

The Impact of CAFTA Agreement on Trade, Challenge and Opportunities

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Abstract

Main CAFTA (China ASEAN Free Trade area) has been started on 1 January 2010. The full CAFTA will be realized in 2015. It has political and economical motives. The free trade area is the world largest in term of population and the third largest in term of GDP (Gross Domestic Product). This paper discusses the theoretical and possible impact of CAFTA on trade particularly in Indonesia. Some products will be exported and imported more. This will increase production of some products and decrease production of some other products. The final benefit results will be depended on the readiness of the country. Therefore there are suggestions to dig more benefit and to prevent losses. The promotion of some product, the protection of domestic production and increase the competitiveness of the country should be done.

A. Introduction

Association of South East Asian Nations (ASEAN)- China Free Trade Agreement is signed on November 6th, 2001. On that day, both parties at the annual summit agreed to undertake an unprecedented initiative aimed at establishing a bilateral free trade area in 2010. In short the free trade area is called ACFTA (ASEAN China Free Trade Area) or CAFTA (China ASEAN free Trade Area). Starting on January 1th, 2010 CAFTA has been realized especially for ASEAN-6 (Indonesia, Singapore, Thailand, Malaysia, Brunei Darussalam and Philippines). The other new members called CMLV (Cambodia, Myanmar, Laos and Vietnam) will be realized in 2015. The free trade area created by this initiative will have 1.7 billion customers and a combined gross domestic product (GDP) of approximately

US\$6 trillion in 2008. The free trade area becomes the world largest in term of population and third largest in the world in term of GDP after EU (European Union) and NAFTA (North America Free Trade Area) (Bello, 2010).

China's motivations in offering ACFTA are both political and economic. Politically, China wishes to remain on friendly terms with its neighbors on its southern front. ACFTA is part of confidence building that includes China's participation in the ASEAN Regional Forum and China's accession to the ASEAN Treaty of Amity. ACFTA is to allay ASEAN concerns that China poses a threat with its economic ascendancy by providing preferential access to its rapidly growing domestic market. China is also eyeing the ASEAN region for its various natural resources, especially oil and its market of 560 million consumers. Closer economic relations with ASEAN will enable China to build its geopolitical clout in Southeast Asia and counterbalance the influences of Japan and US. The swift progress of ACFTA

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has hastened Japan as well as the US, South Korea and India to propose economic cooperation arrangements with ASEAN as well ASEAN governments welcomed the China initiative for a number of reasons. First, China is a huge and dynamic economy and its growing demand for ASEAN goods and services could serve as a new engine of growth. Chinese tourists are already a key factor in the growth of tourism in the region. ASEAN also looks to more Chinese investments as well. China's WTO entry will also mean a trading partnership based on international rules and discipline. Closer ASEAN-China economic ties will also enable ASEAN to reduce dependence on the US, EU and Japan. Second, China's offer of special treatment and development assistance for the CLMV group as well as the extension of WTO most-favoured-nation benefits to the non-WTO members of ASEAN have helped them to accept the China initiative more readily. Third, China and ASEAN will be able to go further than the WTO in liberalizing agricultural

trade, as China's temperate agriculture and ASEAN's tropical agriculture are complementary in many product areas. Thailand, in particular, looks to accelerating agricultural exports to China. Nonetheless there are continuing concerns over the impact of preferential opening of ASEAN markets, as many ASEAN labour intensive manufactures will not be able to compete with China on price.²

Interesting to know what are the impacts of the latest agreement especially on trade in Indonesia. This paper is to explore the possible impacts on trade, challenges and opportunities.

B. Conceptual framework

It is common that international trade has barrier either tariff barriers or non-tariff barriers to trade. The free trade agreements basically want to change gradually from protected international trade to free trade by decreasing the barrier. Theoretically this change can be described by graph as follow.

