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The Potential Political Economy Impact of the Proposed Indonesia-Peru Preferential Trade Agreement

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The Potential Political Economy Impact of the Proposed Indonesia-Peru Preferential Trade Agreement

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Serie: Documentos de Trabajo

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Abstract

This paper evaluates the political economy implications of the proposed Indonesia-Peru Preferential Trade Agreement (IP-PTA). The foreign policy analysis shows that IP-PTA bodes well in their respective foreign policies agenda as both countries have common interest to enhance economic cooperation relations to encourage economic growth and improve people's welfare. The product competitiveness mapping analysis showed that over the years, the majority of both countries' export have low competitiveness and as net importers. Further, both countries have relatively similar specialization export structures and are highly dependent on the primary sector. Meanwhile the partial equilibrium analysis predicts that both countries would benefit from IP-PTA which dervied from higher trade volume and consumer surplus. But the study also predicted tariff revenue loss in both countries. The study suggests both countries to expedite and start the IP-PTA negotiation process which is still pending since the Joint Feasibility Study (JFS) which was resumed back in 2016 in conjunction with fostering socio-cultural cooperation to encourage people to people interaction and dialogue to deepen understandings and friendships between both states.

Keywords: Indonesia-Peru Preferential Trade Agreement, Product Mapping Analysis, Revealed Symmetric Comparative Advantage, Trade Balance Index, Partial Equilibrium Analysis, Foreign Policy Analysis

Resumen

Este artículo evalúa las implicaciones de economía política del propuesto Acuerdo de Comercio Preferencial Indonesia-Perú (IP-PTA). El análisis de la política exterior muestra que IP-PTA es un aporte positivo para la agenda de política exterior de ambos países ya que los mismos tienen un interés común por mejorar las relaciones de cooperación económica para fortalecer el crecimiento económico y mejorar el bienestar del pueblo. El análisis del mapeo de la competitividad del producto mostró que a lo largo de los años, la mayoría de las exportaciones de ambos países tienen baja competitividad y son importadores netos. Además, ambos países tienen estructuras de exportación de especialización relativamente similares y altamente dependiente del sector primario. Mientras tanto, el análisis de equilibrio parcial predice que ambos países se beneficiarían del IP-PTA que se deriva de un mayor volumen de comercio y un excedente del consumidor. Pero el estudio también predijo la pérdida de ingresos arancelarios en ambos países. El estudio sugiere que ambos países aceleren e inicien el proceso de negociación IP-PTA que aún está pendiente desde el Estudio de Factibilidad Conjunta (JFS) que se reanudó en 2016 en conjunto con el fomento de la cooperación sociocultural para fortalecer la interacción y el diálogo entre las personas con el objetivo para profundizar las comprensiones y amistades entre ambos estados.

Palabras clave: Acuerdo Comercial Preferencial entre Indonesia y Perú, Análisis de Mapeo de Productos, Ventaja Comparativa Simétrica Revelada, Índice de Balanza Comercial, Análisis de Equilibrio Parcial, Análisis de Política Exterior.

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1. Introduction

The diplomatic relations between the Republic of Indonesia and the Republic of Peru were formally established on 12th August 1975. Initially, the Indonesian Embassy in Brazil was accredited concurrently to Peru. Afterward, on 20th February 2002, the Indonesian Government opened its Embassy in Lima. Meanwhile, the Peruvian Government opened its resident Embassy in Jakarta on 1st November 1992. So far, it can be said that Indonesia-Peru diplomatic relations are warm and friendly, even though the relations are still considered ‘low politics’ because both countries almost have no direct interest in political and security issues.

Viewing from a historical perspective, compared to some other Latin American countries, Peru is indeed not one of Indonesia's old friends in the Latin American region. Indonesia's diplomatic relations with friendly countries in Latin America began in the 1950s. At that time, Indonesia's first President, Ir. Soekarno established diplomatic relations among others with Brazil and Mexico (1953), Argentina (1956), Venezuela (1959), Cuba (1960), and Bolivia (1963). These countries are known as the “old friends” of Indonesia in the Latin American region. However, prior to the official diplomatic relations, people-to-people contact between Indonesia and Latin American states have begun dates back to the 18th century when Spain ruled both the Philippines and Mexico[2] (Sjahril, 2017). Further, in 1930, for instance, a Mexican citizen, Mr. Miguel Covarrubias[3], visited Indonesia for the first time and came back in 1933 to conduct research about Bali (Library of Congress, 2011).

Meanwhile, the first contact between Peru and the Asia Pacific region began as early as 1872, when the Peruvian government, under the Manuel Pardo administration (1872-1876) dispatched a diplomatic mission to the Asia Pacific region, specifically, China and Japan in an effort to expand commercial relations and other fields of cooperation. Historically, Peru was the first Latin American country to establish diplomatic relations with Japan, on June 1873 and Peru was also the first Latin American country to accept Japanese immigration[4].

At the beginning of the Indonesia-Peru diplomatic relations, the relations were limited, and few contacts were made between both states. For instance, the bilateral trade relations, it is recorded that both countries began to trade at least since 1967, prior to the opening of the Indonesia-Peru diplomatic relations in 1975. In 1967, the total bilateral trade volume was only US$25116. In the earlier period, the bilateral trade volume was very low, however over the years the bilateral trade volume steadily increased, and in the year 2018, reached a peak to US$278.57 million.

[2] Certain places in Indonesia, from Sulawesi to Flores, had contacts with the Spanish colonial regime. Indonesia exported cinnamon to Mexico; meanwhile, Mexico introduced vanilla to Indonesia.
[3] During his stay in Bali, he made manuscripts, cartoons, a film, and pictures about Bali geography, Balinese society, and life in Bali. He wrote a famous book in English titled "The Island of Bali" in 1937 and the second edition of his book in 1938 became a best seller and was widely published around the world, making Bali a famous place. He lived in Bali during the Netherlands East Indies regime and spoke Melayu with Balinese accent.
[4] The first wave of Japanese emigration to Peru was in 1899. President Fujimori was widely popular in Japan and made his tenth visit to Japan in 1999 to mark the 100th anniversary of the first wave of Japanese emigration to Peru (McClintock and Vallas, 2003: 38, pp. 74-75).

Indonesia and Peru have a common interest to enhance economic cooperation relations to encourage economic growth and improve people's welfare. This is a potential entry point in which both countries could further elevate the bilateral relations into a higher stage. Both states consider economic diplomacy as a priority agenda. From the political perspective, both countries share values such as freedom, democracy, and the respect for human rights which could potentially become a good foundation to strengthen and elevate Indonesia-Peru bilateral relations.

Indonesia and Peru are very active in seeking opportunities for economic cooperation with many countries around the globe. Especially given the situation of the global economic slowdown in recent years, decline in world commodity prices and the more recent US-China trade war which made the world to become so-called volatile, uncertain, complex, and ambiguous (VUCA) than ever before. Both countries have increasingly become pragmatic and triggered to increase economic cooperation with non-traditional partners in an effort to diversify their products and market to boost export performance. Up till now, the two countries have mainly concentrated on maintaining economic relations with their traditional partners, but the two countries have also made series of efforts to go beyond to strengthen economic relations with the non-traditional partners.

