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# **Should Indonesia join the Trans-Pacific Partnership?**

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## **Introduction**

In October 2015, 12 Pacific Rim economies reached a conclusion to establish a new free-trade agreement, namely the Trans-Pacific Partnership (TPP). With the United States as the main actor, TPP is a comprehensive free trade agreement covering liberalisation in all sectors such as goods, services and investment in scheduled and legally binding manners (Abboushi 2015, pp. 148-152). On the other hand, during his visit to Washington DC in the late of October 2015, President of Indonesia Mr. Joko Widodo officially declared Indonesia's intention to join the TPP (Tau 2015). In response to this statement, domestic reactions were mixed. The supporters, who mostly are government officials, argue that by joining the TPP, Indonesia could speed up its development through broader trade openness and enhanced investment opportunity (Amindoni 2016).

In contrast, the opposing side considers the current domestic industries' competitiveness level compared to other TPP members which is regarded as relatively low. Surprisingly, this opposing argument comes from the academia group that argues the risks of imported goods flood from other TPP members. The increase in imported goods, thus, will have no benefit to domestic industries as they could be hurtful. Hence a question mark whether Indonesia should join the TPP or not (Amianti & Parlina 2015). Against this background, this paper is aimed to identify the economic benefits and challenges of joining the TPP for Indonesia. This paper argues that Indonesia should join the TPP, given the vast and wide opportunities of new market expansion. However, to optimally reap the benefits from the TPP, Indonesia should also focus to strengthen the competitiveness of domestic industries.

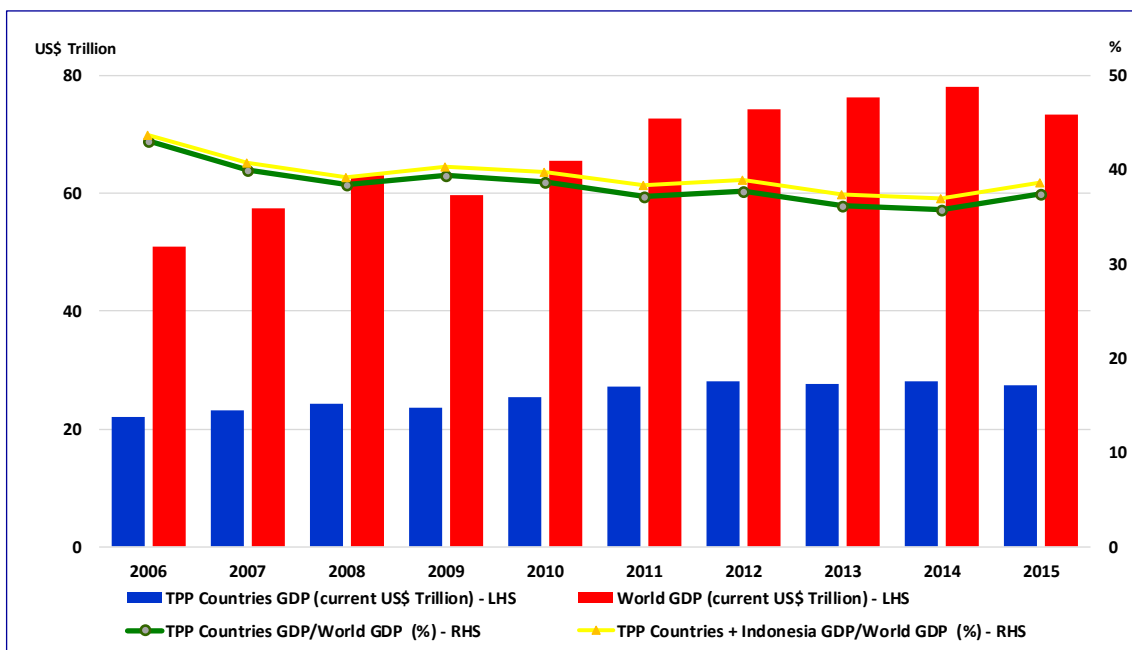
## **Literature Review**

### **(1) What is TPP?**

After reaching a conclusion in establishing the TPP on October 2015, 12 TPP countries include Australia, Brunei Darussalam, Canada, Chile, Japan, Mexico, Malaysia, New Zealand, Peru, Singapore, the United States and Vietnam signed the finalised TPP agreement on 4 February 2016. Initially designed as a Pacific region trade agreement, the TPP has five features to cope both issues covered by previous free trade agreements as well as current and emerging trade issues. These five features are (1) comprehensive

