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The Impact of Institutional Regulation and Facilitation on Cross-Border Trade

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Abstract: The conventional wisdom in the economic circles suggests that reducing trade tariffs will enhance cross-border trade. However, it is not necessarily the case in reality, as there can be other institutional mechanisms that influence cross-border trade. To gain some understanding of this reality, this article analyses the impact of trade restriction and facilitation regulations on the cross-border trade of Dumai in Indonesia's Province of Riau. The methodology consisted of interviewing key government officials and cross-border traders and examining documentary sources. The findings of the study revealed that institutional restriction on and facilitation mechanisms of Dumai's cross-border trade had worked to the disadvantage of the local trading communities and local economy. Not only did restriction regulations curtail cross-border trade and thus local economic development, it had also prohibited the growth of trade related facilities such as one-stop logistics centres. In conclusion, local states would be handicapped in enabling cross-border trades if cross-border trade regulations were controlled by the central government. As such, further cross border trade studies should explore inter- and intra-state relations to gauge further insights into the complexity of the matter.

Key words: Institution • Cross-border trade • Regulation • Facilitation

INTRODUCTION

Cross-border trades are trades between two neighbouring countries that have a common border. They portray the transactions and exchanges of goods between companies and/or individuals across two bordering countries, entailing regions and places such as trading ports in two countries. Cross-border trades through complementary needs and socio-economic interdependencies provide access to external market while enhancing local and regional development within the border regions [1]. Cross-border trades, in particular and cross-border cooperation, in general, have been viewed as promising strategies to exploit opportunities.

One of the arguments put forward in the recent globalization debate is that regional economies need to liberalize, by way of opening their markets through deregulation and reduction of fiscal incentives to encourage increase in exports and imports of goods so that the region can together compete at the global level. It is envisaged that such platforms would enable greater growth to local economies, especially border regions. Thus, cross-border trades can contribute to a regional integration effort and function as a regional competitive instrument to propel the domestic regional economy into the global market place. This, however, depends on how free trades are envisaged at the borders and how fair the trades are taking into account the relative development stage of the neighbouring countries [2].

How free trades are really free of encumbrances at the cross border depends on the interplay between institutional restrictions and facilitations. Institutions can be defined as regulations, policies, rules and facilitation process that shape economic activities in this case, pertaining to cross-border trades [3].

Conventional literature on trade and cross-border trade are uneven in its treatment of institutional restrictions and facilitations of cross border trades. For example, it has tended to emphasize the role of institutional regulation, in particular tariff measures, as

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enabling cross-border trade [4-5]. Yet, Wilson and Mann [6] found that regulatory barriers such as trade tariffs can impact trade negatively. In fact, Tokarick [7] has argued that the existence of import tariffs is a deterrent for a country to export, as the rival neighbouring country will reciprocate, thus reducing cross-border trade prospects.

Less attention has been paid to other non-tariff measures such as restrictions which also impact cross-border trades [8-12]. For instance, the requirement of an import licence to bring in certain items, such as cultural products, for the reason of protecting the country's interest (such as preserving its cultural identity) can have negative consequence on cross-border trade [8]. These restrictions, coupled with administrative requirements may incur extra costs. In recent years, the issue of non-compliance with regulatory standards [9], especially the non-compliance of exporters to mandatory health and safety standards for food and agricultural products have hindered cross-border trade.

The role of institutional facilitation has been somewhat neglected in the literature with the exception of a World Bank report which has highlighted its importance [9]. These institutional facilitation factors may be divided into two categories, namely, logistic services and costs [13-14] and administrative procedures [15-18].

There is also a literature gap on the interdependence between institutional regulation and institutional restriction. This scarcity is regrettable as the role of the state at varying levels of this interdependency may shape the very outcome of cross-border trades.

Cross-border trades have been well established in the island economies of Southeast Asia given the long history of free flows of people, goods and information in the region and between Malaysia and Indonesia in particular. Since cross-border trade agreements between the two neighbouring countries had existed since 1967 and revised in 2003, the aim of this paper is to analyse the impact of trade institutional regulation and facilitation on cross-border trades in Dumai, a port town in the Indonesian Province of Riau.

Methodology

Description of Study Area: Dumai's geo-demographic profile, its trade policies and port provide the contextual account. Dumai City is located strategically on the east coast of Sumatra, is an important trading port, located in *Kabupaten* (district) Bengkalis in Riau Province. Dumai as a strategic port gateway for trading also serves as a key oil terminal and palm oil terminal, reflecting the major industries present, whilst the majority of the people work in the traditional agriculture and fishing activities. Although its population is relatively small, registering having a small population (215,789 in 2008), its growth has been rapid after the decentralization process of district autonomy [19].