Indonesia itself has proactively pushed for deepening economic cooperation with many countries around the globe. As of March 2020, at least there are more than 40 economic initiatives that are being studied, negotiated, or have entered into force (Asian Regional Integration Center, 2020). Indonesia’s free trade initiatives tend to mainly concentrate with its partners in Asia and main traditional trading partners, for instance, the United States and Western European states. However, in recent years, Indonesian economic initiatives with its non-traditional trading partners (for instance, countries in Africa, Eastern Europe, and Latin America) are also rising quite rapidly.

With the Latin American counterparts at least two trade initiatives are currently being pursued, namely, the Indonesia-Chile Comprehensive Economic Partnership Agreement (IC-CEPA) signed 14 December 2017 and entered into force on 10 August 2019, Indonesia-Peru Preferential Trade Agreement (IP-PTA) in which Joint Feasibility Study[5] (JFS) was completed on 17 November 2016, and Indonesia-Colombia Free Trade Agreement (IC-FTA) which is still being proposed and under study. Indonesian economic diplomacy towards the Latin American region began to receive higher attention, particularly with its current trade policy priorities towards the region pushing the FTAs with the Latin American counterparts (Center for Foreign Trade Policy of the Ministry of Trade of the Republic of Indonesia, 2013).

[5] The JFS found that trade complementarity between Indonesia and Peru has improved over time, but Peru has yet to increase its participation among Indonesia’s import sources. Further, the simulated scenario of full trade liberalization between Indonesia and Peru revealed an increase in welfare, Gross Domestic Product (GDP) and demand for labor in both countries. The JFS concluded that both countries are considered ready to define the terms of the negotiation of their trade liberalization and economic cooperation agreement, and offered recommendations that Indonesia-Peru trade liberalization agreement could be approached through an incremental scheme, starting from merchandise trade liberalization (Indonesia-Peru Trade in Goods Agreement/INDOPERU TIGA) (Ministry of Trade for the Republic of Indonesia, 2016).

So far, the current interests and initiatives shown by the Indonesian officials (and also the Latin American counterparts) could be argued have not yet been successfully boost the trade volume. As an illustration in 2018, Indonesia's largest trading partner in Latin America was Brazil (US$2.94 billion) followed by Argentina (US$1.67 billion), Mexico (US$1.19 billion), Peru (US$278 million), and Chile (US$273 million). This is not yet to mention Indonesian trade relations with the smaller countries in the Latin American and Caribbean region. In general, the current Indonesia-Latin American trade relations too many viewpoints are still very below its potential and more efforts should be done to strengthen bilateral trade volume.

Peru is one of the countries classified as the non-traditional market for Indonesia's economic diplomacy mission (Sjahril, 2017a). Peru is the 39th largest country in the world and classified as an upper middle-income country. It is one of the world's fastest-growing economies. Peru has around 32 million population with national Gross Domestic Product (GDP) more than US$200 billion and GDP per capita reaching US$5400, higher than the Indonesian GDP per capita. Over the years, the country's economic performance has been tied to international trade relations. Peru is known for its free market-liberal policies, support the private sector and foreign investment, and with less government involvement in the economy. Its foreign policy has a clear goal to engage more with the Asia Pacific partners. For instance, Peru is one of three states within the Latin American region, which started trade initiatives (IP-PTA) with Indonesia.

Peru adopted an open economy policy and made strong initiatives to establish free trade agreements with many countries around the globe, including Indonesia. Peru with its market-oriented economic policy has made a number of free trade agreements with many countries around the globe and has signed 26 bilateral promotion agreements and reciprocal protection for investments.

Acknowledging Peru's economic potentialities, then Indonesia should consider and may view this state as one of the strategically potential partners in Latin America need to be engaged in. In fact, during the foreign minister Retno Marsudi work visit on 23rd May 2018 in Lima, she stated that Peru is an important market for Indonesia, but the economic cooperation still needs to meet its potential, and stressed the importance of increasing business interaction between the two countries and diversification of products in bilateral trade (Sheany, 2018). Both countries agreed to step up economic cooperation starting with a Trade in Goods Agreement (TIGA) to intensify trade engagement.

Peru has prospective economic potentialities, clear goals on fostering economic relations with the Asian Pacific region and geographically located across the Pacific region making the country to be well-positioned to become as the gateway (commercial nexus) for Indonesian commodities in Latin America. Classical matters such as its geographical distance, no direct flight transportation, language barriers, lack of historical connection, cultural and political reasons and even lack of information and interests could become some concerns. But these conventional problems could partially be reduced and overcome if Indonesia and Peru could both show full commitment and proactively finding creative ways to strengthen bilateral relations.

Relatively few researches have been done so far particularly on issues concerning Indonesian economic relations with the Latin American and Caribbean countries (including Peru). This study attempts to identify and find ways to strengthen Indonesia-Peru bilateral relations with a strong emphasis on commercial relations. To conduct the proposed policy paper, the study will analyze the Peruvian foreign policy followed by the Indonesia-Peru bilateral trade relations analysis including the country's export competitiveness, free trade simulation and the potential political economy impact if both countries agreed to establish IP-PTA. From the analysis results, finally, the policy paper attempts to formulate the appropriate policy recommendation for both countries.

2. Data and research methodology

The study basically covers four main aspects. The first part discusses the rationale to pursue IP-PTA based on their respective foreign policy objectives. The second part describes the patterns of trade between Indonesia and Peru. The third part of this study seeks to identify and analyze each country's export competitiveness and an illustration of both countries' economic structures in the given years. And the fourth part discusses the impact and implications of Indonesia-Peru bilateral free trade agreements scenarios.

The first part, the analysis of both countries foreign policy objectives and missions will be a qualitative study based on the given literature, bibliographical studies, and in-depth interviews. For the second part, the trade patterns analysis uses the Trade Complementarity Index (TCI). This indicator could be used to analyze and predict the potential successfulness of the proposed IP-PTA. TCI measures the feasibility of the IP-PTA through analyzing the complementarity between the structure of Indonesian exports with Peruvian import structures (and vice versa). TCI measures how well the export profile of one country matches with the import profile of another country (World Integrated Trade Solution, 2019a). In other words, it gives the measurement of the scope for trade cooperation through inter-industry trade. Furthermore, changes in the index over time can help to determine whether trade profiles are becoming more or less compatible.

