

Kukuh Sembodho

Author

Arumdriya Murwani

Author

INNOVATION



FREEDOM



PROSPERITY

International Trade Barrier Index 2021

The Effects of Pre-Shipment Inspections on Food Trade in Indonesia

Case Study

Abstract

While tariffs on international trade have been declining, non-tariff measures (NTM) have increased in recent years. Their less visible and opaque nature allows NTMs to circumvent trade agreements and be used for the protection of domestic production. Pre-Shipment Inspections (PSI) are one of the NTMs widely applied by the Indonesian government on various commodities, including rice and horticultural products. PSI impose additional costs that increase import prices stemming from the cost of third-party services and costs due to delays. This case study explains the effects of PSI on food trade, consumption patterns, and nutrition intake of low-income Indonesians.

The Effects of Pre-Shipment Inspections on Food Trade in Indonesia

By Kukuh Sembodho¹ & Arumdriya Murwani²

TBI 2021



CIPS

Center for Indonesian
Policy Studies

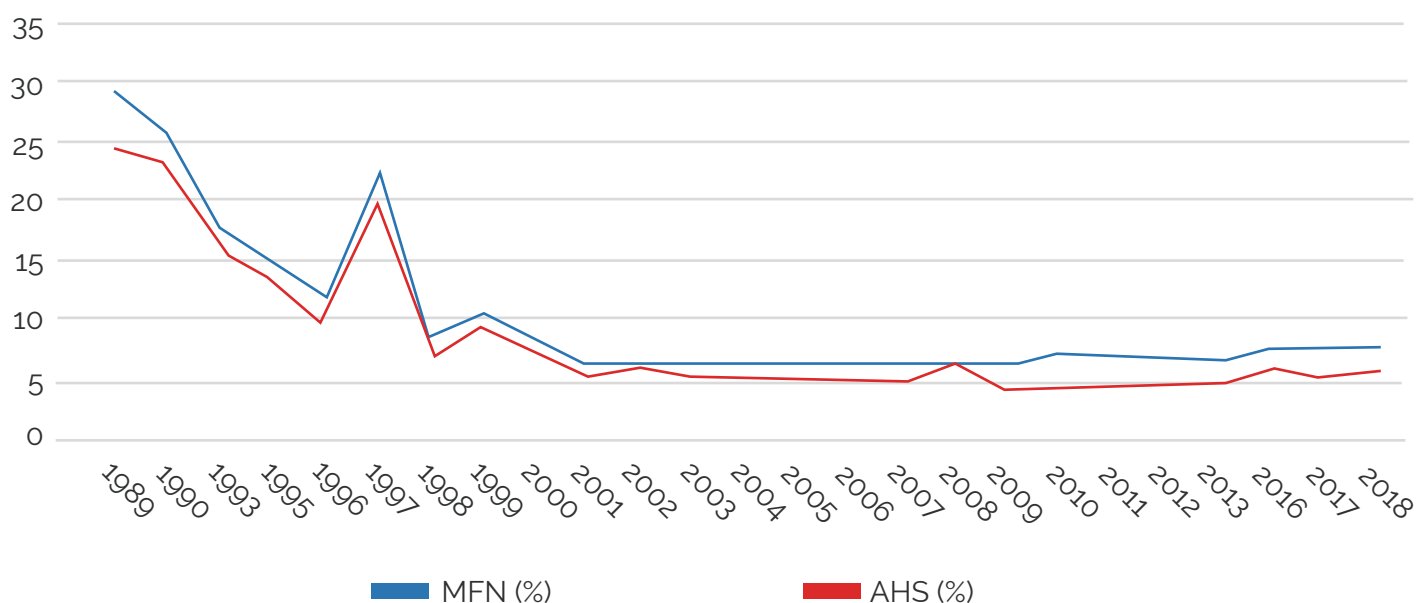
1. Researcher
2. Researcher

I. Brief Overview of Indonesia Trade Barriers

Cross-border trade usually encounters two barriers: tariffs and non-tariff measures (NTMs). In Indonesia, the use of tariffs has been declining due to trade reforms after the economic crisis of 1989. At times, uncertain global trade conditions and protectionist sentiments to keep the domestic industry secure from global competition contributed to a slight increase in the maximum tariffs (Most-Favored Nation tariffs / MFN) that Indonesia charged all other World Trade Organization (WTO) member countries (Hertanti and Munadi, 2019). During the last two decades, however, Indonesia's participation in various bilateral or regional trade agreements kept Effectively Applied Tariffs (AHS) low. According to the World Trade Integrated Solution (WITS) database, both MFN and AHS tariffs stayed consistently below 10% in the World Trade Integrated Solution (WITS) database. Between 2014 and 2018, the simple average of effectively applied tariffs was 6.25%. Under the more recently concluded Regional Comprehensive Economic Partnership (RCEP), Indonesia committed to phasing out tariffs on over 90 percent of traded goods during the next 20 years (Regional Comprehensive Economic Partnership, 2020).

FIGURE 1: Indonesia Tariff Rates, 1989-2018

Source: Author, based on World Trade Integrated Solution (2020).



Despite the benefits of lower tariffs for global trade and cooperation, a worrying trend is on the horizon. Munadi (2019) noted Indonesia's growing use of NTMs after 2014 as an effort to protect domestic industry from international competition. Their number increased from 676 in 2015 to 977 NTMs in 2018 (Munadi, 2019).

