

## **CHAPTER IV BILATERAL TRADE RELATIONS BETWEEN INDONESIA AND CHINA POST RATIFICATION OF ACFTA**

In each agreement that has been agreed upon, there must be an impact caused by the outcome of the agreement. The ACFTA seems to give more benefits to the more ready and stronger state. In order to examine this case, this chapter would be divided into three subchapters. The first chapter will discuss implementing ACFTA and the impact on Indonesia economy. The following chapter subchapter will about the development of China trading to ACFTA Indonesia after implementation, and the last chapter chapter chapter will discuss China benefits toward Indonesia after implementation ACFTA.

### **A. The Implementation of ACFTA and the Impact Toward Indonesian Economy**

The advantages and challenges of the ACFTA for the Indonesian economy, especially when viewed from the trade balance between Indonesia and China during the period 2005 - 2010. The ACFTA agreement places several benefits, such as broader access to the Chinese market for Indonesian exporters. Another advantage of the agreement is that there are more different choices of goods at low prices in the local market. In addition to these benefits, the negative impact of the agreement is related to the industrial sector that needs attention. Domestic markets which are flooded with Chinese products with very competitive quality and prices will encourage domestic entrepreneurs to move from clothing manufacturers to importers of Chinese products.

In the study of international relations, the concept of free trade can also be assumed as an open trade or trade

between countries. To deal with the Asian China Free Trade Area (ACFTA), business people/producers and the Indonesian government made several efforts to build competitive advantages, including among others by increasing the competitiveness of product products and the government implementing protection policies on Indonesian industry products.

The ASEAN-China Free Trade Area (ACFTA) is an agreement between ASEAN member countries and China to create free trade areas by eliminating or reducing barriers to trade in goods both tariffs and non-tariffs, increasing service market access, investment regulations and provisions, as well as increasing aspects of economic cooperation. The cooperation agreement was signed in Phnom Penh, Cambodia, November 4, 2002, and was intended for the establishment of a free trade area in 2010, precisely January 1, 2010.

The economy agreement for Indonesia in the future will be more influenced by international economy relation. The economic and trading growth with China which has high growth and become the new power will strongly affect the Indonesia trading and investment. Those states start to heading as a state which has a comparative advantage in a particular product. Their product has entered to all state in this world, include Indonesia.

The financial trading of both states has some problem, such as the social economy and politic factor. The rapid China economy growth becomes the chance and challenge especially for Indonesia and another ASEAN state. The global financial crisis since the last year of 2008 which continued to 2009 caused many states experienced the reduction of economic growth. Moreover, also as we know that China growth in 2008 which registered only 8% or reduced compare to the previous year, which as big as 10%. China is the fifth export destination of Indonesia in International trade (WITS, 2014). The total bilateral trading volume of Indonesia and China until the beginning of 2008 reached US\$25,01 Billion, or exceed of US\$20 Billion, however at that period Indonesia registered

deficit as big as US\$210 million. From the investment, China has a contribution to 0,5% or still less than 1% of total foreign investment (foreign direct investment / FDI) every year in Indonesia.

International trade is one form of trade carried out by the people of countries in the world. Transactions carried out through international trade will have a positive impact on the economy of a country. Economic relations between countries include three forms of relations, including Exchange of results or output from a country with another country, or what we are familiar with international trade, Relations in the form of debt between countries, and Exchange or production flow or means of production.

International cooperation in the field of trade occurs because of several driving factors that require a country to establish cooperation in the trade sector. Because every country cannot fully meet the needs of its own country without the resources of other countries, it can be from natural resources, human resources, capital and in terms of technology.

Related with Free Trade, ACFTA agreement can also create a positive or negative impact. The positive impact is Increasing Chinese investment in Indonesia will be achieved because Indonesia has various advantages, including relatively good economic stability. Thus a relatively stable government, including social and political issues is quite conducive, which means that Indonesia's risk country continues to decline and other positive impacts, Indonesia has natural resources including abundant energy sources such as coal, oil and natural gas. Likewise, many human resources are relatively cheap. With these various opportunities, of course, Chinese investors will be interested in investing in Indonesia.

Moreover, the negative impact, Infrastructure to support and encourage increased investment in Indonesia is still inadequate. This infrastructure is related to soft infrastructures (soft infrastructure) such as services, business climate, communication, legal certainty, laws, and others.