For the third part, to identify and analyze each country's export competitiveness, the analytical tool applied is a product mapping using Revealed Symmetric Comparative Advantage (RSCA) and Trade Balance Index (TBI). This analytical tool was introduced and used by Tri Widodo (2008). To create product competitiveness mapping analysis, two analytical tools are utilized, Revealed Symmetric Comparative Advantage (RSCA) and Trade Balance Index (TBI). RSCA is an indicator of comparative advantage, whereas TBI is an indicator of export-import activity. The RSCA index is a simple transformation of the Revealed Comparative Advantage (RCA). RCA is also an indicator of comparative advantage (or product competitiveness). The RSCA index is formulated as follows:

$$RSCAij = (RCAij - 1) / (RCAij + 1)$$

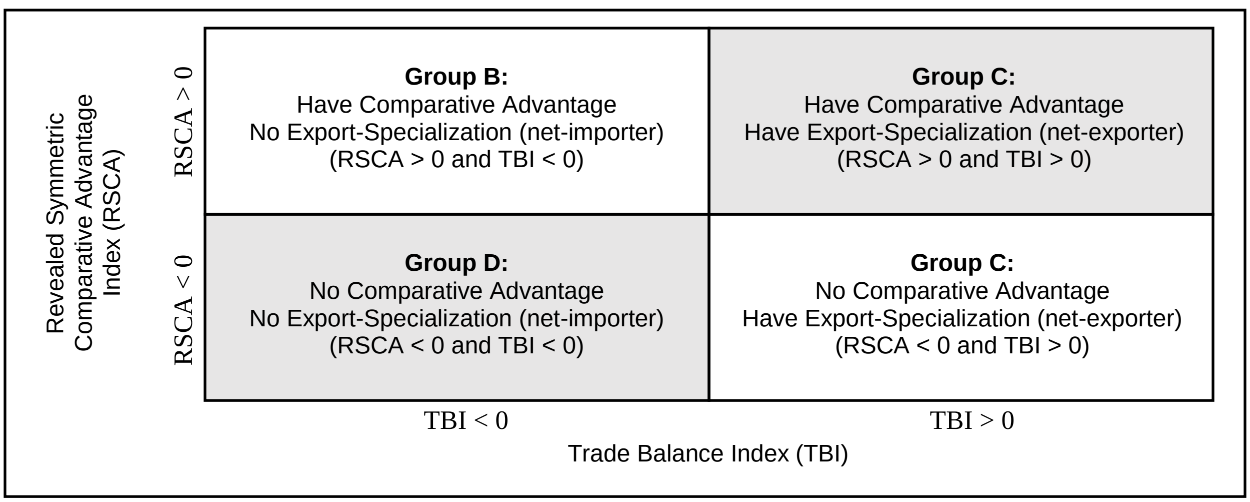
Where the RSCAij index value varies from -1 to 1 (-1 ≤ RSCAij ≤ + 1). If RSCAij more than 0 means country i has a comparative advantage in product group j. Conversely, if RSCAij is less than 0 then country i has no comparative advantage in product group j.

Meanwhile, TBI is used to analyze whether a country has specialized in export (as a net-exporter) or in import (as a net-importer) for a particular product group (SITC). TBI is simply formulated as follows:

$$TBIij = (Xij - Min) / (Xij + Mij)$$

TBI_{ij} symbolizes the country's trade balance index i for product group (SITC) j; The index values vary from -1 to +1. Extreme, TBI equals -1 if a country imports only, and vice versa, TBI equals +1 if a country only exports it. The value of the TBI index cannot be determined if a country is not exporting or not importing at all. In this case, a value of 0 is given to potential product groups for export or import. The value between -1 and +1 indicates that the country exports and imports the commodities simultaneously. A country includes a net-importer on a particular product if the value of TBI is negative, and as a net-exporter if the value of TBI is positive.

Picture 1: Product Mapping Analysis



Source: Tri Widodo (2008)

Using the RSCA index and the TBI index, product mapping can be performed. The product (SITC) can be categorized into four groups, namely A, B, C and D as shown in the figure above. Group A contains products that have comparative advantages as well as export specialization. Group B consists of products that have comparative advantages but do not have export specialization. Group C contains export-oriented products but does not have a comparative advantage. Group D consists of products that do not have a comparative advantage and export specialization.

This study will examine the product competitiveness mapping between Indonesia and Peru by using trade data period 1976-2018. Furthermore, this policy paper uses SITC 3 Digit code Revision 2. Given the wide range of export products, only selected products will be analyzed.

And fourth, this study will use SMART (Software for Market Analysis and Restrictions on Trade) obtained from World Integrated Trade Solutions (WITS) in order to analyze the overall impact of Indonesia-Peru bilateral free trade scenarios (IP-PTA). SMART Model is a partial equilibrium model and has been used by many analysts to evaluate the trade effects, change in tariff revenue, and welfare effects. Finally, this paper attempts to formulate policy recommendations (particularly the economic diplomacy measures) for both countries' policymakers.

3. Analysis

3.1. Foreign Policy Analysis

Issues of sovereignty, territorial integrity, regionalism, continental solidarity, and economic independence have been central to the foreign policy of Peru since its foundation in 1821. Within the political realm, the Republic of Peru strongly supports democracy, the rule of law, and the promotion of human rights which are essential to support and achieve socio-economic development and economic growth with equity. Meanwhile, within the economic realm, economic diplomacy is one of the main priorities within the Peruvian foreign policy. Foreign policy and commercial policy have been two powerful instruments of Peru's endeavor to reinsert the country internationally. Acknowledging its own relatively limited domestic market, thus, as a small open economy, Peru's insertion in the international markets would be its foreign policy objectives.

In general, the Peruvian government promoted orthodox economic policies, free-market reforms, and support for market-friendly policies. Thus, in line with these orthodox economic policies, the Peruvian foreign policy emphasizes on free trade and market reforms (Bruce, 2017). This is understandable as Peru is a small open economy and the country highly relies on export-led growth; consequently, trade policy and foreign policy remained inextricably intertwined. The Peruvian government is very aggressive in pursuing trade agreements with many countries and several regional organizations around the world, and as of 2019, there are at least 22 trade initiatives (SICE OAS, 2019).

Peru's foreign economic policy stance is clear – to find ways to integrate into the global economy through opening the economy. Here it is argued that the global market is a factor shaping economic diplomacy. Thus, it is a neo-liberal economic doctrine (sometimes known as mainstream economics) is pursued by the Peruvian Government. To achieve this, Peru's foreign policy adopts so-called "Look to the West Policy", in which the Asia Pacific region is considered as an important region and this is reflected among others by a number of economic cooperation initiatives such as the signing of the Free Trade Agreements (FTAs), the active participation in the Asia Pacific Economic Cooperation (APEC), Forum for East Asia-Latin

America Cooperation (FEALAC) and Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

For instance, Peru's inclusion into APEC in 1998 and its participation as host economy in 2008 and later in 2016 demonstrates clearly that the Asia Pacific region is a priority in its foreign policy. Further, during the General Debate of the 73rd Session of the UN General Assembly 2018, President Martin Vizcarra Cornejo firmly expressed that nowadays nationalist discourses promoting protectionism, discrimination and xenophobia are resurfacing. He reaffirmed Peru's commitment to multilateralism and free trade, and called on other countries to make the same commitment and avoid protectionist practices (United Nations Audiovisual Library, 2018).

Peru endeavors to reinsert itself internationally to reap the benefits of globalization, opening up to the world market, strengthening the credibility and global reputation of the state. In the late 1980s, after the end of the first term Alan Garcia Perez (1985-1990), Peru suffered an economic crisis reaching -12.3% (1989) and the country suffered a huge debt default from the International Monetary Fund (IMF) and other lending agencies, making it one of the leading debtor nations in the world. To restore Peru's credibility and its global reputation, the Alberto Fujimori administration (1990-2000) has made significant efforts on economic reforms as part of the economic stabilization program to make the country to become economically and politically stable.

The success of the economic reforms put in place through the privatization program and a friendly open market-oriented economy has led to boost economic growth, exports increased, attracted foreign direct investment, and low inflation rate. The government attempts to diversify its economic structure, broaden trade links, and pushed for enhanced bilateral, regional and multilateral economic cooperation. The country attempts to take advantage of new opportunities in an increasingly multicultural and multipolar world.

