



Facing a Political Lock-In Situation with the ACFTA Which options for Indonesia?

Ivan Lim, Philipp Kauppert, FES Jakarta, March 2010

- By signing a Free Trade Agreement with China, ASEAN expects to strengthen its bargaining position for international trade. Being one of the key members of ASEAN, Indonesia has been promoting ACFTA proactively.
- For the supporters, ACFTA creates better opportunities for local business to export more goods to the important Chinese market and increases bilateral trade and investment across the region. For the opponents, ACFTA has the potential to seriously damage domestic industries and lead to mass layoffs.
- The Indonesian Government is urged to take preventive measures in anticipating and compensating the negative impacts of ACFTA. Those efforts include renegotiating several tariff posts, granting fiscal incentives for the affected industries, improving the national infrastructure and reforming the deficient Social Security System.

Since 1 January 2010, the ASEAN¹-China Free Trade Agreement (ACFTA) has become fully effective in introducing zero tariffs on 6682 tariff posts in 17 sectors, including 12 in manufacturing and 5 in agriculture, mining and maritime sectors. This has triggered a lively public debate in Indonesia; some voices emphasize the opportunities, while others consider it as a threat to the Indonesian economy. The concern seemed plausible: the statistics of the Ministry of Trade showed that although the amount of total trade between Indonesia and China has more than tripled from US\$ 8.7 billion in 2004 to US\$ 26.8 billion in 2008 with a usual record of surplus, it indicated a deficit of US\$ 3.6 billion for Indonesia in 2008.

The political situation is unlikely to allow a complete renegotiation of the ACFTA. So facing the initiated upcoming of the free trade agreement, this article will try to answer the following question: Is a win-win solution for Indonesia actually possible? By beginning with the introduction of ACFTA, its origins and motivation from both China and ASEAN perspec-

tives, this article will approach its initial question. It then follows with the perspective of Indonesia, focusing on its government, business organizations and trade unions. The conclusion shows some possible solutions offered by experts from various backgrounds and the government for those fearing the negative impacts of the ACFTA implementation.²

ACFTA, the third biggest free trade area besides the European Union and the Northern American Free Trade Agreement (NAFTA), is an agreement among the ten member states of ASEAN and China. It is predicted that the establishment of the ACFTA will create an economic region with 1.7 billion consumers, a regional Gross Domestic Product (G.D.P.) of about US\$ 2 trillion and a total trade volume estimated at US\$ 1.23 trillion. The removal of trade barriers between ASEAN and China is expected to result in lower costs of production through economies of scale, expanded intra-regional trade and increased economic efficiency. Simulations conducted by the

¹ The Association of Southeast Asian Nations (ASEAN) comprises Brunei-Darussalam, Cambodia, Indonesia, Lao PR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam.

² Ivan Lim is an International Business student at the German Swiss University of Jakarta and has worked for FES Jakarta during an internship. Philipp Kauppert is Deputy Resident Director of FES Jakarta. The opinions expressed reflect the views of the authors.

ASEAN Secretariat using the Global Trade Analysis Project (GTAP) suggest that an ACFTA will increase ASEAN's exports to China by 48% and China's exports to ASEAN by 55.1% and could probably raise ASEAN's G.D.P. by 0.9% or by US\$ 5.4 billion while China's real G.D.P. could expand by 0.3% or by US \$2.2 billion. The governments supporting this initiative hope that with the formation of an ACFTA, enterprises in ASEAN and China will become more efficient and further promote specialization in order to be more competitive than other world regions. This is supposed to boost productivity and economic welfare as well as attracting more investment into the region.

The Origins of ACFTA

The idea of a free trade area between China and ASEAN was first proposed by Chinese Premier Zhu Rongji at the November 2000 China-ASEAN summit. In October 2001, the China-ASEAN Expert Group on Economic Cooperation issued an official report recommending a "WTO-consistent ASEAN-China FTA within ten years". A month later, at the November 2001 China-ASEAN summit, the relevant leaders endorsed the ideas of the Expert Group and the negotiation process officially commenced. Then, at the Eighth China-ASEAN Summit in November 2002, the ASEAN leaders and Chinese Premier Zhu Rongji signed the "Framework Agreement on Comprehensive Economic Cooperation". As laid out in the framework agreement, a free trade area covering trade in goods between China and the original five ASEAN members (Indonesia, Malaysia, Singapore, the Philippines and Thailand) is to be completed by 2010. The remaining five ASEAN members are expected to fully join by 2015.