Unlike tariffs, NTMs are less visible and more opaque, allowing governments to mask their protectionist intentions and add national import costs. Calculations by Kinzius et al. (2019) on trade protection and non-tariff barriers concluded that import control measures reduce trade between countries by 2% - 8%. Additionally, trade restrictions distort the market and favor larger enterprises. Unlike tariff measures, the costs associated with non-tariff measures are often fixed, meaning that additional costs will not change depending on the traded goods' quantity or value. These fixed costs put a disproportionate burden on small and medium-sized trading partners and can potentially drive them out of the exchange with certain countries (Ahn & Gnutzmann-Mkrtchyan, 2019). As a result, trade restrictions increase the domestic prices of imported commodities (Marks, 2017). They ultimately threaten community welfare when applied to essential sectors—such as food and agriculture, and will be explored in this case study.

According to the WITS database, pre-shipment inspections are among the NTMs most commonly imposed by Indonesia. Indonesia scored particularly high on Pre-Shipment Inspections (PSI) in the 2019 Trade Barrier Index by the Property Rights Alliance, followed by price controls and quantitative restrictions. According to the WITS database, PSI requirements are heavily imposed on fuels, textiles, and food products. Yet, there is relatively little research about their impact.

According to the UNCTAD TRAINS database, which includes NTMs based on official regulations, Indonesian PSI requirements cover several commodities in the food and agriculture sector, including rice and horticultural products, such as fruits and vegetables. They hold a vital role in ensuring the nutritional intake of Indonesian consumers and are therefore the focus of this case study.

II. Pre-Shipment Inspections on Food and Agricultural Trade

Pre-Shipment Inspections (PSI) are applied to check the quality, quantity, and prices of traded goods at the country of origin before they are shipped (Anson et al., 2003; Koul, 2018). Governments or importing bodies usually appoint the services of a third-party private surveyor to conduct the PSI, who then issues a report of findings. This report determines the applicable import tax regime with tariffs, exemptions, or special treatment of goods. This serves customs agents as a basis to collect import taxes (Anson et al., 2003). PSI are conducted to ensure that exporting parties abide by contractual obligations related to the goods, assure customs administrations that the goods are not under or over-declared, and prevent fraud. Under-declared goods can lead to applying a tax regime with lower tariff rates and the loss of state revenues. Therefore, governments use PSI to prevent under-declarations related to the quantity, quality, and prices of goods and to protect their import tariff revenues (Anson et al., 2003).

The United Nations Economic Commission for Europe (UNECE) recognized in the 1980s that PSI generate costs because of obligations to hire third-party services and additional delays to the trading process. Hiring a third-party surveyor creates fixed costs (Marks, 2016) because costs remain the same regardless of the quantity imported. As such, for large exporters, these costs are not significant and might not affect their sales prices. However, these fixed costs can hurt small to medium-sized trade partners (Ahn & Gnutzmann-Mkrtchyan, 2019). They might deter trade partners from importing to Indonesia and reduce price competition and product variety in domestic markets.

