

## Indonesian Case





# Assessing the Impacts of an ASEAN-EU Free Trade Agreement on the Indonesian Economy

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The research examines the proposed plan of ASEAN and the European Union (EU) to establish a free trade agreement and / or arrangement (FTA) in the near future. More specifically, it attempts to assess the economic impacts of this proposed arrangement on Indonesia, a member country of ASEAN.

Given the economic imbalance between the EU and ASEAN in the world economy, this study argues that ***economic relations between ASEAN and the EU favour the EU. Consequently, the proposed ASEAN EU Free Trade Agreement (AEUFTA), in order to redress this imbalance, must take into account the development objectives of ASEAN, including Indonesia.***

This study uses both qualitative and quantitative research methodology. In the qualitative side, both primary and secondary qualitative data was collated and analysed. Research interviews with state and non-state establishments at national (Indonesia) and regional (ASEAN and the EU) levels were carried out.

In the quantitative side, this study uses the Equilibrium Model with Economic Regional Analysis Dimension (EMERALD). The basic data or input-output of this model has been modified though the aggregation of all sectors that are expected to be incorporated in the AEUFTA. EMERALD is a useful economic modelling tool for highlighting the economic costs and benefits of engagement in the AEUFTA for Indonesia. The economic-wide effect of this analysis is composed of macro-economic and sectoral results, both at the national and provincial levels.

The Impacts of EU's FDI and Trade Expansion in Indonesia under the AEUFTA: A Computable General Equilibrium (CGE) Model Analysis. Then, IGJ quantitative analysis of AEUFTA Impacts on Indonesia would be based on two scenarios as follows: first scenario, the expansion of EU direct investment by 10 percent and second scenario, the increase of Indonesia's export to EU by 18,5 percent.

In line with the above, the first scenario of the expansion of EU direct investment by 10 percent results as follows:

1. Reduce the welfare of Indonesia.
2. More gains for EU's, instead of Indonesian economic actors.
3. True that under this scenario Indonesia's exports to EU would grow by 2.65 percent (and this would cause national GDP, employment, and capital by 1.16 percent, 0.89 percent, and 1.53 percent respectively.
4. However, household expenditure or consumption can be expected to reach -0.11 percent if the capital inflows from the EU are non-existent.
5. The growth of employment is unlikely to be sufficient to counteract the loss of profits amongst Indonesian economic actors as a result of increase competition from EU.

Furthermore, the second scenario of the increase of Indonesia's export to EU by 18,5 percent results as per details:

1. 18.5 percent estimation is well over-exaggerated.
2. Some winning and losing sectors.
3. AEUFTA will only make small contributions to overall national GDP growth.
4. Positive long-term effect – e.g. increase productivity of labour, household income, and the overall welfare.
5. However, AEUFTA would also generate an increase in consumption by 0.48 percent.

In short, the second scenario yields better results than first scenario.

In conclusion, as an expanding economic entity, the EU has more power than many other global economic superpowers. ASEAN, on the other hand, has yet to evolve into a supranational economic entity capable of competing with the EU on the world stage. Regional integration amongst the member countries of ASEAN remains weak despite the ASEAN Charter, which was signed during the Thirteenth ASEAN Summit in Singapore on November 2007. Ideally, an FTA between the two regional blocs should be pursued only after the member countries of ASEAN become capable of fully transforming themselves into one integrated bloc. In other words, ASEAN should concentrate its efforts into establishing an ASEAN Community by 2015, instead of pursuing bilateral free trade initiatives.

For Indonesia in particular, the adjustment costs resulting from the AEUFTA, especially in the short-term, will severely affect the welfare of its people. As a relatively reluctant free trader in the past, Indonesia now actively pursues trade and investment liberalisation initiatives. ASEAN is responsible for several regional liberalisation initiatives (e.g. the ASEAN Free Trade Area, the ASEAN Investment Area, and so on) and three bilateral free trade agreements (with China, Japan and South Korea). The people of Indonesia, like the people of other Southeast Asian nations, were promised that ASEAN-level economic integration would be used as the training ground for further integration into the global economy at a later stage. The realisation of the ASEAN Economic Community is still seven years away, and the economies of the developing and least developed countries of ASEAN, including Indonesia, are far from experienced in economic integration.

These countries find themselves forced to make significant adjustments to accommodate bilateral, inter-regional and global level liberalisation. The consequences of such liberalisation are likely to affect the overall developmental objectives of Indonesia and other developing and least developed ASEAN members.



The authors aim to highlight some of the key concerns and recommendations related to the AEUFTA as an international trade strategy for both ASEAN and Indonesia as follows:

1. The importance to incorporate some of the development perspectives of the EU and ASEAN.
2. Special Products /Special Safeguard Mechanism (SP/SSM) are justified because both schemes can act as guarantees to ensure the sustainability of items or products deemed sensitive by the economic actors in ASEAN
3. EU must expand its Generalized System of Preferences (GSP) schemes to and to ensure greater market access facilitation of products coming from ASEAN (mainly due to the limited ability of ASEAN economic actors to carry out operations beyond national borders).

4. The EU needs to clarify its policies on market access and subsidy (despite low tariffs on manufactured products, ASEAN economic actors are still hit by Sanitary and Phytosanitary (SPS).
5. EU must clarify whether the AEUFTA aims to encourage ASEAN members to remain low-level producers (e.g. produce raw materials and agricultural products) or to encourage the development of manufacturing industries in the Southeast Asian region (If the issue of tariff peaks remains unresolved, one cannot fault ASEAN for thinking that perhaps it is the EU's trade policy to keep its ASEAN partners as farmers and fishermen, rather than manufacturers.
6. AEUFTA needs to ensure concrete foreign investment from both sides to invest in the two regions - foreign investment is the 'prime mover of the development process', this promise remains a pipedream if no real capital investment flows into the regions, particularly into ASEAN.
7. The importance of civil society and marginal sector in the AEUFTA policy-making process.

This Executive Summary is based on the research study and publication, **"Assesing the Impacts of an ASEAN-EU Free Trade Agreement on the Indonesian Economy"** published by Institute for Global Justice, Jakarta, Indonesia, 2008