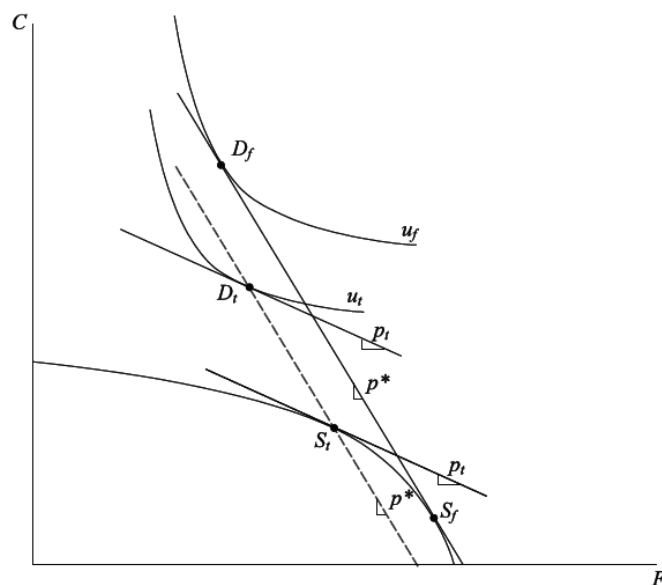


Figure: Graph of the impact of trade liberalization on trade, production and consumption.

² Yue, Chia Siow, "ASEAN-China Free Trade Area," in Paper for presentation at the AEP Conference, (Hong Kong: 2004).

It is assumed that here are two goods, F (food) and C (cloth). P^* is the price ratio under world price, p_t is price ratio under domestic price with tariff (barrier to trade). Under world price, the country stay at product possibility curve (ppc) at S_p , which the price ratio line tangent to the ppc at S_f . under tariff regime, the price ratio (p_t) tangent to ppc at S_t . under CAFTA agreement assumed the price ratio is p_f and before CAFTA assumed the price ratio is p_t . After CAFTA, the country produces F more and less C.

Under the CAFTA the country consume at D_p , where indifferent curve u_f tangent to price ratio line p^* . under tariff regime (before CAFTA), the consumption is at D_t , where the indifferent curve u_t tangent to price ratio line p_t . the total consumption of product after CAFTA (F +C) is greater than it before CAFTA, as a result the welfare is greater ($u_f > u_t$)

After CAFTA, The country export F more and import C more, as a result the trade increase. But the domestic production of F increase and the production of C decrease. This consequences must be understood when decide the CAFTA agreement.

So there are two kind of goods, exported goods and imported ones. Generally, exported goods will be exported more and imported goods will be imported more. The increase exported goods will increase domestic production. The increase imported goods will compete with goods produced domestically so called import substitution goods. These products will decrease. The total production will increase and the total consumption will increase. The trade between ASEAN and China will increase. These will promote economic growth and welfare in the two parties, ASEAN and China countries.

Although they can have advantageous, but there are problems or disadvantages. For the whole ASEAN, how much the advantageous and disadvantages are, can the advantageous exceed the disadvantages? The problem of each ASEAN countries like Indonesia is that can we (Indonesia) can compete with other ASEAN countries to take the opportunity of increase in trade. The other problem is that the domestic import substitution goods producers will suffer. This change will influence domestic economy

The further discussion, the benefit and problems of the CAFTA agreement on ASEAN countries are not mentioned. It is concentrated on those related in Indonesia side.

C. Trade between Indonesia and China

The trade between Indonesia and China has been increasing. The trade increased from 2004 to 2008, but then declined in 2009 due to global financial crisis. That is true for both export and import. In the earlier year Indonesia earned trade surplus, where the value of exported goods exceeded the imported value. It can be seen on the table that from 2004- 2007 Indonesia enjoyed trade balance surplus, while in the succeeded years, 2008 and 2009 Indonesia had deficit. It can be seen that for non-migas (non oil goods) it worse. It was only in 2004 the trade balance was surplus, while in the succeeded years, 2005-2008 they suffer deficit trade balance. For further details, see table 1 below. The rate of increase in export (24.95%) was lower than that in import (35.09%).

