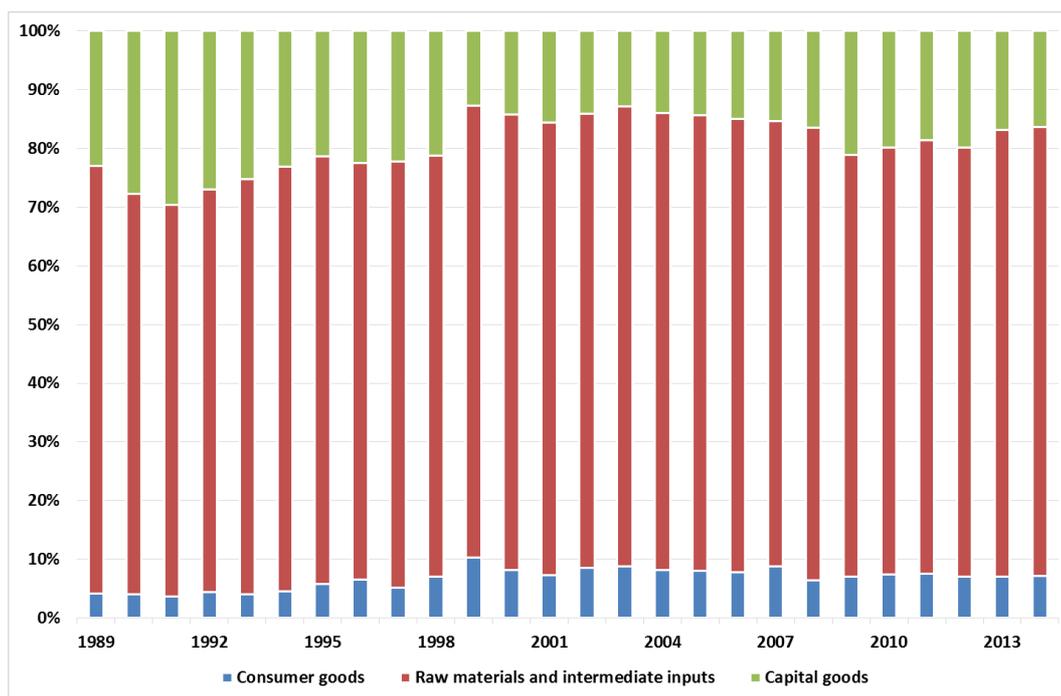
The high correlation between exports and imports can be explained by the high share of raw materials and capital goods in Indonesia's imports (see Figure 4). Therefore, any policy imposing restrictions on imports is likely to have adverse effects on Indonesia's exports, and thus its growth prospect.

Indonesia's high dependency on imported raw materials and capital goods has also encouraged an ill-founded belief that Indonesia should adopt an import-substitution strategy. One example of this concerns the issue of local content requirements, when foreign companies are required to procure goods and services locally, in particular to find local partner (joint ventures) and transfer technologies to domestic small-medium enterprises (SMEs) by incorporating the latter into their production network. For many years, Indonesia has been using various local content restrictions, affecting sectors such as mining, oil, gas, automotive, machinery, electronics, and telecommunication, to encourage foreign multinational companies to invest in Indonesia. However there is no clear evidence that these policies have led to their intended outcomes, i.e. higher local industry capability. This indicates that such policies may not be targeting the real problems.

²¹ See Yose Rizal Damuri, "Indonesia's Import Phobia", East Asia Forum, 10 August 2012, (<http://www.eastasiaforum.org/2012/08/10/indonesia-s-import-phobia/>).

In fact, Indonesia’s import substitution policy contrasts starkly with the phenomenon of ‘international production networks’.²² Today, most goods are no longer produced in one specific country. Instead different parts are produced in many different countries before being shipped off to be assembled. The production units are spread out over several countries, and forcing firms to use locally made products or to partner with local players will limit their ability to procure the most efficient inputs. This in turn is likely to increase overall production costs, adversely affecting efficiency and profitability. Such a policy is likely to deter efficiency-seeking FDI that is part of Global Value Chain (GVC).

Figure 4: Indonesia’s Imported Goods by Type, 1989-2014



Source: BPS. Author’s calculation.

Forcing companies in the automotive and electronics sectors, for example, to use locally made products or services goes against current international trade and investment patterns. Indonesia may think that it has a large domestic market, but for global brand companies, this market may not be large enough to attract them enough to the point where they reconfigure their supply chains to comply with the local content regulations.²³ In addition, multinational corporations, especially those that are technology-intensive and have proprietary rights, such as those in the electronics and automotive sectors, are reluctant to relocate to places with a poor intellectual property right record, like Indonesia. These industries are understandably concerned that their technology may be imitated and copied by local firms, especially given how weak legal enforcement on proprietary rights is known to be in Indonesia.

²² Daisuke Hiratsuka, “Production Fragmentation and Networks in East Asia Characterized by Vertical Specialization”, chapter 5 in Hiratsuka & Uchida eds., Vertical Specialization and Economic Integration in East Asia, Chosakenkyu-Hokokusho, IDE-JETRO, 2008.