Apart from building strong relationships with its neighboring countries in Latin America, the Peruvian foreign policy clearly targeted stronger relations with the major industrialized states and the Asia-Pacific region[6]. Relations with the industrialized world, especially Western Europe and the United States, focused on increased aid, trade, and investment through the promotion of human rights and democracy, together with cooperation in the fight against drug trafficking and terrorism.

The Peruvian government was able to maintain a strong working relationship with the United States. The U.S. embraced the Peruvian approach in areas like the promotion of democracy, human rights, market reform, and free trade policies at a time when populist, socialist regimes, for instance, in Bolivia, Cuba, Ecuador, Nicaragua, and Venezuela advocating nationalization and socialism and increasingly offered alternatives unwelcome in Washington (Bruce, 2017). Peru is considered by the U.S. as one of the most reliable partners in the Latin

[6] As the 1990s progressed, the Fujimori government was increasingly active in the Asia-Pacific region. President Fujimori later built on his Japanese heritage (as a Japanese diaspora, Peruvian citizens of Japanese origin or ancestry) to promote investment and trade with the region, including China, South Korea, and Japan (Bruce, 2017).

American region. Bilateral relations with the United States were the most positive in recent memory.

But recognizing of the changing role of the United States in world politics and the global economic slowdown, and the urgent need to find new markets for export diversification purposes, the Peruvian government at the same time has increasingly looked to wider and deeper relations with many countries around the world, but the Asia Pacific counterparts have received higher attention. Diplomatic and commercial relations with China and other Asian states reached new heights. Since the 2008 Global Financial Crisis (GFC), China has become one of the economic powerhouses in the world. As the largest trading nation in the world, China is also the largest trading partner for most Asian countries and to many countries around the globe including Peru. In fact, now China plays an increasingly important economic role in Peru.

In the Asia Pacific region, Peru concluded FTAs among others with Thailand (2005), Singapore (2008), China (2010), South Korea (2011) and a Commercial Agreement with Japan (2011) (SICE OAS, 2019). Further, Peru has also engaged in free trade talks with Indonesia. In 1991, Peru became a member of the Pacific Economic Cooperation Council (PECC) and the Pacific Basin Economic Council (PBEC), and in 1998, it joined the Asia-Pacific Economic Cooperation (APEC) forum. Further, in February 2016, Peru signed the Trans-Pacific Partnership (TPP).

It was emphasized on several occasions that in the Southeast Asia region, Indonesia is an important partner of Peru in the future. Peru considers Indonesia as one of the most dynamic economies in Southeast Asia, with a large population reaching more than 260 million people and a total GDP of more than US$1 trillion. In the last decade, both Head of States have met four times. First, during the sidelines of the 24th APEC Leaders Summit in Vladivostok on 9th September 2012 and 25th APEC Leaders Summit in Bali on 7th October 2013, in which President Susilo Bambang Yudhoyono held bilateral meetings with the President Ollanta Moises Humala Tasso. Besides signing the Memorandum of Understanding (MoU) on Agricultural Cooperation and Cooperation Agreement on Management of International Law, both parties agreed to propose IP-PTA.

During the Jokowi administration, the incumbent President has met twice with the President of Peru. First, during the sidelines of the Leaders Event COP-21 in Paris on 30th November 2015 in which President Jokowi held a bilateral meeting with President Ollanta Moises Humala Tasso. Both leaders agreed to enhance the bilateral trade and investment cooperation, and the Government of Peru established its commercial office in Jakarta in 2015. Further, President Jokowi has also met with President Pedro Pablo Kuczynski during the sidelines of the APEC-ASEAN Leaders Informal Dialogue in Da Nang, Vietnam, on 10th November 2017.

Economic diplomacy is not a new term and has been used by the practitioners and academicians at earlier times. For instance, in Indonesia, on 19th August 1971, in the opening remarks by Ismael M. Thajeb acted as the Director-General of Foreign Economic Relations at Kemlu in the book titled “25 Years of the Ministry of Foreign Affairs of the Republic of Indonesia (1945-1970)” clearly stated that Indonesian economic diplomacy must be strengthened in the upcoming years as the current national agenda focuses on economic development to enhance national economic welfare (Department of Foreign Affairs of the Republic of Indonesia, 1971). In fact, the Economic Directorate has existed in the Kemlu's organizational structure since October 1949 implying the Indonesian economic diplomacy has already been running since then.

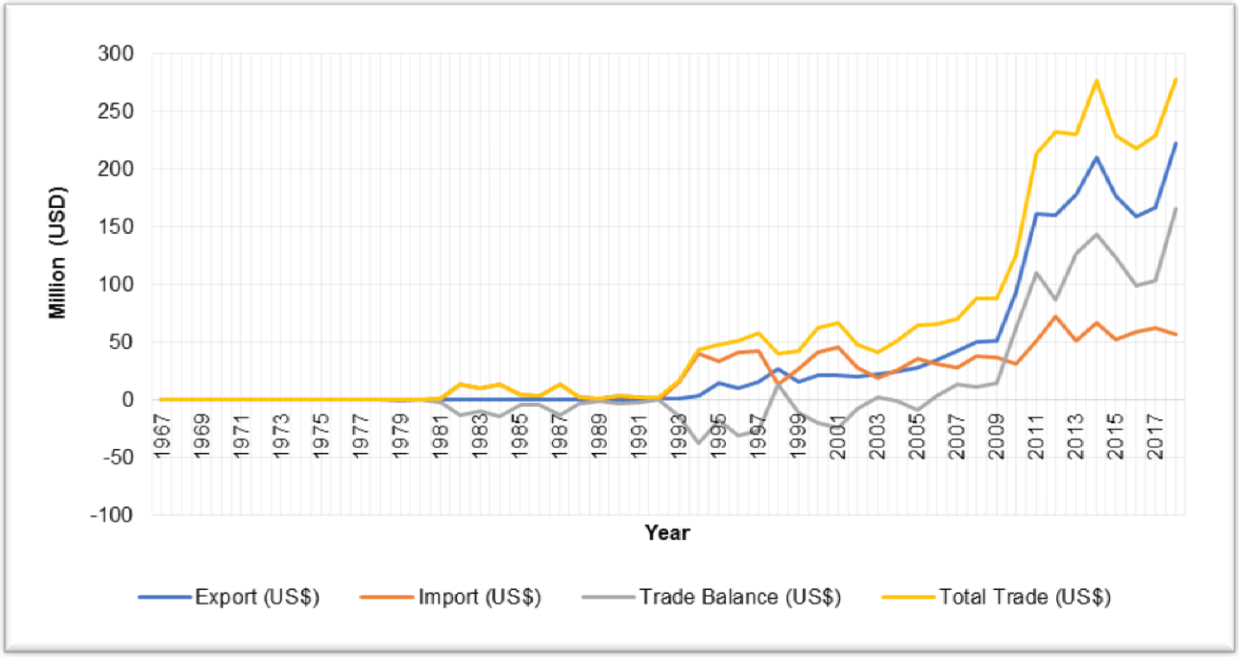
The current Indonesian President, Joko Widodo (Jokowi) has reiterated that economic diplomacy becomes one of the highest priorities foreign policy agenda arguing that strengthening economic diplomacy is crucial to support country's economic growth and promote national prosperity (so-called welfare-enhancing effect). President Jokowi's economic diplomacy agenda could be viewed as a mercantilist[7] doctrine, believing a trade surplus would be the key to boost economic growth. On one occasion, the incumbent President stated that 80-90 percent of the Indonesian official representatives' task should be focused on economic cooperation (Medan Bisnis Daily Online, 2014). Jokowi's economic diplomacy clearly puts a strong emphasis on commercial diplomacy in which all Indonesian official representatives abroad should become as salesmen in order to boost Trade, Tourism, Investment and Services (TTIS) performance.