Besides, there is hard infrastructure such as transportation facilities, communication facilities, ports, roads, and others. Some Central Governments and Regional Governments are still out of sync in taking policies regarding investment, including a large number of levies that will lead to high costs.

At the period of ACFTA, Indonesia and China would be face to face in the market, since the trade barriers are being reduced and eliminated. The preparation of each government would become a critical point in facing ACFTA. China government has an active role in support its enterprise, especially the small to medium enterprise. They launch some policy which effectively supports the SME, such as the infrastructure development and also the provision of good energy source. China also provides credit with low interest for the SME. The interest is only about 0-2% which is this thing could support and make China's SME feel more comfortable in looking for capital to run their production activity. China is also is known as the state with low-cost labor which could cut the production cost. Those things are well supported China's SME, and it possible China's SME to produce goods at low cost and have high competitiveness in the market because of its price and the product variety.

The realization of export-import from China to Indonesia before and after the signing ACFTA. Can be seen in Table V below:

*Table 4 4.1 The Realization of Export - Import from China to Indonesia Before the Signing of ACFTA*

Year	Indonesia statistic		
	Total	Export	Import
1990	182,0	834,4	652,4
1991	355,9	1,190,9	835,0
1992	644,9	1,396,4	751,5
1993	386,0	1,250,0	864,0
1994	-47,3	1,321,7	1,369,0
1995	146,6	1,641,8	1,495,2
1996	459,9	2,057,5	1,597,6
1997	711,3	2,229,3	1,518,0
1998	925,8	1,823,0	906,2
1999	766,7	2,008,9	1,242,2
2000	745,8	2,767,7	2,021,9
2001	358,0	2,200,7	1,842,7
2002	476,0	2,903	2,427
2003	846,0	3,803	2,957

*Source: Badan Pusat Statistik*

*Table 5 4.2 Indonesia and China After Implementation ACFTA (2004-2010)*

Year	Petroleum & Natural Gas		Non Petroleum & Natural Gas		Total volume	
	Exports	Imports	Exports	Imports	Exports	Imports
2004	1,564.5	1,173.2	5,593.9	3,479.2	7,158.5	4,652.5
2005	1,923.1	1,745.7	6,642.8	4,024.3	8,566.0	5,770.1
2006	2,118.8	1,897.5	7,950.2	4,210.3	7,950.2	6,107.8
2007	3,011.4	600.6	0,664.1	7,957.2	9,675.5	8,557.8
2008	3,849.3	299.2	7,787.1	14,947.9	11,636.5	15,247.1
2009	2,393.1	452.6	7,713.2	12,006.7	10,106.3	12,461.3
2010	3,462.3	537.4	12,229.8	19,886.2	15,692.1	20,423.6

*Source: Badan Pusat Statistik*

*Table 6 4.3 Bilateral Trade of Indonesia-China After the Implementation of ACFTA (2010-2015)*



*Sources: Ministry of Trade*

From the table, we know that before the implementation of ACFTA, Indonesia still able to get surplus fro trading with China. We can see that from the trading balance of the import and export. When before ACFTA, Indonesia saw to be quandary to equilibrate China in trading activity, and Indonesia frequently got deficit from trading activity. We can see on the export-import table between Indonesia and China after implementation ACFTA. When ACFTA implemented, Indonesia still got little surplus from trading activity.

At 2010, Indonesia got a deficit from the trading activity with China. Moreover, in 2008, we can see on the table of trading activity between Indonesia and China after ACFTA was implemented., Indonesia got deficit US\$ - 3,610,665,2 ; at 2009, Indonesia get deficit -2,355,006,0 and when 2010, as we know that the implementer of this agreement was thoroughly done, Indonesia get deficit US\$ - 4,731,500. So then at 2011, Indonesia still gets deficit US\$ - 3,27 billion; at 2012 Indonesia gets deficit US\$ -7,73 billion, at 2013 Indonesia get deficit US\$ -7,25 billion, at 2014

Indonesia get deficit US\$ -13,02 billion and at 2015 Indonesia still get deficit US\$ -14,36 billion.