Table 1. Trade Balance INDONESIA- RRC years 2004-2009 (thousand US \$)

Item	2004	2005	2006	2007	2008	TREND (%)		Jan-Dec		CHANGE (%) 2009/ 2008
						2004- 2008	2008	2009		
TOTAL TRADE	8.706.064,2	12.505.216,3	14.980.466,4	18.233.389,8	26.883.672,6	30,11	26.883.672,6	25.501.497,8	-5,14	
Oil & Gas	1.910.341,8	3.994.183,4	4.011.873,8	3.612.035,6	4.148.600,9	15,61	4.148.600,9	3.090.052,24	-25,52	
Non Oil & Gas	6.795.722,4	8.511.032,9	10.968.592,6	14.621.354,3	22.735.071,7	34,40	22.735.071,7	22.411.445,5	-1,42	
EXPORT	4.604.733,1	6.662.353,8	8.343.571,3	9.675.512,7	11.636.503,7	24,95	11.636.503,7	11.499.327,3	-1,18	
Oil & Gas	1.167.306,4	2.702.591,2	2.876.961,3	3.011.412,8	3.849.335,3	28,33	3.849.335,3	2.579.242,8	-33,00	
Non Oil & Gas	3.437.426,7	3.959.762,6	5.466.610,0	6.664.099,9	7.787.168,4	24,06	7.787.168,4	8.920.084,4	14,55	
IMPORT	4.101.331,1	5.842.862,5	6.636.895,1	8.557.877,1	15.247.168,9	35,09	15.247.168,9	14.002.170,5	-8,17	
Oil & Gas	743.035,4	1.291.592,2	1.134.912,5	600.622,7	299.265,6	-22,78	299.265,6	510.809,4	70,69	
Non Oil & Gas	3.358.295,7	4.551.270,3	5.501.982,6	7.957.254,4	14.947.903,3	42,55	14.947.903,3	13.491.361,1	-9,74	
TRADE BALANCE	503.402,0	819.491,3	1.706.676,2	1.117.635,6	-3.610.665,2	0,00	-3.610.665,2	-2.502.843,2	-30,68	
Oil & Gas	424.271,1	1.410.998,9	1.742.048,8	2.410.790,1	3.550.069,7	61,35	3.550.069,7	2.068.433,4	-41,74	
Non Oil & Gas	79.130,9	-591.507,7	-35.372,5	-1.293.154,5	-7.160.734,9	0,00	-7.160.734,9	-4.571.276,6	-36,16	

Source: Badan Pusat Statistik (processed by Pusdata Ministry of Trade)

This table indicates that the domestic productions are not competitive and the competitiveness has been declining. It is understood that this happened. The Republic of China takes very seriously when it entered to be a member of WTO (World Trade Organization) in 2001. It prepared to provide better infrastructure and business environment, such as technology, finance, energy, industry zoning, etc. to make any industries become more competitive. This was followed by entering the CAFTA, China was well prepared and ready for competition with ASEAN countries, while Indonesia did not prepare seriously. People said that Indonesia thought business as usual. Whether or not joining the CAFTA and WTO business as usual, there were no special efforts to enhance the competitiveness of the industry.

There is another explanation,

why the trade balance declined. It was because there were illegal imports. But this is not to change the conclusion that the competitiveness declined, since the CAFTA means minimum (0-5%) tariff or liberalization. In that situation, illegal import is not relevant anymore. If Indonesia does not take care of this development, Indonesia might not be able to compete with China and other ASEAN countries. Therefore special efforts must be given to increase the competitiveness of the industries.

In the future, export to and import from China will increase. Export of oil will increase higher than non-oil export. Import of non-oil will increase higher than those of oil import. Domestic ally non-oil import substitution production will suffer more compared the oil products.

1. Exported goods

Exported goods that have been exported to China before 2010 will have opportunities to enjoy acceleration as long as they can maintain the competitiveness with similar products from China and other ASEAN countries. It is better if they can enhance the competitive advantage so the export increase will be faster. Those exported goods can be seen in the table below.

