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The Rise of Murky Protectionism: Changing Patterns of Trade-Related Industrial Policies in Developing Countries: A Case Study of Indonesia

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The Rise of 'Murky Protectionism': Changing Patterns of Trade-Related Industrial Policies in Developing Countries

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Abstract

Over the past two decades, an array of international actors including developed countries, the World Trade Organization (WTO), and international financial institutions (IFIs), have pushed developing countries to remove their discriminatory trade policies in the name of speeding up development. Many analysts claim that, in doing so, developing countries have lost a set of policies central to the success of previous industrialisers. However, few studies actually examine how the new rules of the international system impact developing countries' choice of industrial policies, and those that do fail to consider the possibility that developing countries are responding to the restrictions by adopting new policy instruments. This paper argues that efforts to 'shrink the policy space' of developing countries have not had purely liberalising effects, as is traditionally posited. By examining the trade-related industrial policies used by Indonesia from the mid-1980s to the present, this paper unearths evidence that developing countries are finding ingenious methods of challenging and circumventing some of the new policy restrictions. This suggests that developing countries have more policy space for development than is commonly thought.

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List of Acronyms

BIT	Bilateral Investment Treaty
GATT	General Agreement on Tariffs and Trade
GOI	Government of Indonesia
GTA	Global Trade Alert
IFI	International Financial Institutions
IL	Import License
IMF	International Monetary Fund
IPR	Intellectual Property Right
LCR	Local Content Requirement
NTB	Non-Tariff Barrier
RBTA	Regional and Bilateral Trade Agreement
SAP	Structural Adjustment Program
USTR	United States Trade Representative
WTO	World Trade Organization

1.

2. Literature Review

Most attempts to study the impact of the new policy restrictions on developing countries' policy space approach the question from the perspective of 'what is allowed', thus making the false assumption that the rules contained in international agreements accurately represent the restrictions faced by countries. Moreover, both they and the few studies that look directly at policy outcomes, fail to adequately account for ways developing country governments may be responding to these pressures, for example by engaging in policy substitution. This section will examine each of the major methodological approaches in turn, arguing that by applying recent insights on the topic of policy substitution to the approaches that examine actual policy implementation, a much more accurate lens is provided to assess the restrictions faced by developing countries with regards their use of industrial policies.

2.1 Rules-Based Approaches

The majority of previous studies on the subject of policy space for development follow a 'rules-based approach' – that is, they examine the rules and commitments of various trade agreements and assess how these prohibit the use of industrial policies by developing countries.[1] Early studies were justifiable in their resort to this common approach, in part because of its efficiency in drawing broad conclusions from a single analysis of the rules, and in part because the transition periods for many of the new commitments meant that the impacts were not at first observable. However, while their methodological approach is highly similar, the conclusions they draw are not.

One group, which can be referred to as the 'globalisation as constraint' view, argue that the loss to developing countries' policy space from the new international agreements have enormous ramifications for their prospects for development. They argue that the rules of the WTO create severe obstacles to development by making illegal many of the policies used by past industrialisers to catch-up to the lead economies of their time – specifically, the protection of infant industries, the regulation of foreign investment, and the appropriation of technology through weak protection of intellectual property rights (Chang, 2002; Wade, 2003). Moreover, they argue that the policy space remaining under the WTO is inadequate for the necessities of development. Weiss (2005), for example, argues that the policies permitted under the WTO, such as subsidies for R&D and technology-intensive industries, provide room for only technologically advanced types of industrial policies. However, these are unsuited for most developing countries and therefore provide little opportunity for 'catch-up'. Held et. al. (2000) go as far as to claim that the only policies still viable for developing countries are those that promote human capital formation. Therefore, they argue, the rules of the WTO effectively lock developing countries in to subordinate economic positions in the international hierarchy.

Another group of scholars are less pessimistic with regards to the impact of the WTO on developing countries' policy space. They argue that while some important policies have been lost under the new rules, the fundamental strategies of past industrialisers are still allowed under the WTO (Amsden, 2005; Rodrik, 2004). They focus on the institutional arrangements used by past industrialisers to identify economic constraints, select policy solutions, and condition protection on specific performance standards (Amsden & Hikino, 2000; Rodrik, 2004)

[1] The term 'rules-based approach' is borrowed from DiCaprio and Gallagher (2006).

Moreover, they emphasize that some of the policies permitted under the WTO, such as subsidies developing countries could use, in practice it generally left them alone to choose their own policies (Hudec, 2010). While it is undeniable that the WTO and other forms of recent agreements are more restrictive in their enforcement of commitments than the GATT, it is by no means clear that the rules are enforced to a point where no flexibilities exist.