1. The Perspective of China

China's new diplomatic strategy seeks to capitalize on globalization to accelerate China's economic development in order to cope with the growing demands and to hinder social conflicts. In Southeast Asia, the "peaceful rise" is promoted through an FTA agenda reflecting geopolitical and economic objectives - cultivating goodwill among neighbors, maintaining regional stability, and securing key markets and raw materials needed for China's economic growth. China sees

ACFTA as a tool to respond to challenges posed by competitive regionalisms in the world economy, to consolidate growing economic ties with Southeast Asia, to secure the access to raw materials, and to ensure a peaceful environment to support China's growing influence to counterbalance American and Japanese power.

2. The Perspective of ASEAN

By signing a Free Trade Agreement with China, ASEAN expects to improve its bargaining position in the international arena. Moreover, increased trade between the two sides since the normalization of ASEAN-China bilateral relationships in the early 1990s has fuelled the confidence of ASEAN policy-makers, who now feel that ACFTA could provide a much needed economic boost to a Southeast Asia still weakened by the 1997 economic crisis. As China's economy lacks of natural resources, the demand for ASEAN exports might even still increase in the near future. As a further advantage of the ACFTA, ASEAN countries can benefit from a growing number of Chinese tourists due to the rise of Chinese middle class. In any respect, ACFTA could be seen as a bulwark against potential hostile behavior from China towards the Southeast Asian region. Nevertheless, despite a closer relationship between the two parties, China might remain a concern for ASEAN countries. China's defense expenditure rose from US\$ 6.06 billion in 1990 to US\$ 14.6 billion in 2002. This development alone constitutes a key rationale for the Southeast Asian governments to seriously further engage themselves with the growing power of China.

3. The Perspective of Indonesia

Being the largest country in Southeast Asia and rich in resources, Indonesia is of strategic importance for the development of the whole region. As one of the key member countries of ASEAN, this country has been a major player in promoting ACFTA which has been carried out since January 1 of 2004, through an Early Harvest Program reducing tariffs on many agricultural products.

a. Government, the Supporters of ACFTA

President Susilo Bambang Yudhoyono expressed his opinion that the Free Trade

Agreement between ASEAN and China (ACFTA) would not threaten Indonesia's industries, but would rather create a higher amount of opportunities for local business to export more goods to China.

The Ministry of Trade emphasized that the implementation of ACFTA was expected to strengthen bilateral trade and investment across the region. This is yet another important element of the context of the strategic partnership between Indonesia and China.

The Minister of State-Owned Enterprises (SOEs) explained that ACFTA created higher opportunities for three industrial sectors for exports, namely maritime, food and beverage, forestry and agriculture products. To anticipate negative impacts of the ACFTA, SOEs planned to engage in the domestic steel industry. Hereby, the Minister requested to apply more stringent regulations on imported products from China.

But there are also voices fearing a negative impact of ACFTA within the government. Based on the field research in Tanah Abang Market and Cibaduyut, the State Minister of Cooperatives and SMEs informed that local garments and shoes industries are basically fitted to compete with foreign industries in ACFTA. However, he asserted that the ACFTA might cause some damage to a high number of Medium Enterprises (SMEs) which play an important role in Indonesian overall business, quoting data from the Central Statistics Agency (BPS).