3.2. Indonesia-Peru Bilateral Trade Relations Analysis

Both countries began to trade at least since 1967, prior to the opening of the Indonesia-Peru diplomatic relations in 1975. In the beginning, the bilateral trade volume was very low but steadily increasing particularly in the 1990s and rapidly increasing in the midst 2000s, and in the year 2018, the bilateral trade volume reaches at peak amounted US$278.57 million. It seems that issues such as the GFC followed by prolonged world economic downturn in the mid-2000s have led many countries around the globe (including Indonesia and Peru) to search for alternative prospective markets. Also, the graph illustrates that domestic economic problems such as the Peruvian Economic Crisis in 1983 (GDP= -10.4%), 1989 (GDP= -12.3%), 1992 (GDP= -0.5%) and 1998 (GDP= -0.39%) and Indonesian Economic Crisis in 1998 (GDP= -13.1%) have also negatively affected the bilateral trade relations.

[7] With some risk of oversimplification, mercantilism could be defined as a trade policy doctrine of "export more and import less" with the purpose to accumulate wealth vis-à-vis the rest of the world through improvements in the trade balance (Viner, 1991).

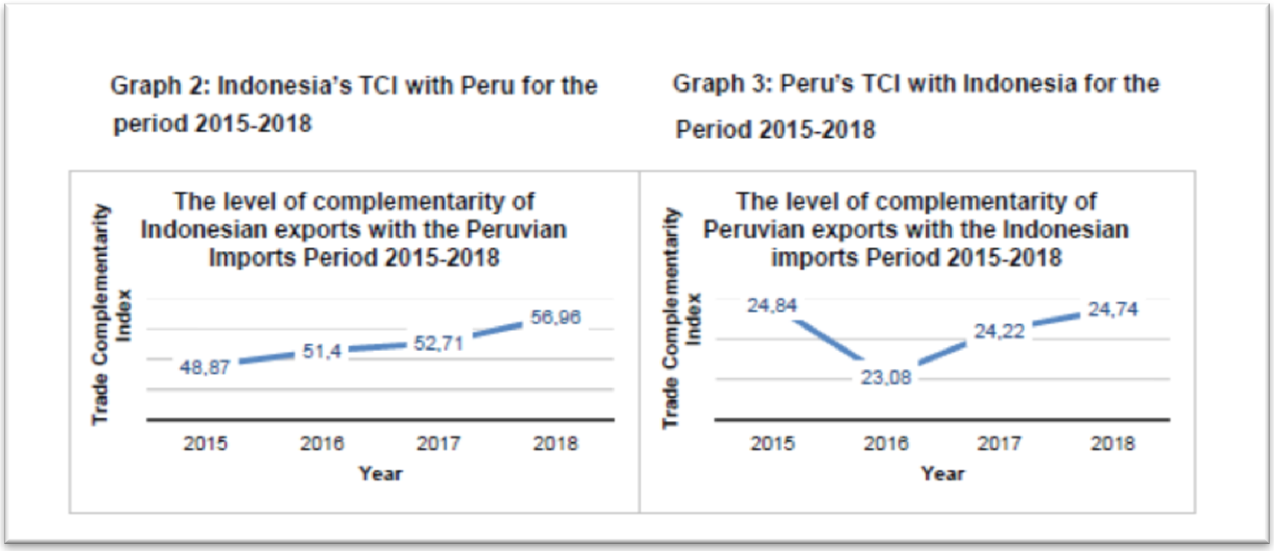
Graph 1: Indonesia-Peru Bilateral Trade During the Period 1967-2018



Source: Author's Computation from World Integrated Trade Solution (2019)

Trends over the past five years (2014-2018), the bilateral trade volume appeared to be quite volatile. In 2018, the trade value of the two countries amounted to US$278.57 million with a trade surplus for Indonesia amounting US$165.65 million. The main Indonesian exports to Peru were Passenger motor cars, for the transport of passengers & goods (SITC 781, US$55.14 million), Miscellaneous chemical products, n.e.s. (SITC 598, US$29.47 million), Footwear (SITC 851, US$24.98 million), Paper and paperboard (SITC 641, US$24.21 million), and Textile yarn (SITC 651, US$15.80 million). Meanwhile, the main Peruvian exports to Indonesia were Cocoa (SITC 072, US$15.86 million), Fertilizers – manufactured (SITC 562, US$14.43 million), Fruit & nuts (not including oil nuts), fresh or dried (SITC 057, US$11.27 million), Sanitary, plumbing, heating and lighting fixtures (SITC 081, US$4.82 million), and Motor vehicles for transport of goods/materials (SITC 782, US$1.75 million).

However, this trade value is still below its potential. Therefore, it is expected that the proposed IP-PTA initiative could be one of the positive solutions to strengthen the bilateral trade relations by opening up opportunities for both countries to export their competitive products to one another. For instance, on the one hand, Indonesia has the potential to export among others: palm oil, auto parts, footwear, textiles, natural rubber, wood products, furniture, and many others. On the other hand, Peru has the potential to export copper, fish meal, animal feed, wine, wheat and fertilizer to Indonesia.



Source: Calculated from UN Commodity Trade Statistics, United Nations (2019)

The TCI index is calculated from 2015-2018. Graph 2 shows TCI for the Indonesian export structure to the world with Peruvian import structure from the world, and Peruvian export structure to the world with an import structure Indonesia from the world. The figure shows the level of complementarity of Indonesian exports with Peruvian imports is higher than the complementarity of Peruvian exports with Indonesian imports. In 2018, the figure shows that 56.96% of Indonesian product exports match with the Peruvian import demand, meanwhile only 24.74% of Peruvian product exports match with the Indonesian import demand.

But despite this increasing (some positive) trend, it can be said that the trade between the two countries is relatively not complementary (particularly from the Peruvian perspective). Further, both countries could potentially become competitors due to the relatively similar specialization export structures.

3.3. Product Competitiveness Mapping Analysis

3.3.1. **Product Competitiveness Mapping Analysis: Indonesia versus Peru**

Using the product competitiveness mapping tool, during the period 1976-2018, it is depicted that over the years the majority of both countries' export products are clustered in Group D. For instance, in 2018, Peruvian export products clustered in Group D accounted for 72.76% of the Peruvian total export products, and the same case applies to Indonesia, in which 57.87% of the Indonesian total export products fall into Group D, meaning that the majority of both countries export products have low competitiveness and as net importers. Meanwhile, in the same year, export products that fall within Group A, for Indonesia, it was accounted 20.85% and Peru accounted for 14.04% of the total export products. This may imply that both countries' economic structures appeared to have not yet successfully diversified their export products within a given over more than 40 years.