More substantial are costs associated with delays in ports of origin and in Indonesian ports resulting from PSI requirements. In ports of origin, the commodities must arrive ahead of the shipping schedule due to the required inspection and technical verification processes prior to the shipment. This adds extra time and incurs cargo parking costs in the port of origin. Once the report is issued and added to the import declaration, the commodities can be shipped to Indonesia. Upon arrival, they must go through customs clearance. According to the United States Department of Agriculture (2019), Indonesian customs clearance can take between a day to several weeks, based on the completeness of import documents. In case of incomplete documentation or discrepancies of information presented in the declaration, the shipped commodities might be held for extra weeks in the port. These delays incur extra cargo parking costs of up to USD 500 per container per day (Kamil et al. 2018). For perishable items such as horticultural commodities, added dwelling time incurs additional costs stemming from the need to use the port's electricity and cold storage facilities.

Marks (2016) reported that the costs for PSI plus compliance with cold-storage protocols for fruit traders in Indonesia could be as high as 6%. In the case of Australian prime cut meat, the PSI process generated an additional USD 250 - 300 per shipment and prolonged the importation process by two weeks (Intaravitak & Munadi, 2019). These additional costs will ultimately be recovered through increased retail prices, and they generate consumer price increases in the domestic market (Intaravitak & Munadi, 2019).

Ministry of Trade (MOT) Regulation No. 46/DAG/PER/8/2014 stipulates that technical inquiry or verifications must be conducted by government-appointed surveyors prior to shipment. The surveyors' reports are needed for the import declaration and can only be used for one-time shipping only. Specifically, for rice, Ministry of Trade Regulation No. 01/2018 requires that verification or technical inquiry must be conducted in the country of origin by a ministry-approved surveyor before rice can be shipped to Indonesia. The same is stipulated for horticultural products in Ministry of Trade Regulation No. 44/2019, which replaces Ministry of Trade Regulation No. 64/2018.

MOT Regulation No. 64/2018 on horticulture replaced the previous Regulation No. 16/2013 that caused international concern and a lengthy WTO dispute settlement process. New Zealand and the United States took the case to the WTO Dispute Settlement Body (DSB) in 2014 and they were joined by 14 other countries as third parties (World Trade Organization, n.d.).¹ Eighteen measures were challenged concerning Indonesia's importation regime for horticultural products, animals, and animal products, including PSI requirements in Ministry of Trade Regulation No. 16/2013. It was criticized that Indonesia

1. DS477 and DS478

only allowed government-appointed third-party surveyors to conduct pre-shipment inspections, which caused unnecessary trade restrictions. The complainants believed that Indonesia "imposed unreasonable and discriminatory PSI requirements" which caused unreasonable delays to the trading process (Request for Consultation by United States, 2014; Request for Consultation by New Zealand, 2014; Evelin et al., 2019). They also argued that the information declared in the PSI unnecessarily duplicated information that was already provided in phytosanitary certificates.

A WTO panel ruled that all the disputed 18 measures restricted the importation of horticulture, animal, and animal products and recommended Indonesia to amend its regulation to follow the GATT 1994 agreement (World Trade Organization, 2016). Indonesia's attempted appeal to the Appellate Body was denied by the WTO (World Trade Organization, n.d.). In 2019, Indonesia informed the DSB that it had taken the appropriate measures to implement the recommendations, including Ministry of Trade Regulation No. 64/2018 that revised some of the measures concerned. However, the PSI requirements remain, as evident in the latest Ministry of Trade Regulation No. 44/2019. In its latest communication to the WTO on 8 December 2020, Indonesia reiterated its commitment to implement the recommendations of the DSB.

III. Impact of Trade Barriers

The implementation of burdensome NTMs on food and agricultural imports threatens the welfare of millions of impoverished Indonesians. Restrictive trade measures in this sector have been linked to increased poverty, lower nutrition, and poor health outcomes (Ilman, 2020; Ilman & Wibisono, 2019; Marks, 2017; Octania & Biru, 2019).

Indonesia's highly regulated food and agriculture sector stems from a protectionist and nationalistic sentiment in the country. Current import laws and regulations are driven by the belief that Indonesia should be self-sufficient in feeding its people and limiting imports.