## **B. Increasing the Competitiveness as a Strategy for the Indonesian Government in Facing ACFTA**

From this condition, we know that threaten Indonesia economy and Industry sector. The emergence of new competitors in investment and international trade such as China, Vietnam, and India provide lessons and strategies to attract investors to Indonesia. There are several facilities and infrastructure that are very necessary to attract investors to invest in Indonesia. Revitalizing these facilities and infrastructure include:

### **1. Infrastructure**

Infrastructure development is a crucial factor in the success of national economic and trade development, as well as being able to create and encourage the availability of extensive employment opportunities for the community and creating a multiplier effect. The impact on the economy is comprehensive.

Indonesia needs to increase the allocation of funds for infrastructure development. As a comparison, China spends 6.9% of its GDP to build infrastructure, compared to other developing countries, which on average spend around 6.3% (low income) and 3.6% (middle income, while the current condition of Indonesia has fallen to a figure of around 2% of GDP. We hope that through the infrastructure development launched by the government.

### **2. Investment Climate**

Investment is believed to be an economic stimulant. Meanwhile, to increase investment from China to Indonesia, a conducive investment climate is needed. According to (Stern, 2002), defining the investment climate as all policies, institutions, and the environment, both ongoing and expected

to occur in the future, which can affect the rate of return and risk of an investment.

A healthy business environment is needed not only to attract domestic and foreign investors but also for existing companies to still choose locations in Indonesia. The main factors affecting the business environment are labor and productivity, regional economy, physical infrastructure, socio-political conditions and institutions (Kuncoro, 2006).

Therefore, mobilizing and mobilizing economic instruments in the form of fiscal and monetary regulations to create a healthy business climate. One important thing is to change the business paradigm that is more aggressive and competitive by continuing to increase efficiency, including continuing the development of infrastructure that supports the development of the business world. Likewise gradually reducing the cost of production for the Indonesian business community.

### **3. The Effectiveness of the Implementation of Investment Relations Program**

Investor Relations Program is one program that plays a vital role in creating better communication between creditors and debtors. Investor relations is the management of the flow of financial, marketing and strategy information between the state/company and investors. In order to build trust between the parties involved, especially in the capital market, the effectiveness of investor relations will be reflected in the success of building a positive image of a country/company and the validity of market assessments made so that it can reduce the cost of capital in a company/country.

The long-term anticipation that is profitable to increase investment and face the impact of China's rapid economic growth is that Indonesia and other Asian countries form regional economic strengths. This can be done by continuing joint agreements in the world of trade to stabilize the region. Besides that, the possibility of using a single currency in the Asian region continues.



### **C. The Government Implemented a Protection Policy Against Indonesian Products**

After the implementation of the ACTA agreement, the expansion of Chinese products continues to expand in the domestic market. Chinese goods circulating in the domestic market have lower prices, which makes Chinese products preferred by domestic consumers. This is a result of the reduction and elimination of tariffs on the ACFTA agreement. That way, indirectly domestic products must deal directly with Chinese products. So, many producers who switch professions from producing too small Chinese agency are more profitable.

Protection policy is a government policy to protect the growing domestic industry (infant industry), this statement and application for infant industry protection were initially proposed by Hamilton (in 1791), Friedrich List (in 1841), and John Stuart Mill (in 1848). Furthermore, the application for protection is increasingly being asked and protecting new companies from large companies which from unfair competition also protect from the competition of imported good protection policy is a government policy to protect the growing domestic industry (infant industry). This statement and application for infant industry protection was initially proposed by Hamilton (in 1791), Friedrich List (in 1841), and John Stuart Mill (in 1848), and furthermore the application for protection is increasingly being asked and protecting new companies from large companies which from unfair competition also protect from competition of imported goods.

Domestic industries fledgling usually have a cost structure that is still high, making it difficult to compete with foreign industries that have a lower cost structure (because it already has a significant economic scale). This protection provides an opportunity for domestic industries to learn more efficiently and provide opportunities for their workforce to acquire skills. Protection policies are usually temporary. If one day the domestic industry is felt to be large enough and able to

compete with foreign industries, then the protection will be withdrawn.

In foreign trade, the concept of protection means government efforts that limit or reduce the number of goods imported from other countries to achieve specific so, essential objectives in the country's development and the country's economic prosperity. The critical purpose of protection is:

1. Overcoming the problem of deflation and unemployment.
2. Encouraging the development of new industries.
3. Diversifying the economy.
4. Avoid the decline of specific industries.
5. Improve the balance of payments.
6. Increase government income.