It can be seen from the table 2 above, that HS 15, HS 40, HS 47 and HS 26 are the biggest 4 export goods. Their trends were increasing significantly. It is expected

2. Potential Export to China

The potential exported goods to china are the existing exported goods especially those have high value. As mentioned in the table palm oil (and its derivative products) and rubber products are among main exported products. Other exported goods which had small value can be developed if the supply is big enough, like sweet snake fruit (salak pondoh). Other potential products are exported products which were exported products to other countries. The main exported products such as HS 15, HS 27, HS 85, HS 40, HS 84, HS 26, HS48, HS62, HS87, HS44,

Table 2. The value of export from Indonesia to China (million US\$), 2004-2008

No	HS	2004	2005	2006	2007	2008
1	15	588,3	673,1	1043,2	1.520,6	2.119,1
2	40	252,1	340,9	689,4	762,1	901,2
3	47	262,8	380,5	553,0	510,9	742,3
4	26	67,1	165,1	304,1	613,1	649,2
5	29	564,2	569,8	557,2	549,9	335,1
6	74	117,4	229,5	352,7	330,2	315,5
7	85	190,9	145,7	180,9	217,9	279,1
8	84	126,7	154,2	202,8	276,6	255,7
9	48	200,0	173,7	200,4	194,9	195,1
10	44	332,7	279,2	254,1	194,7	157,9

Source: Processed from Central Agency for Statistic (2009)

that after CAFTA those commodities are promising. Among big ten export goods, there were two goods decreasing, they were HS 29 and HS 44

The more details but rough commodities are provided by China Attaché for trade (2009) as follows.

HS61, HS74, HS39, HS94 can be directed to China.³

³ Masyhuri, "Dampak CAFTA Terhadap Perdagangan, Implikasinya Terhadap Ketenagaan Kerja di Indonesia" in Papers at the Interactive Discussion at the Ministry of Employment and Transmigration, (Jakarta: Indonesia, 2010)

Table 3: Exported products to China in 4 digits of HS.

HS	Product	2006	2007	2008
1511	Palm oil & its fractions, etc	713,23	996,76	1439,93
4001	Natural rubber etc	680,37	650,81	751,88
4703	Chemical wood pulp etc		623,05	621,92
2601	Iron ores etc		285,96	540,59
8542	Electronic int. circuits etc		297,78	237,54
8529	Parts for TV, radio etc		172,52	135,42
2905	Acyclic alcohol etc		134,97	127,37
8541	Semiconductor devices			83,52
8471	Atom data proc machines etc		516,25	364,04
2902	Cyclic hydrocarbon		304,48	147,98
8443	Print mach etc			142,04
HS	Product	2006	2007	
2902	Cyclic hydrocarbon		304,48	
2603	Copper ores & concentrates		200,90	
2917	Poly carboxylic Acid & anhyd etc, halogen, sulfur etc		171,82	
8473	Parts etc for typewriter& other office machines		79,56	
8708	Parts & access for motor vehicle, head		64,23	

Source: Attaché Trade in China (2009).

3. *Imported goods*

Goods that have been imported from China before the CAFTA was realized have potentially to increase further. Those imported products can compete with the similar products that produced domestically. This new direction makes the production will decrease and some production may decrease to zero or bankrupt. If this is happened, unemployment will raise. These products can be seen in the table below.

It can be seen that the imports for all of big ten import goods (HS 84, HS 85, HS 72, HS 73, HS 29, HS 28, HS 39, HS 31, HS 52, HS 08) were increasing. It indicates that exporting industries in China perform well.

The further but rough details in 4 digit HS can be seen table 5 below.

4. *Potential imported products from China*

The above products have potential increase in import. Besides, imported goods

in small number but has potential to increase. They are batik, cloths and other textile products. Further more, there are products which were imported goods from other than China, but have potential to be imported from China. They are HS84, HS85, HS72, HS87, HS29, HS39, HS73, HS31, HS10, HS 88.⁴

5. *Direct competition*

There are other products which were exported to China in great amount but also imported from China in great amount either. The example of the products are HS 8443, HS 8529. Further direction can be influenced by the competitive advantage of each country.

D. *What should be done?*

To meet the opportunity and cope the challenge and problems, the government should have protection and promotion strategies, and to increase the competitiveness of the industry in the country

Table 4. The Value of import goods from China, 2004-2008 (million US\$)

No	HS	2004	2005	2006	2007	2008
1	84	549,6	903,7	1.002,3	1.503,8	3.394,2
2	85	425,6	518,0	619,9	1255,0	3281,0
3	72	340,8	573,9	559,2	858,2	1026,2
4	73	85,6	284,3	229,1	366,3	872,9
5	29	182,4	218,6	266,2	371,6	511,5
6	28	154,7	221,8	222,6	269,8	466,6
7	39	89,0	100,8	134,9	182,5	335,2
8	31	58,3	80,8	114,9	106,5	323,2
9	52	72,2	76,0	84,5	86,4	299,6
10	08	85,2	98,9	161,4	225,4	248,0

Source: Processed from Central Agency for Statistic (2009).