Wider trade regulation policies that have bearing on Dumai are primarily based on free duty cross-border agreement and import restriction. Cross-Border Trade Agreement (CBTA) was initiated in 1967 and later revised as Border Trade Agreement (BTA,1970). The BTA Agreement was later consolidated with PMK No. 89/PMK 04/2007(i.e.Finance Minister Rules*)* with the intent on reducing the gap between border regions [19] by increasing the participation in peoples' economy through access to external market via cross-border trade. Cross-border trades for all goods between the border region of Riau and Peninsular Malaysia were given free duty amounting to RM6000 and below for a single day transaction [19].

The complementarities of goods between the border regions in terms of production of raw materials in Riau proper and the semi-finished goods in the Peninsular Malaysia proper and the socio-economic interdependencies of both border communities facilitate cross-border trade. The import restriction is constructed as a specialization policy spelt out in the Trade Minister Decree No. 56/2008 [19]. The declaration of Dumai city as a specialty zone dealing in food and beverage has restricted the range of goods imported, although it can trade in any range of goods at free duty for goods below RM6000. The idea of Dumai as a Special Economic Area came to fruition and has impacted its potential as a trading gateway. The central government has all along been skeptical from a national security perspective in managing the sea front in Dumai and its neighbouring ports. Besides that, Dumai and its border region are viewed as potential sites for specialization in agriculture, in view of limited industrialization process within the region.

Cross-border trades entail the utilisation of trading ports as their infrastructure. Dumai is linked to many sea ports within the Riau Province as well as Peninsular Malaysia. Besides Dumai, other ports that links Riau's border region to neigbouring Peninsular Malaysia are: Selat Panjang,Bengkalis, Senaboi and Pulau Rupat. Meanwhile, ports that link Peninsular Malaysia's central and southern border region to Riau are Kuala Linggi (Melaka), Sg. Rambai (Melaka), Tanjong Beruas (Melaka), Muar (Johor), Port Dickson (Negeri Sembilan) and Port Klang (Selangor).

Data Collection and Analysis: Primary data were collected through key informant interviews of government officials, trade representatives and cross-border traders during two field studies in Dumai and Pekan Baru. The first field study of March 2009 was conducted in Pekan Baru and Dumai and the second November 2009 in Dumai. The interviews were conducted after a round-table discussion with the respective key informants. Besides that, relevant secondary literature and documents were obtained and examined. Narrative data from the interview sources were analyzed qualitatively based on their bearing on the impacts of cross-border trades.

RESULTS AND DISCUSSION

Institutional Regulation Impact

Impact of Tariff Policy: The tariff policy was for all goods to be given free duty amounting to RM6000 and below for a single day transaction. At inception, this trade tariff policy had enabled substantial numbers of local small-scale traders to engage in the trading of a wide range of products. Dumai had immense opportunities to trade its rich fisheries and agricultural products for the processed goods of neighboring Peninsular Malaysia. This complementarity appeared to benefit the small traders. The Riau traders dealt in fish, fruits, textiles and crafts while their Malaysian counterparts dealt in canned food, confectionary items, bottled drinks, modern furnitures, carpets etc.

However, the positive impact of tariff policy on local small traders was short-lived when outside traders with larger capital entered the fray. Cursory evidence suggests that illegal trade and smuggling were rampant in the border areas. Long coastline, the open nature of the borders and the functioning of small ports dotting the border lines had rendered Dumai and its proximate borders susceptible to illegal cross-border trades. Malaysian products that came into Indonesia illegally via Dumai were primarily sugar, diesel oil, gas tanks, rethread tyres, motor vehicles etc. Dumai's easy access and the roro (roll-in roll-out) facility at nearby ports such as Pulau Rupat, which is located closer to Melaka coastline, had enhanced the flow of illegal items, mainly controlled by outside traders.

Meanwhile Indonesian products that 'dive' (i.e. selam representing the connotation of illegal underwater trade) into the Peninsular Malaysia waters were mainly items such as petrol oil, timber, cigarettes, textiles and coal. Although the free trade arrangements facilitate cross-border trade, its positive impact on local communities and peoples economy is limited. For example, fish items such as *tenggeri*, *senagi*, *siakap* and tiger prawns were traded by coastal fishermen via middlemen 'taukeh' who then engaged in cross-border trade with their Malaysian counterparts. The 'taukeh' controlled the prices as they bought in bulk and extended credits. Besides that the utilization of technology in handling perishable items gave them an added edge. As such the local fishing communities were unable to engage in cross-border trade in a profitable manner.