Protection includes tariffs and non-tariffs through import duty rates, classified into two types, namely nominal rates and effective tariffs. Nominal rates are expressed as a percentage of the value of imports (FOB), while effective rates are calculated by knowing in advance the value added of a commodity, which can be created domestically and the added value of the commodity on the international market. Then, the percentage difference is calculated. Non-tariff protection can take the form of import bans, restrict imports, administrative obstacles, and import licenses.

This tariff and non-tariff policy relate to other economic variables, such as government revenues, prices of domestic goods, including in terms of raw materials, domestic and foreign exchange rates, production technology, employment opportunities, and also related with agricultural sector production and industrial efficiency. A relatively high tariff level for consumer goods will reduce competitiveness, while for raw materials, it will cause a relatively high price, and it is difficult to obtain competitiveness. Within a certain time limit, protection can encourage economic growth, but if it continues, it will harm the economy in the country because each commodity will experience a period of saturation. Domestic production is relatively more available, while the

price is relatively expensive, so the purchasing power is not as high as expected. This can lead to higher under-capacity conditions and further, encourage high-cost economies.

The Ministry of Trade has compiled concrete steps to strengthen the trade sector, namely (a) securing domestic goods markets, (b) strengthening global competitiveness, and (c) strengthening exports, including tightening supervision of the use of SKA (origin) from ACFTA partner countries, use of domestic goods, and supervision of goods and services.

The direction of domestic trade policy in the next five years is to improve the arrangement of the national distribution system to ensure the smooth flow of goods and services, business certainty, and competitiveness of domestic goods. The Ministry of Trade is determined to improve the efficiency of the logistics and distribution systems, especially regarding essential commodities, strengthening the domestic market, the efficiency of the commodity market, increasing the effectiveness of consumer protection, the trade business climate, the performance of the Big Trade and Retail sector, and the Creative Economy.

There are several things that the government should do to safeguard or carry out protection policies against Indonesian products:

### **1. Tariff**

Tariff is the tax applied to the price of imported goods. Rates will be made when international market prices are lower than domestic market prices. When tariffs are applied, automatically the price of imported goods will be higher than the prices of domestic goods. This will result in people becoming less interested in buying imported goods because of high prices. The following are some types of tariffs in international trade:

- a. Single rate (Single Column Tariff): This tariff applies the same percentage of commodity imports from any country without exception.

- b. **General / Conventional Tariff (General / Conventional Tariff):** This tariff sets a different percentage between one country and another. This rate is also called the two column tariff.
- c. **Preferential Tariff:** This tariff has a lower percentage, even for certain commodities it can be zero percent because there is a special relationship between the importing country and the exporting country.

## **2. Quota**

A quota is a protection policy carried out by the government by limiting the entry of imported goods. Restrictions on imported goods mean that goods which enter a limited amount so that the average cost for each item will increase. Prices of imported goods will rise so that domestic products can compete.

Quotas have the same effect as rates, which will make the prices of imported goods higher and make people less interested in buying them. Unlike the rate at which consumers pay taxes to the government, through a quota, some of the income will fall into the hands of foreign companies. Quotas are the fastest way to reverse the balance of payments deficit.

## **3. Subsidies**

Subsidies are government policies by assisting with domestic products so they can be sold at lower prices so they can compete with imported products. This assistance is in the form of additional funds for capital, facilities, every assistance for production, and tools.

The government funds subsidies through taxes received by the state. If subsidies increase, then taxes will also increase. This is different from the rate which is the tax paid by consumers who use the product. Meanwhile, subsidies are funded by taxing everyone. Some people may feel unfair, mainly if they do not use products from industries that get subsidies.

#### **4. Supervision of Export-Import**

The supervision strategy is carried out in three layers, starting from the goods exported by the country of origin, border, and the domestic market, seeing the fact in the export-import trade balance deficit between Indonesia and China, the weak competitiveness of Indonesia's export products due to high production costs, the still weak mastery and application of technology such as the integration of MSMEs with large-scale industries. Seeing the swift flow of exports and imports, it takes the role of the government to supervise exports - imports to anticipate a surge in incoming goods. So that the government promotes and supervises export-import provisions in the implementation of ACFTA.