Table 1: Peruvian Competitiveness Products During the Period 1976-2018

Group	1976	1980	1985	1990	1995	2000	2005	2010	2015	2018
A	24	35	34	33	32	30	37	34	34	33
B	1	2	1	3	6	6	3	5	10	8
C	22	34	27	38	12	16	23	23	17	23
D	185	162	170	155	184	182	171	174	174	171

Source: Author's Computation from World Integrated Trade Solution (2019)

Table 2: Indonesian Competitiveness Products During the Period 1976-2018

Group	1976	1980	1985	1990	1995	2000	2005	2010	2015	2018
A	24	35	34	33	32	30	37	34	34	49
B	1	0	1	3	5	8	4	6	0	23
C	22	28	43	41	34	45	57	34	73	27
D	185	186	168	151	147	119	120	148	93	136

Source: Author's Computation from World Integrated Trade Solution (2019)

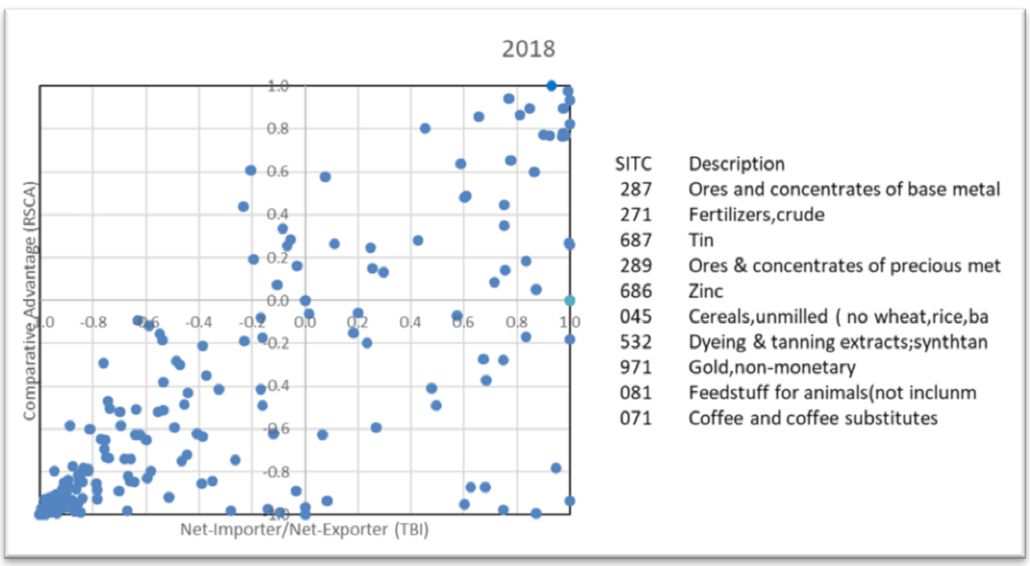
In 2018, it is shown that there are 33 Peruvian export products that have high competitiveness combined with high TBI (clustered in Group A), in which among others are: Ores and concentrates of base metal (SITC 287), Fertilizers, crude (SITC 271), Tin (SITC 687), Ores and concentrates of precious metals (SITC 289), Zinc (SITC 686), cereals, unmilled (SITC 045), Dyeing and tanning extracts (SITC 532), Gold non-monetary (SITC 971), Feedstuff for animals (SITC 081), and Coffee and coffee substitutes (SITC 071). On the other hand, there are 49 Indonesian export products that fall in Group A including: Coal (SITC 322), Vegetable oil (SITC 424), Natural rubber (SITC 232), Tin (SITC 687), Other man-made fibres (SITC 267), Animal and vegetable oils and fats (SITC 431), Gas, natural and manufactured (SITC 341), Spices (SITC 075), Cocoa (SITC 072), and Fuelwood (excluding wood waste) (SITC 245).

Table 3: RSCA and TBI Results for Peru in 2018 (Top 10 Products)

Rank	SITC	Description	RSCA	TBI
1	287	Ores and concentrates of base metals	0.97537	0.99418
2	271	Fertilizers, crude	0.93982	0.76921
3	687	Tin	0.93113	0.99910
4	289	Ores & concentrates of precious metals	0.89501	0.84901
5	686	Zinc	0.89300	0.97795
6	045	Cereals, unmilled (no wheat, rice)	0.86472	0.81187
7	532	Dyeing & tanning extracts; synthtan	0.85727	0.65888
8	971	Gold, non-monetary	0.821819	0.999894
9	081	Feedstuff for animals	0.79956	0.45450
10	071	Coffee and coffee substitutes	0.78155	0.97512

Source: Author's Computation from World Integrated Trade Solution (2019)

Graph 4: Peruvian Product Competitiveness Mapping Analysis in 2018



Source: Author's Computation from World Integrated Trade Solution (2019)

The product competitiveness mapping analysis shows Peru is excessively dependent on primary commodity exports, and the country faces structural challenges to achieving a more diversified and productive economy. The mining sector covering copper, iron, gold, and other minerals have accounted for around 60% of total Peruvian exports. Fortunately, the growing global demand for its minerals and other natural resources, combined with sound macroeconomic policies and through aggressive pursuit of FTAs and new foreign investment have made Peru experiences remarkable economic growth over the last decade. Peruvian policymakers can be credited for the successful negotiation of FTAs.

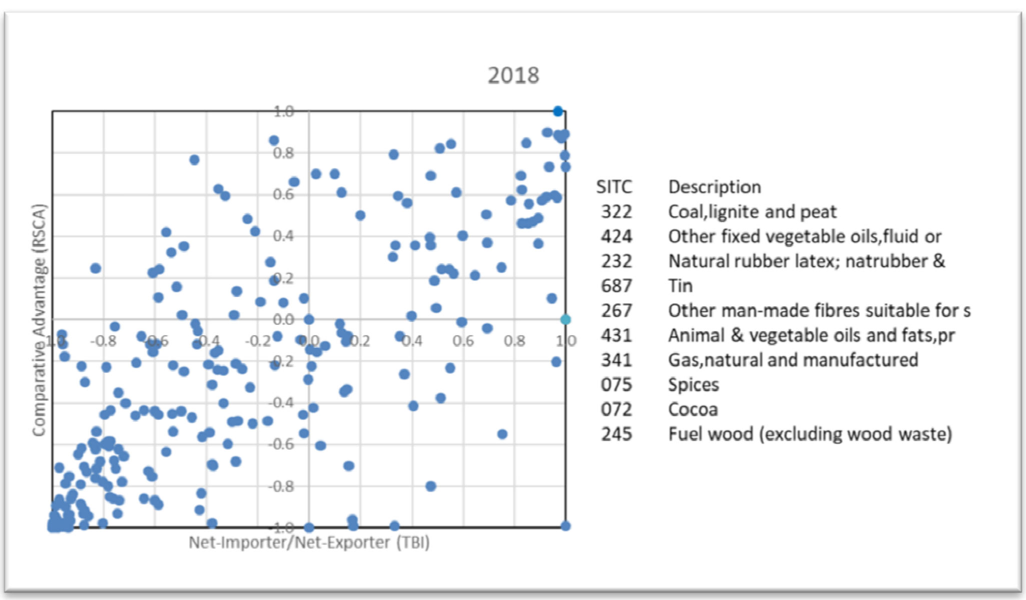
The same case applies to Indonesia, in which the country is also highly dependent on the primary sector including the oil and gas sector, and faces similar structural challenges in order to achieve a more diversified and productive economy. Although the Government of Indonesia has made series of efforts to diversify and enhance its export competitiveness but based on the product competitiveness mapping analysis, the study reveals that the progress seems to be relatively slow.