market access by eliminating or reducing tariff and non-tariff barriers, (2) regional approach to commitments, (3) addressing new trade challenges by promoting innovation, productivity, and competitiveness, (4) inclusive trade by covering the issue of small and medium enterprises and capacity building in trade and development issues, and (5) platform for Pacific integration by an open membership system (USTR 2015). Once the TPP comes into force, it will bring a new approach to deal with wide range trade policy issues and transcending the extent of traditional trade agreements (Lakatos et al. 2016, p. 229).

Figure 1 TPP countries output 2006 - 2015



Source: World Bank (2016)

According to World Bank (2016) data as shown in Figure 1, the output of TPP economies was about US\$ 27.5 trillion or accounted for 37.5 percent of world GDP in 2015. On average, TPP countries represent 38.4 percent of the global economy in the last decade. If Indonesia joined the TPP, there will be an additional one percent GDP into TPP, which means the role of TPP in the world's economy become more important. In terms of trade, DFAT (2016) reports that TPP countries' trade accounted for 25.9 percent of the world's trade in 2014. With 819 million of population or 11.3 percent of the world's population lives in TPP countries (DFAT 2016), TPP creates an opportunity to become a large and integrated market for products of its member nations. As the TPP membership is open to other Asia-Pacific economies (Lakatos et al. 2016, p. 219), it is possible for the TPP to

grow and broaden its coverage and subsequently, plays the more important role in Pacific region as well as the global economy.

## **(2) The main principles of TPP**

There are several main TPP principles that could potentially encourage Indonesia to become more open and competitive economy. First, TPP implements the principle of freer trade and binding and enforceable commitments. Free trade defined as the exchange of money, goods and services over political barriers in the absence of restrictions, or in other words, the expansion of the of the “market” concept across state borders (Funderburk 2011). Reduction in trade barriers is one of the main objectives in encouraging trade. The TPP has the potential to go beyond the WTO in regards to the tariff cuts and services liberalization among trading partners, as well as the evasion of complex and trade-restricting rules of origin, thus brings a notable economic advantages (Lester 2014). TPP will enable high-level or comprehensive removal in tariff regarding its coverage and the deepness of tariff reductions. Tariff bindings encompass entire goods in each participant countries. The members of TPP in general cannot rise the tariff of goods, since they are tied in the commitments to reduce or eliminate tariff in the TPP. However, there are some exception that can narrow the horizontal application of the tariff bindings among members. For instance, in terms of the automotive sector, the US determined particular tariff treatment in importing goods from Japan. Tariff eliminations in the manufacturing sector include 12 member states, in general is more than 99 percent concerning both trade value and tariff lines. Finally, when the phase-out period ends, there will be no tariff barriers in almost every trade in goods (WEF 2016a, pp. 5-6).

Moreover, the TPP also applies non-discrimination principle, which is interpreted as a compulsion to give an equal treatment to the countries, embodied in the most-favoured nation treatment (MFN) and national treatment (NT) and encompasses products, services and service suppliers (Qin 2005, p. 295). In the trade commitments in the investment area, TPP ensures the MFN principle obviously, in which multi-state regime countries have to provide an optimum investment circumstances to the foreign investor equally, regardless of the country of origin of the investors. Since the investment registration phase, Investors are also permitted to petition towards the government. In government procurement chapter, TPP enforces MFN and NT principles. Eliminating tender requirement that is more benefiting domestic bidders, for instances an obligation to use domestic suppliers or product, and term on the transfer of technology. TPP members should confirm their

tender procedures to secure their own interests in regards to substandard performance and poor capacity tenders, although the bidders offer significant inexpensive price as it is often done by China's bidders (Massmann 2016). Furthermore, non-discrimination principle stipulates E-commerce and digital outputs and the decision of SOEs in making a purchase or sell to dis-incentivise monopoly power (Pelzman 2016).

