

THE POLITICAL ECONOMY OF TRADE POLICY OF
INDONESIA AND TURKEY TOWARDS MUSLIM
COUNTRIES IN THE OIC

BY

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ABSTRACT

Despite the fast-growing literature on the political economy over the last three decades, several important issues remain under-examined. This thesis addresses three substantive issues concerning the roles of democratic and non-democratic institutions in the economy. First, this thesis aims to examine the trade intensity of Indonesia and Turkey with OIC member countries. Second, the thesis aims to examine the changing specialization and comparative advantage of Indonesia's and Turkey's bilateral trade with their trading partners. Third, this research aims to examine the effect of democracy, governance, openness, FTAs, and RTAs on Indonesia's and Turkey's bilateral trade with OIC member countries. In terms of three substantive issues of examination, the results show that Turkey has higher trade intensity with OIC member countries than Indonesia on both overall OIC and individual. The average value of Indonesia's Trade Intensity Index with overall OIC countries from 2001 until 2018 was more than 1 but has a decreasing trend throughout observation. Note that, if Trade Intensity Index more than 1, it indicates that, Indonesia's trade intensity with OIC countries is greater than would be expected, given their importance in world trade. Meanwhile, Turkey's trade intensity is even much higher than Indonesia's. Since the average value of Turkey's Trade Intensity Index with OIC countries from 2001 until 2018 was more than 2. Turkey's trade intensity with OIC countries has an increasing trend but continues to decline for the last four years. In specialization and comparative advantage, Indonesia and Turkey were able to maintain their export of primary products and unskilled-labor intensive products between three points of decades in 1996, 2006 and 2016. Meanwhile, Turkey is more concerned to increase its technology-intensive products than Indonesia. As for the trade determinants examination of Indonesia's and Turkey's trade toward OIC countries, the examination results are as follows. In the Indonesian case and Turkey case, most trade determinants on both Indonesia and Turkey are insignificant. In contrast, most of determinants on OIC's partners have significant effects namely democracy, governance, openness, and trade agreements. In detail, the democracy of OIC partners has a positive and significant effect. Furthermore, voice and accountability, political stability, government effectiveness, and control of corruption have a positive and significant effect on bilateral export. Meanwhile, the rest of the two indicators, such as regulation quality and rule of law have a negative and significant effect on bilateral export. Finally, joint membership in the same Free Trade Agreements and Regional Trade Agreements in both-side have positive and significant effect on bilateral trade flow. Since joint membership is effective, then this might result in trade creation inside trade block and increase bilateral export flow. Nevertheless, if there is only one country joins Free Trade Agreements and Regional Trade Agreements, then there is no trade diversion from Indonesia and Turkey or their OIC partners toward other countries outside their trading bloc. Therefore, there is no significant effect to increase or decrease Turkey's exports to the OIC countries. In brief, for the Indonesian and Turkey case, some results were in line with the hypothesis. In conclusion, Indonesia and Turkey need to maintain their trade intensity to OIC countries and keep with the trade intensity index, which recently is relatively high. Indonesia and Turkey need to focus on technological deepening in production and exports. Finally, trade policies such as Free Trade Agreements and Regional Trade Agreements are still relevant as modern trade policies. OIC countries' democracy and governance are effective as a part of trade policy. Therefore, the level of democracy and governance quality has to be enhanced to increase the bilateral export of Indonesia and Turkey toward OIC countries.

Keywords: trade intensity, specialization, comparative advantage, gravity model, RTA, FTA