Table 4: RSCA and TBI Results for Indonesia in 2018 (Top 10 Products)

Rank	SITC	Description	RSCA	TBI
1	322	Coal, lignite and peat	0.89852	0.92761
2	424	Other fixed vegetable oils, fluid or	0.88885	0.99415
3	232	Natural rubber latex; natrubber &	0.88575	0.96778
4	687	Tin	0.86917	0.98077
5	267	Other man-made fibres suitable for s	0.86217	-0.13897
6	431	Animal & vegetable oils and fats, pr	0.84947	0.84276
7	341	Gas, natural and manufactured	0.84349	0.55309
8	075	Spices	0.82394	0.50642
9	072	Cocoa	0.79346	0.32986
10	245	Fuel wood (excluding wood waste)	0.78987	0.99627

Source: Author's Computation from World Integrated Trade Solution (2019)

Graph 5: Indonesian Product Competitiveness Mapping Analysis in 2018



Source: Author's Computation from World Integrated Trade Solution (2019)

3.4. Indonesia-Peru Bilateral Free Trade Scenario: A Partial Equilibrium Analysis

In this section, this policy paper uses SMART (Software for Market Analysis and Restrictions on Trade) Model obtained from World Integrated Trade Solutions (WITS) in order to analyze the possible overall impact of Indonesia-Peru bilateral free trade scenarios. SMART is a partial equilibrium model and a market access simulation package and has been used by many analysts to evaluate the impact of change in the trade policy on the trade effects, change in tariff revenue, and welfare effects. The main advantage of using the SMART model is in its user-friendliness for policymakers/practitioners and its minimal data requirement. The SMART model only requires data for the trade flows, the trade policy (tariff), and a couple of behavioral parameters (elasticities).

This study illustrates and discusses the potential impact of the Indonesia-Peru bilateral free trade scenario in 2018. This paper uses the SITC 3 Digits Code Revision 2 and a complete tariff dismantlement scenario (extreme scenario) in order to clearly expose the whole potential effects of trade liberalization on all products.

3.4.1. The Impact of Indonesia-Peru Bilateral Free Trade Scenario on the Consumer Surplus, Trade Creation Effect, and Revenue Effect

The SMART simulation results reveal positive consumer surplus, trade creation effect and revenue effect for both countries, Indonesia and Peru. The SMART simulation revealed that the Peruvian consumer surplus is predicted to increase by US$459978. The Indonesian products such as footwear, textile yarn, vehicles, garments, and household equipment were predicted to contribute the highest Peruvian consumer surplus. Meanwhile, the Indonesian consumer surplus is predicted to increase by US$49720. The main Peruvian products contributed the highest Indonesian consumer surplus among others are: motor vehicles for transport of goods/materials; civil engineering & contractors plant and parts, travel goods, handbags, brief-cases, purses, sheaths; garments, miscellaneous chemical products; machines & equipment specialized for particular industries; rotating electric plant and parts, and footwear.

Table 5: The Impact of Indonesia-Peru FTA Scenario on Peruvian Consumer Surplus (Top 10 Products)

Product Code	Product Name	Consumer Surplus in Thousands USD
851	Footwear	**160.77**
651	Textile Yarn	**86.91**
781	Passenger motor cars, for the transport of pass & goods	**62.38**
845	Outer garments and other articles, knitted	**35.87**
843	Outer garments, women's, of textile fabrics	**27.37**
846	Undergarments, knitted or crocheted	**24.61**
842	Outer garments, men's, of textile fabrics	**15.30**
653	Fabrics, woven, of man-made fibers	**11.32**
775	Household type, elect. & non-electrical equipment	**7.47**
844	Undergarments of textile fabrics	**4.51**

Source: Author's Computation from World Integrated Trade Solutions (2019)

Table 6: The Impact of Indonesia-Peru FTA Scenario on Indonesian Consumer Surplus (Top 10 Products)

Product Code	Product Name	Consumer Surplus in Thousands USD
782	Motor vehicles for the transport of goods/materials	**160.77**
723	Civil engineering & contractors' plant and parts	**86.91**
831	Travel goods, handbags, brief-cases, purses, sheaths	**62.38**
844	Undergarments of textile fabrics	**35.87**
846	Undergarments, knitted or crocheted	**27.37**
845	Outer garments and other articles, knitted	**24.61**
598	Miscellaneous chemical products, n.e.s.	**15.30**
728	Mach.& equipment specialized for particular ind.	**11.32**
716	Rotating electric plant and parts	**7.47**
851	Footwear	**4.51**

Source: Author's Computation from World Integrated Trade Solutions (2019)

Meanwhile, Indonesia's total trade creation effect (change in import) is expected to be US$1.11 million meaning the zero-tariff scenario of the bilateral Indonesia-Peru causes an expected increase of Indonesian imports from Peru by US$1.11 million. The Peruvian products which contributed the highest Indonesian trade creation effect are Civil engineering & contractors' plant and parts (SITC 723), followed by Motor vehicles for the transport of goods/materials (SITC 782), and Travel goods, handbags, brief-cases, purses, sheaths (SITC 831). On the other hand, Peruvian trade creation effect is expected to be US$14.16 million in which Indonesian products such as Textile yarn (SITC 651), Footwear (SITC 851), and

Passenger motor cars, for the transport of passengers & goods (SITC 781) contributed the highest Peruvian trade creation effect.

Table 7: The Impact of Indonesia-Peru FTA Scenario on Indonesian Trade Creation (Top 10 Products)

Product Code	**Product Name**	**Trade Creation in Thousands USD**
723	Civil engineering & contractors plant and parts	**452.17**
782	Motor vehicles for the transport of goods/materials	**187.26**
831	Travel goods, handbags, brief-cases, purses, sheaths	**144.35**
844	Undergarments of textile fabrics	**91.08**
846	Undergarments, knitted or crocheted	**77.47**
728	Mach.& equipment specialized for particular ind.	**34.04**
598	Miscellaneous chemical products, n.e.s.	**24.27**
845	Outer garments and other articles, knitted	**15.65**
716	Rotating electric plant and parts	**14.93**
744	Mechanical handling equip. and parts	**12.03**

Source: Author's Computation from World Integrated Trade Solutions (2019)

Table 8: The Impact of Indonesia-Peru FTA Scenario on Peruvian Trade Creation (Top 10 Products)

Product Code	**Product Name**	**Trade Creation in Thousands USD**
651	Textile Yarn	**3347.29**
851	Footwear	**2742.01**
781	Passenger motor cars, for the transport of pass & goods	**2688.77**
775	Household type, elect. & non-electrical equipment	**807.86**
762	Radio-broadcast receivers	**508.68**
845	Outer garments and other articles, knitted	**393.20**
899	Other miscellaneous manufactured articles	**391.43**
843	Outer garments, women's, of textile fabrics	**342.71**
846	Undergarments, knitted or crocheted	**310.58**
898	Musical instruments, parts and accessories	**298.49**

Source: Author's Computation from World Integrated Trade Solutions (2019)

Under the case of perfect tariff liberalization, the SMART model simulation results also revealed that Indonesia's tariff revenue loss is predicted to be -US$763186, while Peru may lose tariff revenue about -US$8.28 million. It implies Peru may lose almost eleven times more tariff revenue loss compared to Indonesia. Products such as Footwear (SITC 851), Passenger motor cars, for the transport of passengers & goods (SITC 781), and Undergarments, knitted or crocheted (SITC 846) contributed the highest Peruvian tariff revenue loss. Meanwhile, Indonesian tariff revenue loss originated among others from products such as Motor vehicles for the transport of goods and materials (SITC 782), Civil engineering & contractors' plant and parts (SITC 723) and Undergarments, knitted or crocheted (SITC 846).

