# An Analysis of the Indonesian Balance of Trade Before and After Implementation of the ASEAN China Free Trade Area (ACFTA)

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## Abstract

The aim of this research study was to show whether the implementation of ASEAN-China Free Trade Area (ACFTA) contributes advantages or disadvantages in the Indonesian context by statistically analyzing the balance of trade using t-test (paired t-test) and trend line analysis. The sampling technique of this study was the total exports and imports of Indonesia to and from Brunei Darussalam, China, Malaysia, the Philippines, Singapore, and Thailand from January 2005 to 2014. Data was obtained from the official website of the Indonesian Central Bureau of Statistics.

The study found that there was a significant relationship between the Indonesian Balance of Trade before and after implementation of the ACTFA; the result of a 2-tailed test was a value of 0.035. Furthermore, a linear regression line showing the Balance of Trade before and after ACFTA became steeper after the implementation of ACFTA, showing that the Indonesian trade deficit between exports and imports widened after ACFTA. What may be deduced from these findings is that free trade under ACFTA did not improve Indonesia's Balance of Trade; instead, its trade performance worsened after implementation of ACFTA.

**Keywords**: *Free trade, import, export, and balance of trade*

## Introduction

ACFTA, which stands for the ASEAN-China Free Trade Area, is an international free trade agreement that was implemented on January 1, 2010 between seven countries – namely China, and six out of the ten ASEAN members consisting of Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand. This free trade agreement is built on eliminating trade limitations and barriers such as quotas and import tariffs. Moreover, it also saw modifications made on protectionist, subsidy, and import-export tax policies (Tarmidi, 2010; Pasha & Imran, 2012). Despite its perceived value for international business, it was feared that implementation of the ACFTA would impede render some local products uncompetitive, subsequently weakening the national economy. Ernovian G. Ismy, the general secretary of the Indonesian textile association, raised his concerns regarding the possible collapse of the national industry. In contrast, Indonesia's commerce minister Mari Elka (Menperdag, 2010) said that ACFTA would boost exports and bring other advantages such as an increase in foreign investment. To examine the advantages and disadvantages of ACFTA, this study was conducted by analyzing balance of trade differences in exports and imports for five years before and five years after its implementation. Specifically, this study analyzed the difference between the total value of imports and exports by comparing them through time series analysis both before and after implementation of ACFTA. The problem addressed by this research is whether or not there is any difference in Indonesia's trade performance before and after ACFTA.

## Conceptual Model and Review of Literature

Globalization affects national relationships due to the joining of exchange, finance, and labor markets into worldwide commercial centers (Kapoor, 2011). Countries increase production of goods that are sold to countries which are less efficient in producing these goods; thus, international trade helps to improve global standards of living. Moreover, economists such as David Hume, Adam Smith and David Ricardo have expressed that free commerce and free markets not only improve the quality of life, but also serve as doors to economic success and more effective utilization of assets (Frunza,

Maha, & Mursa, 2009). Heakal (2015) stated that since some nations have larger amounts of certain resources (land, labor, capital, and innovation), they can produce some products more efficiently and offer them at lower prices than other nations. When a nation is unable to efficiently produce certain goods, it may choose to exchange these products with other countries instead.

Pursuit of trade advantages motivates both traders and consumers. Consumers support free trade because goods and services cost less and have higher levels of quality. Free trade likewise offers a chance to export products and services to different nations, fortifying national development. We can see this in the United States of America, a country which Goldstein and Martin (2000) mentions as having benefitted a lot from free trade. Their study demonstrated that many organizations profited from free commerce under the North American Free Trade Agreement (NAFTA). Nonetheless, free trade brings not only advantages, but also certain threats and disadvantages (Suharyati & Nurdan, 2012). Brookfield (2003) said that unavoidable threats come from foreign countries, leading to tougher competition. To counter this threat, companies must pay special attention to managing and producing products, or managing the way that they specialize in certain services. Otherwise, these companies will not be able to survive. Julien, Joyal & Deshaies (1994) studied the impact of free trade on small and medium-sized enterprises; their study showed that for some companies, free trade yielded a positive contribution, and for some it yielded a negative contribution, too.

Atilgan and Kanat (2007) wrote that globalization has intensified competition for economic, technological, social and political resources. Some countries try to avoid this danger. Hills and Donker (2004) suggest that current trade rules do not bring success to the world. Free trade can be beneficial, but it can also be harmful for certain countries. In other words, free trade could yield either positive or negative results to a particular country.

**The History of International Trade**

International business is one of the most ancient branches of economic thought. From the era of the Greeks until today, government authorities, scholars, and market analysts have studied trade determinants between nations, have asked whether exchange brings advantages or disadvantages to a country, and – even more importantly – have attempted to figure out what kind of trade regulations are best for specific nations. Since early times, Greek thinkers have identified both the benefits and threats of international trade. The recognition of trade advantages also brings concerns that certain local businesses and workers must compete with their international counterparts. Due to differing weights put on the total benefits or losses from international trade, various researchers have come to different views about its attractiveness (Irwin, 2001).