⁴ *Ibid.*

Table 5: imported products from China.

HS	Product	2006	2007
8517	Electric. app. for line telephone etc	94,58	669,63
8443	Print mach etc		174,64
7208	Flat-rolled product of iron etc		153,01
9013	Liquid crystal devices etc		145,79
8708	Parts and access of motor vehicle etc		112,69
8544	Insulated wire etc		111,11
8481	Tape, cocks, valves for pipes etc		109,64
5407	Woven fabric etc	112,83	108,97
8473	Parts, etc for typewriter etc		95,06
8529	Parts for tv, radio etc		82,57
8521	Video recording etc		53,66

Source: Attaché of Trade in China (2009).

1. *Protection strategy*

The government should protect domestic production from China products for many ways. Legal non-tariff barriers should be applied such as halal certification, free from diseases, etc. Tariff still can be applied for special products (SP) because of strategic and labor intensive industries. It should be identified of those products, Safeguard Safety Mechanism (SSM) can be applied in case there are flood of import. If China implements illegal subsidy and dumping, the government must implement anti dumping and anti subsidy rules.

2. *Promotion strategy*

Subsidy must be given to strategic products, like green box and amber box of WTO. Infrastructure must be given as China government give such as irrigation, road, land conservation, modernization of market, good environment, etc. Export must be promoted.

To increase the competitiveness of the country, the government should implement the policy to enhance quality of human resource, modernization of machine and equipment, higher technology, strengthening institution, good

coordinating among economic sectors, financing, and well macro economic policy.

a. Human resource development

The majority of domestic businesses are small scale business run by low quality of human resource. To make better business there should be a training, empowerment and in-house training. Most of the product are not certified, therefore the government should give nationwide certification program.

b. Financial access

Most small scale businesses have limited access to financial source therefore there should be an effort to provide this access. The problem is that most banks need collateral to releasing the credit and most small scale businesses have limited collateral. The government should provide special financial institution to provide this access. There are many choices. Among others are venture modal model, small scale financial institution like in Bangladesh, cooperative, etc. Government have many program such as P4K (poverty alleviation program), LUEP (local government program), Dana Bergulir (circulated fund), KUR (credit for people), LKM (micro finance), but the success rate are still very low⁵.

c. Institutional strength

Business institution for small scale ones is still weak therefore it must be strengthened. Farmers group, business group, cooperatives are

weak and not permanent. There is a challenge to build strength such association.

d. Coordination among economic sectors

Institution in economic sector is still desperate. Since the local autonomous program lunched, the coordination between central government and local government were still under questioned. This situation led to high cost economy. There should be a good coordination between central and local government and among different sectors in the country.

e. Marketing system

Marketing system has not been efficient yet. This is because of lack of well infrastructure, asymmetric market information, imperfectness of market structure. Therefore an effort must be given for cope this problem.

f. Higher Technology adoption

In order to have high quality of product, technology must be updated to meet the requirement to consumers preference and international standard such as SPS, HACCP etc. this need a special effort especially for small scale business units.

g. Macroeconomic environment

Macroeconomic policy must be well managed to have competitive industry in the country. Macroeconomic policy includes fiscal and monetary policies. Fiscal policy include provide enough fund for better infrastructure, appropriate taxes (central and local taxes), while monetary policy include

⁵ Kompas September 11th, 2009

maintaining fair foreign exchange rate, and low interest rate.

E. Conclusion

CAFTA has been realized since 1 January 2010. Theoretically, it can improve economic growth and welfare in general. However there are potential to reduce some industries. There are opportunity and challenge. To optimize the free trade agreement, government should have policy to protect, promote and make the industries are more competitive otherwise the economy will suffer.

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