Furthermore, TPP promotes transparency principle. One of the main purposes of TPP is to enhance transparency and availability of information, conducting procedures for collaboration and consultation when market access circumstances adversely influence exports from one TPP economy to another (WEF 2016a, p. 4). TPP's stipulations encompass transparency on import and export licensing procedures, for instance, announcement procedures, and a ban that every party cannot undertake or preserve actions that are not in accordance with the import licensing procedures of WTO Agreement. Trade Barrier to trade (TBT) is one chapter in TPP covering transparency and stipulations for regulatory alteration, including allowing stakeholders to be involved in the establishment of technical rules, compatibility and standard evaluation procedures concerning no less beneficial than those for domestic constituencies. Furthermore, transparency and anti-corruption chapter in TPP encourage new and robust regulations concerning transparency in trade and investment. It provides regulations to diminish the fraud and bribery effects on investment, trade and government policies. The rules assure the exporters, investors, service suppliers, and other stakeholders within TPP gain access to information regarding all regulations, laws, assurances and due process rights (ibid, pp. 7-17).

## **Analysis**

### **(1) Economic benefits from joining TPP for Indonesia**

As a preferential trade agreement (PTA) scheme, the heart of TPP would be the process of reducing or removing tariff and non-tariff barriers. In terms of removing tariff, a PTA usually dictates no tariffs among members, but set member's own tariff rates against non-member nations. In the case of the pacific rim TPP, eliminating tariffs for intra-TPP trade is the main goal of its arrangement (Deardorff 2014, p. 5). According to Krugman et al. (2012), by removing tariffs, a PTA could potentially lead to: (1) trade creation, if joining a PTA leads to replacement of high-cost domestic production by imports from other members of the agreement, and (2) trade diversion, if joining a TPA leads to the

replacement of low-cost imports from outside the zone with higher-cost goods from member nations (p. 250).

By joining the TPP, Indonesia could avoid the potential of trade diversion from current trading partner countries, mainly the United States and Japan. This is under the notion that Indonesia has similar export products to other TPP member countries, such as Vietnam and Malaysia. When the TPP comes into force, members would potentially divert their imports to other members in search for lower price of imported goods as a result of tariff-free trade. Deardorff (2014) argues that the level of an FTA to jeopardise non-member countries could be quantified from the amount of reduction in their exports (p. 10).

According to WITS (2016a) data, Indonesia, Vietnam and Malaysia are exporters of manufactured goods, such as textiles, electronics, automotive parts and tires. For instance, in 2014, 40 percent of Indonesia's export of textiles and clothing was to the United States and Japan (WITS 2016b). If Indonesia remained at the outside of the TPP, the role of Indonesia's products could potentially be replaced by Malaysia and Vietnam's as they are benefited from preferential tariffs and better market access the United States and Japan. In total, according to Shauki (2016), the potential loss of trade diversion that could be saved by Indonesia if joining the TPP is about US\$ 600 million per year (p. 10).

In addition, by joining the TPP, Indonesia could potentially be benefited from trade creation among TPP members. At the first stage, Indonesia could potentially correct current import tariffs imposed by trading partners for Indonesia's products. Currently, the average of import tariffs imposed by TPP countries for Indonesia's products is two percent. This average tariff increases to more than five percent if taking into account American countries only, including Canada, the United States, Mexico, Peru and Chile. Compared to other ASEAN countries, such as Brunei, Malaysia, Vietnam and Singapore, the imposed tariffs by American countries for Indonesia's products are even higher. This condition indicates that Indonesia's products are less competitive in these importing countries because of higher tariffs. By joining the TPP, Indonesia could enhance its export products' competitiveness by removing tariff barriers imposed by its trading partners.