خلاصة البحث

على الرغم من الأدبيات سريعة النمو حول الاقتصاد السياسي على مدى العقود الثلاثة الماضية، لا تزال العديد من القضايا المهمة على قيد الدراسة. تتناول هذه الأطروحة ثلاث قضايا جوهرية تتعلق بأدوار المؤسسات الديمقراطية وغير الديمقراطية في الاقتصاد. أولاً، تهدف هذه الأطروحة إلى دراسة كثافة التجارة بين إندونيسيا وتركيا مع الدول الأعضاء في منظمة التعاون الإسلامي. ثانياً، تهدف الأطروحة إلى دراسة التخصص المتغير والميزة النسبية للتجارة الثنائية بين إندونيسيا وتركيا مع شركائهم التجاريين. ثالثاً، يهدف هذا البحث إلى دراسة آثار الديمقراطية والحوكمة والانفتاح واتفاقيات التجارة الحرة واتفاقيات التجارة الإقليمية على التجارة الثنائية بين إندونيسيا وتركيا مع الدول الأعضاء في منظمة التعاون الإسلامي. فيما يتعلق بثلاث قضايا موضوعية للفحص، تظهر النتائج أن تركيا لديها كثافة تجارية أعلى مع الدول الأعضاء في منظمة المؤتمر الإسلامي من إندونيسيا في كل من منظمة التعاون الإسلامي والأفراد. كان متوسط قيمة مؤشر كثافة التجارة الإندونيسية مع دول منظمة التعاون الإسلامي بشكل عام من عام ٢٠٠١م حتى عام ٢٠١٨م أكثر من ١ ولكن كان هناك اتجاه تنازلي خلال فترة المراقبة. ولوحظ أنه إذا كان مؤشر كثافة التجارة أكثر من ١، فهذا يشير إلى أن كثافة تجارة إندونيسيا مع دول منظمة التعاون الإسلامي أكبر مما هو متوقع، نظرًا لأهميتها في التجارة العالمية. وفي الوقت نفسه، فإن كثافة التجارة في تركيا أعلى بكثير من إندونيسيا. نظرًا لأن متوسط قيمة مؤشر كثافة التجارة التركية مع دول منظمة التعاون الإسلامي من عام ٢٠٠١م حتى عام ٢٠١٨م كان أكثر من ٢، فزادت كثافة تجارة تركيا مع دول منظمة التعاون الإسلامي في اتجاه متزايد ولكنها استمرت في الانخفاض على مدار السنوات الأربع الماضية. أما في التخصص والميزة النسبية، فتمكنت إندونيسيا وتركيا من الحفاظ على صادراتهما على المنتجات الأولية والمنتجات كثيفة العمالة غير الماهرة بين ثلاث نقاط من العقود في ١٩٩٦م و ٢٠٠٦م و ٢٠١٦م. والوقت نفسه، تهتم تركيا بزيادة منتجاتها بكثافة التكنولوجيا أكثر من إندونيسيا. أما بالنسبة لفحص محددات التجارة لتجارة إندونيسيا وتركيا تجاه دول منظمة المؤتمر الإسلامي، فإن نتائج الفحص هي كما يلي: في

حالة إندونيسيا وتركيا، فإن معظم محددات التجارة في كل من إندونيسيا وتركيا غير ذات أهمية. في المقابل، فإن معظم المحددات على شركاء منظمة التعاون الإسلامي لها آثار كبيرة وهي الديمقراطية والحوكمة والانفتاح والاتفاقيات التجارية. بالتفصيل، فإن ديمقراطية شركاء منظمة التعاون الإسلامي لها تأثير إيجابي وهام. علاوة على ذلك، فإن الصوت والمساءلة، والاستقرار السياسي، وفعالية الحكومة، والسيطرة على الفساد لها آثار إيجابية وهامة على الصادرات الثنائية. في حين أن للمؤشرين الآخرين، مثل تنظيم الجودة وسيادة القانون، تأثير سلبي وهام على الصادرات الثنائية. أخيراً، فإن العضوية المشتركة في نفس اتفاقيات التجارة الحرة واتفاقيات التجارة الإقليمية في كلا الجانبين لها تأثير إيجابي وهام على تدفق التجارة الثنائية. بما أن العضوية المشتركة فعالة، فقد يؤدي ذلك إلى إنشاء التجارة داخل الكتلة التجارية، وزيادة تدفق الصادرات الثنائية. ومع ذلك، إذا كان هناك بلد واحد فقط ينضم إلى اتفاقيات التجارة الحرة واتفاقيات التجارة الإقليمية، فلن يكون هناك أي تحويل للتجارة من إندونيسيا وتركيا أو شركائهم في منظمة التعاون الإسلامي نحو دول أخرى خارج تكتلهم التجاري. لذلك، لا يوجد تأثير كبير لزيادة أو تقليل صادرات تركيا إلى دول منظمة التعاون الإسلامي. باختصار، بالنسبة للحالة الإندونيسية وحالة تركيا، فكانت بعض النتائج متوافقة مع الفرضية. في الختام، تحتاج إندونيسيا وتركيا إلى الحفاظ على كثافة تجارتهما مع دول منظمة التعاون الإسلامي ومواكبة مؤشر كثافة التجارة، والذي يعد مؤخرًا مرتفعًا نسبيًا. كما أن إندونيسيا وتركيا بحاجة إلى التركيز على التعميق التكنولوجي في الإنتاج والصادرات. أخيراً، لا تزال السياسات التجارية مثل اتفاقيات التجارة الحرة واتفاقيات التجارة الإقليمية ذات صلة كسياسات التجارة الحديثة. وتعتبر الديمقراطية والحوكمة في دول منظمة التعاون الإسلامي فعالة كجزء من السياسة التجارية. لذلك، يجب تحسين مستوى الديمقراطية وجودة الحكم لزيادة الصادرات الثنائية لإندونيسيا وتركيا تجاه دول منظمة التعاون الإسلامي.