Claims that import restrictions benefit Indonesian farmers have been refuted. According to a report by the Asian Development Bank, the Ministry of National Development Planning, and the International Food Policy Research Institute (2019), two-thirds of Indonesian farmers consume more food than they produce. The same report shows that low-income households spent, on average, 76.7% of their expenditure on food (Asian Development Bank et al., 2019). Most farmers and all low-income Indonesians are, therefore, vulnerable to price hikes in the food market. They struggle to access affordable and nutritious food.

As of October 2020, Indonesia's average rice price was USD 0.838 per kg, according to the National Strategic Food Commodities Information Center (PIHPS, 2020). This is almost twice the international price of USD 0.471 per kg (Index Mundi, 2020). Since rice is a staple in the average Indonesian diet, high rice prices affect consumption and nutrition. A study on food prices and malnutrition by Ilman & Wibisono (2019) found that price changes in food alter consumption patterns. A rice price increase of IDR 1,000 reduces per capita household rice consumption by 0.67 kg per month (Ilman & Wibisono, 2019). This decline in consumption leads to adverse health outcomes. When households cannot afford enough

food, the probability of families having stunted children increases (Ilman & Wibisono, 2019). About a third of Indonesian children at the age of 5 years old are stunted, which refers to their low height for their age predominantly caused by undernutrition. Stunted growth leads to more significant risks of illnesses and premature death, and it can reduce the mental development and cognitive capacity of children.

Particularly the consumption levels for fruits and vegetables in Indonesia remain low. According to the Basic Health Research (RISKESDAS) by the Ministry of Health, 95.5% of Indonesians consume less than the ideal amounts of fruits and vegetables per day (RISKESDAS, 2018). Despite providing essential micronutrients, fruits and vegetables are among the most expensive food items in Indonesia (World Food Programme, 2020). Their insufficient intake has been associated with micronutrient deficiencies that can profoundly harm pregnant women and their infants. In Indonesia, maternal nutrient deficiencies contribute 6 percent of low-weight births, responsible for 1 in 4 children becoming stunted (UNICEF et al., 2019). UNICEF et al. (2019) attributed these deficiencies to a lack of access to a diverse diet.

IV. Moving Forward

In 2020, the Indonesian government engaged in major regulatory reforms that seem to ease import restrictions. A new Omnibus Law for Job Creation contains sweeping revisions and deregulations in several sectors, including food and agriculture. It acknowledges imports as one of the legitimate means to attain food security. While this could indicate freer trade for food and agriculture, the new law also recognizes tariffs and non-tariff measures as legitimate means to protect smallholder farmers, fishers, and micro and small-sized food and agriculture businesses. As implementing regulations have currently not been issued, there remains uncertainty on how this will be applied to the country's trade policies on food and agriculture. This lack of predictability and transparency around NTMs makes Indonesia a less favorable trading partner, reducing its attractiveness on global markets.

It is crucial to evaluate the effects of PSI on rice and horticultural product prices, considering their importance for the nutrition of low-income Indonesians. Making trade in food and agriculture less costly is in everyone's best interest, but most importantly, for those at the bottom of the income pyramid. Ensuring that every Indonesian has equal access to affordable food supplies is the first step towards making Indonesia more food secure.