To be sure, the agricultural products traded in Dumai were not locally produced, as the soil was not suitable for vegetable and fruits in large farms growing. Instead, they were brought in by middlemen distributors cum traders from the hinterland hill resorts of Bukit Tinggi in West Sumatra and Beras Tagi in Central Sumatra. Thus although local trading and market spaces were open to all the participation of local community in these trading networks was limited due to their inability to compete with outside traders who enjoyed advantaged position in the trade links.

In other words, although the free trade tariff policy was meant to encourage the participation of the local communities in cross-border trades, enforcement weaknesses had led to 'leakages' in the system and the locals being sidelined. The locals were simply no match to the outsiders' capitalist prowess.

Impact of Restriction: There were two forms of restriction with regard to Dumai's border trades: a) trade quota of RM6000 transaction per day and b) limitation of imports to food and beverage items. The rationale for these restrictions was that they were in line with the central state's policy of regional specialization whereby Riau was to specialize in agricultural produce and Dumai was to function as the gateway port for this produce.

It was found that foreign traders were not abiding by these restrictions. These were well-endowed capitalists with established trade networks, sophisticated technology and exchange mechanism who had little problem in exceeding either the quota or the import item stipulations. This was in stark contrast to the locals who were just small time traders trading for daily survival and very ill equipped to pose any worthwhile challenge to the outsiders.

The rationalisation for the transgression of the trading quota was based on the argument that the restriction was a biased one. It was perceived at the local level as the central state's device to systematically contain the growth of Dumai's prosperity.

Institutional Facilitation Impact

Impact of Logistics: To improve logistical services, it was envisaged that a one stop centre in Dumai Port was necessary. This one-stop centre would be equipped with refrigeration facilities and logistical services for goods processing. The Agribusiness Terminal was built in 2008, but the study found that it had yet to operationalize. The non-operation of the one stop centre was due to the limited volume of trade for traders to engage in, a situation viewed at the local level as a direct consequence of the restrictive quota imposed by the central state on Dumai's cross-border trade.

Impact of Procedures: The central government had the regulatory powers over matters concerning financial policy in both monetary and fiscal matters as well as in international trade and commerce. The power of local authorities such as Dumai City was confined to domestic trade matters and did not extend to international trade which was the primary concern of cross-border trade. As such how the central state and local state coordinate the institutional regulation and facilitation process matters in influencing cross-border trade.

It was common for the state to engage in a multi-level intra-regional and inter-regional trade management. The emerging literature on transnational networks and multi-level governance is suggestive of this trend [20],[21]. Indonesia, however, with its large archipelago, had chosen to manage its domestic regional affairs in its own way. Questions arose, therefore, as to whether the state was really encouraging fair trade and not merely paying lip service to it. This was because the central state's restriction mechanism had the effect of nullifying the benefits of its facilitation mechanism. This effect was felt at the local level. As such, the local government faced the tough task of convincing the central state of this contradiction and the imperative of harmonizing the apparently conflicting mechanisms.

CONCLUSION

The evidence from Dumai points to the fact that the positive benefits of free trade institutional regulation was not realised by the local communities due to the prevalence of illegal activities by big time outside traders. Enforcement was the basic problem but this was mainly the result of conflicting restriction and facilitation mechanisms devised by the Indonesian central state itself. On the one hand, the central state enacted a duty free policy to turn Dumai into a hub of free trade which went well with the liberalization and globalisation argument. On the other hand, it imposed regulatory restrictions (i.e. quotas, product limits for ports) that went against the very spirit of liberalization and globalisation.

The unfortunate consequence of this contradiction was the sidelining of the local communities, the very stakeholders whom the central state intended to be the ultimate beneficiaries of Dumai's cross border trades.

It is apparent from the Dumai experience that the argument for free trade or opening up trade borders in compliance with the globalization imperative is a false one. For in reality, the central state was not hollowing out with this process of liberalisation and globalization. At the same time the porosity of border regions would generate openings for illegal trades that could easily sideline local players and stifle local economy.

The challenge for emerging economies, therefore, is to recognize the complexities of cross border trade governance and take steps to ameliorate the impacts of rigid structures on the local context and conditions, strategize their potential strengths and exploit the opportunities that come across borders.

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