الكلمات المفتاحية: كثافة التجارة، التخصص، الميزة النسبية، نموذج الجاذبية، هيئة الطرق والمواصلات، اتفاقية التجارة الحرة.

APPROVAL PAGE

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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LIST OF ABBREVIATIONS

AANZFTA	ASEAN-Australia-New Zealand Free Trade Area
AEC	African Economic Community
AFTA	ASEAN Free Trade Area
AMU	Arab Maghreb Union
ASEAN	Association of Southeast Asian Nations
BSEC	Black Sea Economic Cooperation
CAEU	Council of Arab Economic Unity
CAEDU	Central African Customs and Economic Union
CBI	Cross-Border Initiative
CIS	Commonwealth of Independent States
COMCEC	Committee for Economic and Commercial Cooperation of the OIC
COMESA	Common Market for Eastern and Southern Africa
DDR	Democracy-Dictatorship
EAEC	East Asian Economic Caucus
ECCAS	Economic Community of Central African States
ECO	Economic Cooperation Organization
ECOWAS	Economic Community of West African States
EFTA	Euro-Mediterranean Free Trade Agreement
ETA	Empirical Trade Analysis
FTA	Free Trade Agreement
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
IFS	International Financial Statistics
IMF	International Monetary Fund
IOC	Indian Ocean Commission
MEACs	Middle Eastern Asian Countries
MENA	Middle East and North Africa
MRU	Mano River Union
NELDA	National Elections across Democracy and Autocracy
OECD	Organisation for Economic Cooperation and Development
OIC	The Organization of the Islamic Cooperation
PC	per capita
PIV	Polity IV
PRETAS	The Protocol of Preferential Tariff Scheme
PWT	Penn World Table
RTA	Regional Trade Agreement
SAARC	South Asian Association for Regional Co-operation
SITC	Standard International Trade Classification
TPS-OIC	Trade Preferential System
UN	United Nations
UN Comtrade	United Nations Commodity Trade Statistics Database
WAEMU	West African Economic and Monetary Union
WDIs	World Development Indicators

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF STUDY

The importance of international trade in political economy studies cannot be overstated. Exchanges of goods and services between countries provide consumers with a wider array of choices and allow them to enjoy products that cannot be produced within the border of their own country or products that can be produced, but at higher prices. Exchanges of goods and services between countries also provide producers with more input options and allow them to sell their products beyond borders. This condition helps improve the utilization of resources not only to prevent wasteful duplications of production, but also to induce specialization, stimulating division of labor and enabling efficiency gains from economies of scale. In the longer term, international trade will help improve the methods of production and advance the standards of products. Exchanges of goods and services open the door of competition between producers in different countries and provide them with incentives to keep innovating to stay competitive.

The importance of international trade has been long acknowledged in Islam. Prophet Muhammad (P.B.U.H) and Makkah Qurayshites establish two great routes for their commercial caravans to Yemen in the south and to Syria in the north. They organize two enormous trading expeditions, one to Yemen in winter and the other to Syria in summer. It is mentioned in Surah 106 Quraysh Makkiyah, which consists of 4 verses revealed after Surah al-Tin “For the covenants (of security and safeguard enjoyed) by the Quraysh, their covenants (covering) journeys by winter and summer, let them adore the Lord of this House, who provides them with food against hunger,