V. Works Cited

- Ahn, D., & Gnutzmann-Mkrtchyan, A. (2019). Indonesia-import licensing regimes: Gatt rules for agricultural trade? *World Trade Review*, 18(2), 197–218. <https://doi.org/10.1017/S1474745619000119>
- Anson, J., Cadot, O., & Olarreaga, M. (2003). *Tariff Evasion and Customs Corruption : Does Pre-Shipment Inspection Help?*
- Asian Development Bank, Bappenas, & International Food Policy Research Institute. (2019). Policies to Support Investment Requirements of Indonesia's Food and Agriculture Development During 2020-2045. In *Asian Development Bank* (Issue October). <https://doi.org/10.22617/TCS190447-2>
- Evelin, E., Rosjadi, F., & Pratono, A. H. (2019). *Dispute Settlement on Trade-Restriction of the Horticultural and Animal Products (Case study of Indonesia, New Zealand, and USA)*. 307(SoRes 2018), 557–562. <https://doi.org/10.2991/sores-18.2019.129>
- Ilman, Assyifa Szami. (2020). *Effects of High Food Prices on Non-Cash Food Subsidies (BPNT) in Indonesia. Cases Study in East Nusa Tenggara*. 26, 1–32.
- Ilman, Assyifa Szasmi, & Wibisono, I. D. (2019). *Analysis of Food Prices and Stunting Prevalence in Indonesia*.
- Index Mundi. (2020). Rice – Commodity Prices. Retrieved December 15, 2020 from <https://www.indexmundi.com/commodities/?commodity=rice&months=12>
- Intaravitak, C., & Munadi, E. (2019). Reform to Improve Transparency and Streamline NTMs in the ASEAN-5. In R. Peters & O. Cadot (Eds.), *Regional Integration and Non-Tariff Measures in ASEAN* (pp. 126–156). ERIA. <https://doi.org/10.1515/9783110289039.734>
- Kementerian Kesehatan. (2018) *Riset Kesehatan Dasar*.
- Kinzius, L., Sandkamp, A., & Yalcin, E. (2019). Trade protection and the role of non-tariff barriers. *Review of World Economics*, 155(4), 603–643. <https://doi.org/10.1007/s10290-019-00341-6>
- Koul, A. K. (2018). Guide to the WTO and GATT. In *Guide to the WTO and GATT* (pp. 489–496). <https://doi.org/10.1007/978-981-13-2089-7>
- Marks, S. V. (2017). Non-tariff trade regulations in Indonesia: nominal and effective rates of protection. *Bulletin of Indonesian Economic Studies*, 53(3), 333–357. <https://doi.org/10.1080/00074918.2017.1298721>
- Munadi, E. (2019). Indonesian non-tariff measures: Updates and insights. *Non-Tariff Measures in ASEAN-An Update, August*, 67–84.
- Octania, G., & Biru, M. D. (2019). The Health and Price Effects of Indonesia's Trade Restrictions on Rice: Case

Studies. In the *International Trade Barrier Index 2019*. <https://doi.org/10.21082/jpptp.v35n3.2016.p163-172>

Pusat Informasi Harga Pangan Strategis Nasional. (2020). Tabel Harga Pangan Komoditas Pasar Tradisional. Retrieved December 15, 2020 from <https://hargapangan.id/tabel-harga/pasar-tradisional/komoditas>.

Request for Consultation by New Zealand, Indonesia — Importation of Horticultural Products, Animal, Animal Products. WTO Doc. WT/DS477/21 (May 8, 2014).

Request for Consultation by United States, Indonesia — Importation of Horticultural Products, Animal, Animal Products. WTO Doc. WT/DS478/1 (May 15, 2014).

UNICEF, Bappenas, & Kementerian Kesehatan. (2019). *Indonesia Maternal Nutrition: Framework for Action*.

United States Department of Agriculture. (2019). Indonesia Food and Agricultural Import Regulations and Standards Report: FAIRS Annual Country Report. Retrieved from https://apps.fas.usda.gov/newgainapi/api/Report/DownloadReportByFileName?fileName=Food%20and%20Agricultural%20Import%20Regulations%20and%20Standards%20Country%20Report_Jakarta_Indonesia_12-31-2019

World Food Programme. (2020). *COVID-19 Economic and Food Security Implications in Indonesia*. March, 1–12.

World Trade Organization. (n.d.). Dispute settlement - the disputes - DS477. Retrieved December 15, 2020, Retrieved from https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds477_e.htm

World Trade Organization. (2016). Indonesia – Importation of Horticultural Products, Animals and Animal Products. Report of the Panel. (16-6998). WT/DS477/R and WT/DS478/R (December 22, 2016).

World Trade Organization. (2020). Indonesia – Importation of Horticultural Products, Animals and Animal Products: Status Report Regarding Implementation of The DSB Recommendations and Rulings by Indonesia (Issue December). Retrieved from <http://repositorio.unan.edu.ni/2986/1/5624.pdf>



THOLOS
FOUNDATION

TRADEBARRIERINDEX.ORG