The consequences for the public financial situation also seem ambiguous. Finance Minister Sri Mulyani Indrawati estimated that ACFTA could cause government to lose Rp 1.6 trillion in import duties on the one hand, but on the other hand these losses should be compensated by increasing value added tax on imported goods, estimated to rise by more than 50% from Rp 66.3 trillion to Rp 102.2 trillion.

b. Profit Organizations: Controversial Issues

Research by the Chamber of Commerce has clarified that this trade agreement provides benefits to certain sectors (i.e. rubber, minerals, machinery and equipment products), but there are others that will experience pressure

such as leather, apparel and metal products. Nevertheless, the option to delay ACFTA is not a wise one because:

- The competitiveness of Indonesian products would be eroded by other ASEAN countries whose products are cheaper for China.
- The products of ASEAN countries in general could be more competitive because they could afford cheaper raw materials or intermediate products from China.
- It could happen that other ASEAN countries get their products from China and export them to Indonesia. Although it is forbidden, it would be difficult to prevent such practices.
- In general, multilateral agreements under the umbrella of ASEAN might provide a better regulatory framework than different single bilateral agreements among the engaged countries.

The businessmen associated in the Indonesian Iron and Steel Industry Association (USIA) complained that they have been having troubles already with 5% tariffs, and that a further reduction to zero tariffs will likely cause serious consequences. The General Chairman, Fazwar Bujang promised to enhance the competitiveness of the national steel industry if ACFTA could be postponed for another two years. In addition, he mentioned that the government should reduce the costs and guarantee a reliable availability of energy.

Indonesia Employers Association (APINDO) Chairman, Sofyan Wanandi claimed that the adverse effect could be seen in the next three to six months after the beginning of the implementation of ACFTA. He added that Indonesia, together with India and China, is one of the countries that have been able to withstand the global crisis. Therefore, now could be the most powerful momentum to attract more inward investment.

A basically optimistic view was felt by the members of Indonesian Textile Associations (API). But, the Executive Secretary of API also hoped that the government would provide protection to local entrepreneurs that could be undermined if there is no strict public supervision.

c. Trade Unions and Other Opponents

According to the Indonesian Farmers Struggle Front, about twenty trade union organizations in a press conference in Jakarta held by the Labor Revolutionary Command (KOBAR) expressed their rejection against the ACFTA implementation that could cause mass layoffs. In this occasion, the Secretary General of All Indonesian Workers Organization (OPSI), Timboel Siregar stated that the signing of the agreement would lead to an increase in unemployment and de-industrialization.

The Chairman of the Confederation of All-Indonesian Workers Union (KSPSI), Mathias Tambing pointed out that the entry of Chinese products has a great impact on the domestic market. Not only that they are cheaper, but their qualities are better too. Subsequently, he assumed that the implementation of ACFTA would be more suitable if domestic productivity could first be overhauled to achieve equal competitiveness.

Fearing the unfavorable result of ACFTA, the Director of Operation and Service of the Jamsostek company, Ahmad Anshori calculated that about 2.5 million workers in the labor-intensive leather and garment factories and agribusiness industries could potentially lose their jobs. In the worst case, the company has prepared a budget of more than Rp. 1 trillion to fund employee termination claims.

Besides the different social and economic effects for Indonesia, the environmental impacts of ACFTA might also be quite negative. The Executive Director of the Indonesian Environment Forum (WALHI), Berry Nahdian was certain that the implementation of a free trade scheme like the ACFTA model could exploit a larger amount of Indonesian natural resources. He clarified that the ACFTA would legalize more coal dredging, logging and land acquisition activities where many were hit by the flood yearly due to forests around them that have turned into coal mining areas.

The Political Lock-In Situation

The Indonesian President has made clear that he is not willing to break an agreement at this stage that has been designed and signed by all the ASEAN members and China al-

ready years ago. Nevertheless, he was aware that it is essential to protect public interest and prepare the relevant elements by working together with the different Ministers.

In order to help to protect the local industries, the House of Representatives' commission VI overseeing industry and trade has demanded the government to renegotiate a number of 228 tariff posts, covering garments, furniture and footwear among others. The Minister of Industry MS Hidayat assumed that the ACFTA implementation could hurt domestic firms, and expressed that the government has sent a letter regarding this matter and it would take some time to be processed.

Coordinating Economic Minister Hatta Rajasa confirmed the renegotiation and mentioned that the government was willing to help bolster local industries' competitiveness by providing more support to improve the national infrastructure as well as through fiscal incentives to those actors directly affected by the ACFTA agreement.