and with security against fear (of danger)” (Yusuf Ali translation Surah 106 Quraysh verse 1-4). The Quraysh verse “encourages traders to undertake long trips,” based on tafsir al-Jalalayn, is translated by Hamza (2017). In gratitude for the security of Quraysh, their security (*ilāfi-him*) repeated for emphasis, it is a verbal noun from the verb *ālafa* (for the journey of winter) to Yemen (and) the journey (of summer) to Syria every year they made use of these two journeys to provide for their trade [*li l-tijarah*] at the station of Abraham in Mecca to attend to the House of God which was their source of pride; they Quraysh were descendants of al-Nadr b. Kināna; “...let them worship” (*fa’l-ya’budū*) is semantically connected to *li-ilaafi* “for the security” the *faa’* being extra (the Lord of this House, who has fed them against that is on account of hunger and made them secure from that is on account of fear, they used to suffer hunger in Makkah due to the lack of crops, and they feared the army of the Elephant - Tafsir al-Jalalayn (al-Mahalli 1459). In another tafsir (interpretation), the tafsir of *fi Zilal al-Qur’an*, the trade is the specific grace of which God reminds the Quraysh, as He reminded them of the Elephant incident in the previous *surah*. It is the grace of their being accustomed to the winter and summer trips, and the abundance with which He endowed them utilizing these two fruitful journeys. God says to them in effect: “For this tradition of the Quraysh, namely their winter and summer trips” (Verses 1-2). “Let them worship the Lord of this House, who provided them with food against hunger, and with security against fear” (Verses 3-4). As their land was infertile, they would have starved had it not been for the sustenance supplied by God. “And with security against fear.” Poor as they were, and living in insecure surroundings, their life would have been one of fear and apprehension. However, God granted them security and allayed their fear - *Tafsir fi Zilal al-Qur’an* (Quthb, 2015).

In Islam, trade has always been recognized as an important aspect of human life. Before revelation came to him, the Prophet Muhammad (P.B.U.H), himself earned his living as a trader. The Prophet Muhammad, before Islam, practiced trade in his caravans to Syria. He used Byzantine (a foreign currency) and applied Zakāh to it. The practice of Prophet in using foreign currency evidenced that Islam encouraged to trade international trade. Prophet Muhammad (P.B.U.H) also endorsed trade with non-Muslim, prophet added “*innama al-‘ushur ‘al-yahudwa al-nasarawalaysa’ala al muslimin ‘ushur*” meaning “*Thithe or one-tenth of something is on Christians and Jewish*” (Hadith narrated by Ahmad and Abu Dawud). The imposition of Anshor indicated the Islam legitimacy of trade with non-Muslim. The support of trade with non-Muslim is reflected in Prophet’s utterance. Another justification of international trade in hadith is that Prophet Muhammad (P.B.U.H) said: “The importer (of an essential commodity) into the town will be fed (by Allah), “...the merchant who sells at a low price is prosperous, and the monopolized is cursed” - *al-Jalib Marzuq wa l-muhtakirmal’un* (Ibn Majah, 1938).

This research is making Islamic territories a priority. This is intended so that fellow Islamic regions can realize economic independence for the Muslims and reduce the *Qibla* or setting the direction to the economic system of non-Muslims. Indonesia and Turkey are well still implementing this because both are under the organization of the Islamic Cooperation Organization (OIC). This research draws attention to the case of the Organization of Islamic Cooperation (OIC). The Organization of Islamic Cooperation (OIC) was established on 22-25 September 1969 in Rabat, Morocco, after pioneers of various Islamic nations concurred on the Rabat Declaration. OIC attested faith in Islam, regard for the UN Charter, and human rights. The development of the OIC was at first determined by the worries of the Islamic fellowship

relationship of Islamic nations to answer different issues looked by Muslims, particularly after the Zionist component consumed a piece of the Holy Al-Aqsa Mosque on 21 August in 1969. The arrangement of the OIC was planned for expanding Islamic solidarity among member nations, organizing participation between member nations, supporting global harmony and security, and ensuring Islamic heavenly places and helping the battle for the foundation of an autonomous and sovereign Palestinian state. The OIC now has 57 Muslim nations or a more significant part of the Muslim populace in the Asia and Africa locale.

As a global association that initially emphasized more on political issues, especially the Palestinian issue, the OIC is now transformed into an international organization that became a forum for cooperation in various political, economic, social, cultural, and scientific fields among Muslim countries in the whole world. To answer the various challenges that have surfaced, OIC member countries see the revitalization of the OIC as an urgent problem. The enthusiasm and support for the need for revitalization of the OIC were motivated by the fact that the structure and performance of the OIC organization were deemed inefficient and ineffective. In this connection, a series of meetings were held, which successfully reviewed and finalized the OIC restructuring TOR prepared by Malaysia. At the 10th meeting of the Heads of State/Government (KTT) in Putrajaya, Malaysia, on 11-17 October 2003, the OIC agreed to initiate concrete efforts in restructuring the OIC Secretariat, primarily on four aspects, namely streamlining structures, methodologies, increasing financial capacity and human resources. The 3rd Extraordinary OIC Summit in Mecca, Saudi Arabia, on 7-8 December 2005 accommodated this desire as outlined in the form of the Mecca Declaration and the OIC 10-years Program of Actions which included the restructuring and reformation of the OIC, as well as the formulation of the new OIC Statute expected to be implemented before 2015.