In the case of the WTO, the rules are enforced less as a set of mandatory principals and more as a type of social contract (Mortensen, 2012). Unlike, for example, criminal law which is actively enforced by institutions of the state, such as the police and judiciary, the law of the WTO requires members to enforce the rules on one another, by bringing each other to the dispute settlement mechanism. Thus, even though a policy may be illegal, if no country is willing to enforce the rule, it becomes *de facto* legal (Mortensen, 2012). In this sense, it can be argued that the majority of previous analyses, which employed rules-similar vein, Melo (2007) focuses on a set of 'open-economy' industrial policies – those compatible with open competitive markets, such as tax incentives and credit subsidies. By noting that a number of countries in Latin America and the Caribbean adopted these types of industrial policies in the three year period from 1994-1996, he argues that countries have adapted to the WTO era by resorting to industrial policies that do not restrict the flow of trade.

While these recent studies have challenged the findings of rules based approaches in terms of the ability of developing countries to employ certain industrial policies, they themselves are subject to a fundamental methodological problem. They do not adequately account for the

In terms of data, this study relies on the annual reports by the U.S Trade Representative on barriers to trade called the National Trade Estimate Report on Foreign Trade Barriers and the WTO's (formerly GATT's) regular publications of its Trade Policy Reviews. These reports cover a wide range of policy instruments and discriminatory policies and will therefore be useful in accounting for policy substitution. While the viewpoints of these reports will be consistent over the period of analysis, it is possible that they will be biased in their position. In order to control for this possibility, the use of two sets of reports helps mitigate any bias that may exist in one of them. Moreover, the results from these two groups of reports are also compared with the GTA dataset, which according to the World Trade Report is the most detailed dataset on trade-related industrial policies (WTO, 2012), although only containing data from 2009 onwards. The two sets of findings on Indonesia compare favourably to each other, with the only major omissions in the trade reports being some policy changes that occurred after the most recent publications.

4. Indonesia's Trade-Related Industrial Policies: 1984-2013

This section examines the changing patterns of trade-related industrial policies in Indonesia in three different time periods, each spanning roughly a decade. The first period, from 1984-1993, serves as the base period in the analysis, demonstrating both the variety of policy instruments and the extent of protection prior to the onset of many of Indonesia's international commitments. The second period, which ranges from 1994 to 2003, demonstrates the country's policy choices in a period of exceptionally high policy pressure, as Indonesia underwent IMF structural adjustment programs, lasting firs and others, such as motor vehicles remained steady at 200% (USTR, 1990). Final consumer goods were also subject to more than double the rate of tariffs for inputs (GATT, 1991). Moreover, the importance of tariffs increased over the period as a result of the deregulation packages. Not only was the liberalisation of tariffs slower than that of NTBs, but many of the sectors that lost protection from NTBs actually received compensatory tariff raises (WTO, 1995(

sourced by manufactur

licensing requirements was brought down to half of the already low 1994 levels (USTR, 2001). Tariff levels were not immune to the liberalisations either, as Indonesia implemented massive tariff reductions

4.3 Period 3: 2004-2013

The period beginning in 2004 was one of more typical policy pressure, as the IMF adjustment programs had ended in 2003. In this period, the GOI re-imposed many of the ‘old’ policy instruments of the pre-1994 era, such as quantitative restrictions, ownership requirements, export restrictions, and import licenses. Although the overall *level* of protection did not come close to that of the 1980s, many of the policy instruments imposed were the same as in Period 1. Moreover, the trend towards new forms of industrial policies, which began in the late 1990s, continued in this period and became a prominent feature of the overall policy regime. In addition to the use of alternative rationales for industrial policies, Indonesia began to employ a range of informal adaptations to its policy instruments and relied on more ‘behind-the-border’ regulations.

The general resurgence of ‘old’ policy instruments in this period did not include a rise in tariffs, as duties on imports remained well below their bound levels under the WTO (WTO, 2007). Indonesia made few significant changes to its import tariff regime, as successive tariff harmonization programs imposed only minor changes to the overall tariff structure (USTR, 2008). However, the structure of tariff rates continued to mimic the first period, with tariff peaks persisting in many of the same sectors, and higher tariffs on finished goods (USTR, 2013; WTO, 2013). While import restrictions did not increase during this period, restrictions on exports were re-imposed, with both bans and duties applied to the export of several raw materials (USTR, 2011). For example, in 2009, as part of a new mining law, the GOI banned the export of mineral ore, with the implication that every mining company operating within the country was forced to establish smelting capabilities (USTR, 2009). Therefore, while import tariffs did not resume their role as the central import restricting device, export tariffs and restrictions once again were employed to promote the processing of raw materials in the country.

Import licenses made the strongest return during this ps-2(i).002 4 >>BDC 0 -1.n(i)8(d [(w)10(ith))9(i) public procurement, thereby returning to the promotion of demand for local products and inputs. LCRs were imposed on equipment in important sectors like telecommunications, mining, and franchising; with rates ranging between 30% and 80% (

5. Discussion

The preceding section's analysis of the trade-

trade and increase transparency

much wider range of policy instruments in its analysis than has traditionally been done, it accounts for the possibility of policy substitution. Therefore

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