²³ Jonathan Pincus, “Local content rules for smartphones - not so smart “, Nikkei Asian Review, 14 may 2015, (<http://asia.nikkei.com/Politics-Economy/Policy-Politics/Local-content-rules-for-smartphones-not-so-smart?page=1>)

The argument that an import-substitution industrialization strategy can spur employment in higher value-added and high-skilled labour sectors is also ill-founded. It is the quality and skilled of Indonesia's workers that will attract FDI with technology that will in turn lead to the development of high value-added and high-skilled sectors. In the case of Indonesia, the lack of skilled workers is likely to deter this type of FDI.²⁴ To promote employment growth in higher value-added and high-skilled labour sectors, the government should instead focus on improving the education and training system to increase both the quantity and quality of the Indonesian workforce. Currently, only less than 9 percent of Indonesia's workforce have a university or college degree. Nearly half of its workforce only has elementary education.²⁵

REGIONAL CONSEQUENCES

Indonesia's protectionist policies will not only affect its own domestic economy but also that of its neighbouring countries. Rising economic protectionism in Indonesia will clearly impede regional economic integration. Initially, hope was great that Indonesia as the biggest member of ASEAN would play a leadership role as the region geared up for the ASEAN Economic Community (AEC) at the end of this year with the goal of achieving a single market for free movement of goods, services, capital, investment and skilled labour. Alas, according to the Global Trade Alert (GTA) report, Indonesia is among the worst 'offenders' for increasing protection since the global financial crisis. The report calculates that Indonesia has introduced 195 non-tariff protectionist measures (NTMs) since 2009.²⁶ In addition to various NTMs imposed for trade in goods, Indonesia, together with the Philippines and Thailand, are the top three most restrictive countries with regard to services trade.

ASEAN economic integration depends on national-level action.²⁷ In the case of Indonesia, the country's trade and industrialization laws have been perceived as protectionist and inward-looking.²⁸ The Trade Law No. 7/2014 hints that Indonesia does not fully embrace free trade. It does not mention Indonesia's international obligations under WTO agreements and the ASEAN legal framework. It even states that the government, with the approval of Parliament, can review and/or cancel existing international trade agreements.²⁹ In addition to the trade law, the Industrial Law No. 3/2014 also indicates that Indonesia will promote import substitution industrialization strategy in order to reduce heavy reliance on imports of capital goods, raw

²⁴ Moekti P. Soejachmoen, "Indonesia's participation in global production networks", East Asia Forum, 9 October 2012, (<http://www.eastasiaforum.org/2012/10/09/indonesias-participation-in-global-production-networks/>)

²⁵ The World Bank, "Slower gains", Indonesia Economic Quarterly, July 2015, (<http://www.worldbank.org/content/dam/Worldbank/document/EAP/Indonesia/IEQ-JUL-2015-english.pdf>).

²⁶ Simon J. Evenett, *The Global Trade Disorder: The 16th GTA Report* (London: CEPR Press, 2014).

²⁷ Tham Siew Yean and Sanchita Basu Das, "Domestic Consensus Vital for ASEAN Economic Integration Beyond 2015", ISEAS Yusof Ishak Institute Perspective, No. 50, 2015.

²⁸ See Peter Alford, "Indonesia's protectionist trade law", *The Australian*, 19 February 2014. He cited an interview with the then Deputy Trade Minister Bayu Krisnamurthi (<http://www.theaustralian.com.au/business/jakarta-freely-admits-it-is-shielding-local-stakeholders/story-e6frg8zx-1226830971710>)

²⁹ Maria Monica Wihardja, 2015, *Growth, Convergence and Income Distribution: A View from Indonesia*, in *Think Tank 20 - Growth, Convergence, and Income Distribution: The Road from the Brisbane G-20 Summit*. Ed. Kemal Derviş and Homi Kharas. Brookings Publication.

materials and intermediary goods.³⁰ Nevertheless, the real effect on regional economic integration will depend on various ministerial regulations which will set the operational framework for these two laws. Under a protectionist trade minister, the operational regulations may see Indonesia choosing a backward-moving policy. However, the newly appointed trade minister, Mr. Thomas Lembong, has signaled that he does want to reverse the previous protectionist policies and he has been trying to deregulate and streamline a number of trade regulations.³¹

Going forward, Indonesia's trade and investment policies will determine the speed of economic integration in the region. If Jakarta continues to choose protectionist and inward-looking policies, it is difficult to believe that the AEC will lead to freer movement of goods, services and people.

CONCLUDING REMARKS

The current economic and political circumstances make it difficult for Jokowi to not give in to strong public pressures demanding protection from heightened global competition. By choosing to tighten protectionist measures and support inward-looking development policy, the President improves his domestic popularity and strengthens his power base. However he should be aware that these policies may make matters worse.

What has been happening is that rising protectionist measures driven by economic nationalism has sent negative signals to potential investors, and Indonesia still badly needs more foreign direct investments in order to support its 7% economic growth target. Moreover, the protectionist measures have created economic distortion and inefficiency. This inefficiency may spill over to other sectors and eventually hurt the whole economy.

In the longer term, protectionist measures cannot address the problem of weak industrial competitiveness, as they are not designed to tackle the core issues affecting competitiveness. Instead Jokowi's government should address fundamental conditions that have been making local businesses less competitive. He could start by simplifying cumbersome and time-consuming licensing procedures, guaranteeing legal certainty, providing better infrastructure, improving the skills of the workforce, and clamping down on corruption in the government bureaucracy.

Finally, Indonesia's rising protectionist policy will also hamper the progress of the AEC. It is hoped that Indonesia will be able to balance its national interests with its regional and global commitments, and it must consider that the AEC will be a much bigger market than its domestic market, and if the country is better prepared, this can actually benefit its industries and workers. The AEC's future now depends on Indonesia staying on track in enhancing the region's economic integration

³⁰ The Jakarta Post, "RI to focus on import-substitution industry", 7 February 2014, (<http://www.thejakartapost.com/news/2014/02/07/ri-focus-import-substitution-industry.html>).

³¹ Khoirul Amin, "Government launches AEC center as RI heads for single market", The Jakarta Post, 29 September 2015. (<http://www.thejakartapost.com/news/2015/09/29/government-launches-aec-center-ri-heads-single-market.html>)

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