"We support the implementation of the Indonesian National Standard (SNI) as an anticipatory measure against goods of below standards coming into the country," stated Manpower and Transmigration Minister Mu-haimin Iskandar. In seeking a solution for dealing with global competition and anticipating possible layoffs following the ACFTA implementation, he announced that the government would assign a special team to monitor and detect layoffs that are not done according to procedures and laws.

Another perspective on the anticipation of the negative effects has been expressed by Rieke Diah Pitaloka, member of the House of Representatives Commission IX,. In a roundtable discussion on ACFTA organized by the network of Asian Social Democrats³, she suggested that the best solution would be a better implementation and a reform of the National Social Security System (SJSN), where the legal basis already exists since the formulation of its laws in 2004. An effective and just social security system could be a positive public measure to protect the Indo-

³ This event took place in Jakarta on the 22nd of February 2010. Find more information about the network under: www.socdem.asia

nesian workers against the thread of potential massive lay-offs in consequence to the free trade agreement.

In response to the anxiety among workers over potential dismissals ACFTA could cause, the employers' organization APINDO, together with a number of trade unions, decided to form the National Bipartite Forum (FBN). "Everyone realized that business continuity should be maintained in order to provide job security for all employees of the company", said Sofyan Wanandi. FBN is supposed to build mutual trust among the employers and their employees with the goal to create healthier businesses and better working conditions that could generally contribute to social welfare.

Conclusion

The guiding question raised at the beginning of this article was whether a win-win-solution for Indonesia was still possible given the fact that Indonesia was facing a political lock-in situation with regards to the implementation of ACFTA. To answer this question, the different positions presented in this article could be divided into the three following categories:

- The Government is generally supporting the ACFTA implementation, despite the fact that the Minister of Industry showed his worries about the danger of hurting domestic firms.
- The Business Organizations are divided into potential winners and losers of ACFTA. Finally, it depends on which industry is capable to compete and therefore might benefit or which might rather be affected from it.
- Trade Unions and others actors who are opposing ACFTA, especially those working in a labor-intensive industry which have a low chance to survive the strong competition with inflowing, cheap Chinese products.

The current political situation in Indonesia indicates that the government is committed to the agreement and has no intention to break it. However, both the supporters and the opponents groups are trying to design some kind of preventive measures to cope with the different future negative impacts of ACFTA. On the side of the government, the renegotia-

tion of some tariff posts with the Chinese government has been requested. Another focus lies on the improvement of the national infrastructures and the provision of fiscal incentives to the negatively affected industries. On the employers and trade unions side, some of them decided to strengthen future collaboration by forming a national bipartite forum. Their hope is that this forum would find a solution for the improvement of industrial relations in Indonesia.

A main problem for the Indonesian industry is its deficient infrastructures, as the electricity crisis in 2008 has caused the economy and business community to suffer. That could be one of the reasons why Indonesia's imports from China outgrew its exports to China. Based on the presentation by the former Indonesian Ambassador for China 2006-2009, there was a significant increase in the imports of electric equipment from about US\$ 400 to 800 million, steam generators from about US\$ 45 to 300 million and several capital goods that contributed the most to the deficit in the balance of trade with China. In a public lecture held at the University of Indonesia on 9 February, he argued that investments into these capital goods would be highly valuable for future development in Indonesia. Therefore, the trading balance deficit could be regarded as a minor source of concern which could have some positive economic effects in the long term.

The Head of Research and Development of the economic and social department from the University of Indonesian Education (UPI), Nana Jiwayana concluded the threat of ACFTA should not be viewed as a frightening specter; it would be more useful if it was seen as a whip for Indonesia to keep pace with the improvement efforts. Considering the potential opportunities presented in this article, perhaps ACFTA could generate some positive effects for Indonesia's economic development. The main challenges lie in coping with the potential negative effects such as de-industrialization and unemployment. If those effects could be prevented by public measures such as an effective social security system or higher investments in the national infrastructure and education, Indonesia might create a win-win solution and be able to profit from the long-term, positive effects of ACFTA.