**Table 2 Indonesia's exports and imports to TPP countries 2014**

No.	Country	Export Value (US\$ Million)	Export Partner Share (%)	Import Value (US\$ Million)	Import Partner Share (%)	Free Trade Agreements
1	Australia	4,962	2.82	5,648	3.17	ASEAN-Australia-NZ
2	Brunei	100	0.06	594	0.33	ASEAN FTA
3	Canada	755	0.43	1,860	1.04	-
4	Chile	178	0.10	242	0.14	-
5	Japan	23,127	13.14	17,008	9.55	Indonesia-Japan (IJ EPA)
6	Malaysia	9,732	5.53	10,855	6.09	ASEAN FTA
7	Mexico	851	0.48	187	0.11	-
8	New Zealand	481	0.27	836	0.47	ASEAN-Australia-NZ
9	Peru	210	0.12	67	0.04	-
10	Singapore	16,752	9.52	25,186	14.14	ASEAN FTA
11	The USA	16,560	9.41	8,189	4.60	-
12	Vietnam	2,451	1.39	3,418	1.92	ASEAN FTA
	<b>Subtotal</b>	<b>76,161</b>	<b>43.26</b>	<b>74,089</b>	<b>41.58</b>	
	<b>Total of the year</b>	<b>176,036</b>	<b>100</b>	<b>178,179</b>	<b>100</b>	

Source: WITS (2016c); WITS (2016d); Ministry of Trade (2016).

Furthermore, according to Indonesia's Ministry of Trade data (2016), among 12 TPP members, Indonesia currently does not have free trade agreement with five of them, which are the American countries: The United States, Canada, Mexico, Peru and Chile. While the United States is one of the most important Indonesia's export destination countries, Indonesia's exports to Canada, Mexico, Peru and Chile were relatively small. As shown in Table 2, Indonesia's exports to these four countries accounted for only US\$ 1.99 billion or 1.13 percent of Indonesia's total exports in 2014. This fact raises the opportunity to expand Indonesia's export to these four countries through trade creation under the TPP. Broader trade creation with the other member nations would also be triggered as Cheong et al. (2014) argue that in general, PTAs would create more trade between member countries through trade creation, while bilateral trade between two member countries would also remain positive and economically significant (p. 235). The potential increase in Indonesia's export value caused by trade creation with TPP countries, according to Shauki (2016), would be about US\$ 2.9 billion per year (p. 11).

On the domestic side, trade creation effects from the TPP would also benefit the domestic consumers. Because the import tariffs will be decreased or will be removed based on the agreement, and Indonesia could replace more expensive domestic supply by the cheaper supply from TPP countries, domestic price of imported goods as well as the domestic substitutes will decrease, thus lead to raise consumer surplus and higher quantity consumed. Even though less competitive domestic producers will lose as a result of sales fall and lower price, and the government might lose revenue from tariffs, the net welfare

effect of trade creation to a country is usually positive (Deardorff 2014, p. 10). The main reason why removing tariff barriers might result in an increase of welfare to a country is because it creates an efficiency case for free trade by eliminating the deadweight loss in term of production and consumption distortion caused by tariffs (Krugman et al.2012, p. 220). Moreover, in the long term, trade creation would persistently encourage a country to specialise in producing the products in which they possess competitive advantages (Bamford & Grant 2014, p. 107). In addition, open markets between members of a PTA would also lead to a more efficient labour division, fostering technology transfer and diffusion, and subsequently, enhancing productivity growth (Hoekman & Javorcik 2006, pp. 19-22).

## **(2) Challenges from joining TPP for Indonesia**

There are several possible challenges of joining TPP that should be a concern for Indonesia to optimise its benefits from TPP. Relatively weak competitiveness level of the domestic industry becomes a major challenge for Indonesia. While, TPP applies the assumption that the pro-competitive atmosphere that promote sanction for anti-competitive measure and open markets is necessitated to apply the commitments related to trade effectively. Hence, the TPP entails the country members to set and implement the procedural framework for fair and transparent competition law (WEF 2016a, p. 31). The Global Competitiveness Index (GCI) is an approach developed by the World Economic Forum, consisting 12 competitiveness instruments to measure a country's competitiveness according to microeconomics and macroeconomics level. Improving competitiveness instrument will bring a positive impact on trade balance (Llatja 2015, pp. 188-192).