Table 9: The Impact of Indonesia-Peru FTA Scenario on Indonesian Revenue Effect (Top 10 Products)

Product Code	Product Name	Revenue Effect in Thousands USD
782	Motor vehicles for the transport of goods/materials	**-238.07**
723	Civil engineering & contractors plant and parts	**-232.12**
846	Undergarments, knitted or crocheted	**-110.43**
598	Miscellaneous chemical products, n.e.s.	**-37.81**
743	Pumps & compressors, fans & blowers, centrifuges	**-29.09**
845	Outer garments and other articles, knitted	**-19.83**
831	Travel goods, handbags, brief-cases, purses, sheaths	**-13.64**
744	Mechanical handling equip. and parts	**-12.05**
728	Mach.& equipment specialized for particular ind.	**-11.23**
716	Rotating electric plant and parts	**-11.20**

Source: Author's Computation from World Integrated Trade Solutions (2019)

Table 10: The Impact of Indonesia-Peru FTA Scenario on Peruvian Revenue Effect (Top 10 Products)

Product Code	Product Name	Revenue Effect in Thousands USD
851	Footwear	**-1967.30**
781	Passenger motor cars, for the transport of pass & goods	**-1568.65**
846	Undergarments, knitted or crocheted	**-772.36**
651	Textile yarn	**-409.06**
842	Outer garments, men's, of textile fabrics	**-330.54**
845	Outer garments and other articles, knitted	**-304.43**
899	Other miscellaneous manufactured articles	**-297.42**
843	Outer garments, women's, of textile fabrics	**-281.41**
898	Musical instruments, parts and accessories	**-278.23**
533	Pigments, paints, varnishes & related materials	**-226.57**

Source: Author's Computation from World Integrated Trade Solutions (2019)

The SMART simulation indicates that there is a potential increase in bilateral trade volume as a result of the proposed IP-PTA. But it should be noted that both countries' export gains may not be materialized, despite tariff removal, due to the presence of non-tariff barriers.

Also, the study shows that both countries would also suffer tariff revenue loss as a result of the IP-PTA.

4. Conclusion and recommendation

Indonesia and Peru have friendly diplomatic relations, but this cordial relation is not being followed by strengthening economic and socio-cultural relations. The current bilateral trade volume is still below its potentialities. Both countries should find ways and common ground to advance their bilateral agenda. Within the economic realm, to enhance the bilateral relations, both countries agreed with the proposed trade initiatives to establish IP-PTA and the JFS was completed in 2016. This initiative is one of the three Indonesian trade initiatives in the Latin American region.

The IP-PTA bodes well in their respective foreign policies agenda and promises to strengthen and elevate the bilateral economic relations into a higher stage. The Peruvian foreign policy puts a strong emphasis on economic diplomacy as a part of Peru's endeavor to reinsert the country internationally. In general, the Peruvian government adopted the neo-liberal economic doctrine, emphasizing on free trade and finding ways to integrate into the global economy through opening the economy. It was stated by the Peruvian government on several occasions that in the Southeast Asia region, Indonesia is an important partner of Peru in the future. On the other hand, the Indonesian government considers Peru as one of the countries clustered as a non-traditional market for Indonesia's economic diplomacy mission with the main objectives to diversify the Indonesian export products and markets, and at the same time to search wider and deeper relations with its non-traditional market counterpart.

Indonesia and Peru began to trade at least since 1967, prior to the opening of the Indonesia-Peru diplomatic relations in 1975. In the beginning, the bilateral trade volume was very low but steadily increasing, and in the year 2018, the bilateral trade volume reached a peak. The TCI result shows that Indonesian exports are relatively complementary and matches with the Peruvian import demand, meanwhile the Peruvian exports are not complementary (substitutes) and many of its exported products do not match the Indonesian import demand. This may partially explain the relatively low Indonesia-Peru bilateral trade volume over the years.

The product competitiveness mapping analysis showed that over the years, the majority of both countries' export have low competitiveness and as net importers. This may imply that over the given years, both countries' economic structures appeared to have not yet successfully diversified their export products. Further, both countries have relatively similar specialization export structures and are highly dependent on the primary sector. As a result, both countries could potentially become competitors due to the relatively similar specialization export structures.

The partial equilibrium economic analysis (SMART simulation) illustrated that there is a potential increase in bilateral trade volume as a result of the proposed IP-PTA, particularly the Indonesian export. The study also revealed an increase in consumer surplus in both countries.

Meanwhile, due to the tariff liberalization, both countries would also experience tariff revenue loss as a result of the IP-PTA.

Based on the above analysis, the policy paper suggests both sides to pursue the IP-PTA. The proposed IP-PTA initiative could further enhance the bilateral trade volume by opening up both countries' market access. The SMART simulation revealed that IP-PTA will boost both countries' export and will benefit from an increase in consumer surplus derived from IP-PTA.

To ensure the potential Indonesian export to Peru (and viceversa) is attained through this IP-PTA initiative, the Indonesian government should pursue commercial diplomacy concentrating on the Indonesian export products that are predicted to contribute significant Peruvian trade creation effect and viceversa. These Indonesian export products among others are Textile yarn (SITC 651), Footwear (SITC 851), Passenger motor cars, for the transport of passengers & goods (SITC 781), and Household type, electrical and non-electrical equipment (SITC 775) which contributed the highest Peruvian trade creation effect. Meanwhile the Peruvian export products among others are Civil engineering & contractors' plant and parts (SITC 723), followed by Motor vehicles for the transport of goods/materials (SITC 782), and Travel goods, handbags, brief-cases, purses, sheaths (SITC 831).

Despite Indonesia and Peru have common interest to stengthen economic relations, but both sides should also find common ground to advance their bilateral agenda, not only limited to IP-PTA. To smoothen the trade and business relations between both states, both sides should have strong political will including to promote business people-to-people contact and creating a business conducive to economic cooperation between the two countries. There may be conventional factors such as language barriers, historical, cultural and political reasons, but these factors, in fact, could be reduced if both sides proactively find effective solutions. For instance, in conjunction with the economic cooperation, socio-cultural cooperation should also be fostered including establishing language trainings and schools of Indonesian and Spanish languages, conducting joint research on exploring the possible common historical connections of both countries, sport cooperation, engaging youth, and further promoting awareness and positive image on Indonesia in Peru (viceversa) are some of the few initiatives. The basic idea behind this initiative is to encourage people to people interaction and dialogue from which understandings and friendships will be developed.

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