Indonesia is ranked 37<sup>th</sup> for the GCI 2015-2016. This ranking is still below the majority of member countries of TPP, even compared with other countries in the Asia Pacific region, Indonesia is still far behind Singapore, New Zealand, Malaysia and Chile (WEF 2016b). With a population of 250 million, Indonesia is the largest economy in Southeast Asia and it is a potential market for world trade. The low level of industrial competitiveness will only make Indonesia as an easy target for other TPP country members to sell their products. The flood of cheap import goods from other TPP country members in the domestic market will harm local producers (Kusumadewi 2016).

In addition, the negative impact of trade erosion resulting from joining TPP will be the next challenge. Indonesia already has trade agreements outside the TPP with several



member countries of TPP, in which the agreement has entailed preferential tariffs for both export and import transaction. By joining the TPP, Indonesia will lose this exclusive preferential tariffs from the trade agreement outside the TPP, since TPP applies the same rights to tariff reductions for all member countries without discrimination. Preference erosion refers to preferential tariff, which disappears due to joining the TPP (Deardorff 2014, p. 10). For example, Indonesia Japan Economic Partnership Agreement (IJ-EPA) which is bilateral trade agreement between Indonesia and Japan covering the reduction or elimination of more than 90% of the total tariff lines of the manufacturing industry (Tambunan 2008, p. 4). Based on the TPP agreement, Japan will levy the same import tariffs towards all TPP member countries.

Moreover, Indonesia is considered too late to join the TPP, causing Indonesia lost the opportunity to incorporate the interests of the state in the rules and provisions of TPP in early stage. TPP which is an open-accession agreement allows other countries to join later on. Considering the advantages, Indonesia has expressed its desire in joining the TPP. Hence, Indonesia can no longer negotiate its special interests since TPP agreement has been officially signed. If Indonesia joins TPP, it must conform to the existing rules, terms and conditions. Not being a member since the beginning of TPP, Indonesia lost the momentum to have the bargaining power to establish provisions consistent with the national interest (Intan 2015). For instance, the application of Chapter 18 on Intellectual Property Rights, which regulates the rules of protection of intellectual property rights both in relation to the protection of brands, copyrights, geographical indications, patents and industrial designs (MFAT 2016).

Unlike the Trade Related Intellectual Property Rights (TRIPs) of the WTO, which provides the flexibility for states to be able to override patents (IGJ 2016). Chapter 18 in this TPP will make TPP agreement as harmful trade pacts related to access to medicines in developing countries. This is because the rules of protection of intellectual property rights, particularly related to the patent will provide maximum protection against patent medicine and pharmaceutical company data that ultimately affect the monopoly of production and the price of medicines by the multinational pharmaceutical industry including generic medicines (MSF 2016). Furthermore, the provisions of Chapter Investment in TPP agreement will further give the right of pharmaceutical companies to be able to sue the state through the mechanism of Investor-State Dispute Settlement (ISDS) regarding the regulations that can reduce their profit. As a developing country,

Indonesia has an interest to lose the exclusivity of intellectual property rights to manufacture cheaper generic medicines to the citizens. Indonesia loses an opportunity to affect this provision by not being a member of the TPP negotiations.

## **Conclusion**

Considering the potential economic benefits and challenges in joining the TPP, Indonesia should take part of the TPP. By joining the TPP, Indonesia could avoid the trade diversion from trading partners as well as creating opportunities of new market expansion through trade creation with the TPP members. Specifically, Indonesia could expand its exports to the American countries which is previously unexploited. Joining the TPP would also benefit domestic consumers as they will obtain lower price on imported goods. However, a relatively weak competitiveness level of the domestic industry is a main challenge. It leads to the the flood of inexpensive import goods from other TPP country members in the domestic market that can hurt local producers. Indonesia should emphasis on the enhancement of the domestic industries competitiveness level to be able to compete with other TPP member countries, in order to gain the economic benefits from the TPP optimally.

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