A critical review of the basic principles of mercantilism reveals that (1) a country's riches depend upon its aggregate wealth (generally, gold); and (2) to become more wealthy, government regulations ought to promote exports and reduce imports. In spite of the fact that the mercantilist era ended in the late 1700s, its contentions still live on. To have a "positive" trade balance, a country's exports must be larger than its imports. When calculating international trade balances, exports that bring more money into a nation lead to a positive trade balance, and imports that drain foreign exchange reserves lead to a negative trade balance (Ball et al, 2002).

*Comparative Advantage*

Trade between countries through import-export activities is known as International Trade. Trade may bring benefits when the country has a certain comparative advantage in products or services. An argument in favor of free trade was advanced by a classical economic expert named David Ricardo who wrote in the early nineteenth century on the Theory of Comparative Advantage. He suggested that a nation exports goods in which it has a relative cost advantage over other nations. For instance, suppose that Indonesia can produce both clothes and automobiles more efficiently than Thailand. If Indonesia can make clothes more efficiently than Thailand, but can manufacture automobiles three times more cost-effectively than Thailand, then Indonesia has an absolute advantage over Thailand in both products. However, it has a relative advantage in automobile production, and so Indonesia may

export automobiles to Thailand while importing shirts, despite the fact that it can produce shirts more efficiently than Thailand.

In practical terms, "relative advantage" means that a county can continue exporting its products despite the fact that other counties can make them more efficiently. Likewise, a nation may continue importing products despite being able to produce them more efficiently than its competitors. From the point of view of Thailand, it may not have an "absolute advantage" in producing either shirts or automobiles, but it has a "relative advantage" in producing T-shirts. Thus, such trade may be profitable to both Indonesia and Thailand. Moreover, the comparative profit proposition states that developing countries which lack an absolute advantage in goods can still engage in mutually profitable trade with developed countries whose industries are more efficient, even if some of their industries may face intense import competition.

The implications of comparative advantage may be seen between the United States (US) and Switzerland. The US is the best country for producing corn; in fact, it is ten times more productive than other countries. However, the wages are just five times higher when compared with those in Switzerland. This implies that it will be favorable for the US to produce corn and export it to Switzerland. In the meantime, however, the US has an advantage in producing watches that is only two times that of Switzerland, which is insufficient to compensate for wages that are five times as high. This is the reason why the US will find it less expensive to import watches from Switzerland (Suranovic, 2007).

### Imports, Exports, and the Balance of Trade

*Imports:* Import means bringing goods from external sources across national borders. The party bringing in goods is called an importer (Joshi, 2009; Sullivan & Sheffrin, 2003). Imports in a recipient country are exports from a sending country, and together are the components of international trade transactions. Imports are comprised of products and services that are exchanged, and occurs when there is a change of ownership from non-residents to residents. Import of services is comprised of all services performed by non-residents for residents. In national records, any sort of direct acquisition of services by residents are recorded as services that are imported; hence, all spending by visitors in the financial zone of other nations is considered a major part of the import of services (Lequiller & Blades, 2014).

In international trade, imports and exports may be restricted by import taxes and tariffs or quotas established by customs authorities. Moreover, importing and exporting goods is subject to trade agreements between the importing and exporting nations.

*Exports*: Trade implies the sale and conveyance of merchandise to and from other nations' ports. "The seller of such goods and services is referred to as an exporter, and is based in the country of export, whereas the overseas based buyer is referred to as an importer." In global exchange, exports allude to offering products and services created in the home country to foreign markets (Bhagwati, 2002; Joshi, 2005).

The value of total exports and imports also commonly includes transport costs. These include expenses incurred for goods or data that is exchanged, hand-carried, sent via air, conveyed by ship, transferred to a webpage, or downloaded from an Internet website. Trade likewise is comprised of data that is sent through emails, messages, faxes, or shared via telephone conversations.

*Balance of Trade:* The Balance of Trade is the difference between the value of a nation's imports and its exports for a specified period of time. A country needs imports when domestically produced goods do not satisfy local demand, or when the cost of goods in the world market is lower than in the local market. A shortage of foreign exchange reserves occurs when imports are generally more than exports. Imports are influenced by a nation's wages and profitable assets (Ball, McCulloch, Frantz, Geringer, & Minor, 2005). Therefore, when a nation imports more than it exports, it purchases more than it produces. Local exchanges are a zero-sum game; someone makes something, sells it and receives cash, and someone else buys it by spending the same amount of cash. The purchaser is poorer, but the seller is wealthier.

When a country imports more than it exports, however, it sends cash abroad. Its purchases are usually paid for with foreign currency, and merchants must acquire this currency in order to buy goods and services. A promising balance of trade is one in which the value of goods and services sent out exceeds the value of outside products that are brought in. Trade with a particular nation is viewed as favorable to the extent that exports outperform imports.

### Protection and Free Trade

*Protectionism:* Protectionism is the opposite of free trade, and leads to the creation of trade barriers. In practice, government laws, arrangements, directions, or practices are often used to shield domestic products from foreign competitors. The most widely used trade barriers are government policies such as subsidies and tariffs. Likewise, import policies, specification requirements, procedures to authorize imports, and customs restrictions are protectionist tools.

A tariff is a fiscal assessment on a specific exported or imported product. Tariffs are commonly utilized when domestic yields fall and imports from foreign competitors increase, particularly if there is a desire to maintain local production.

Subsidies are generally used to provide short-term support to business ventures and encourage local production. Nonetheless, appropriations to support goods or services may lead to overall losses. Subsidies obstruct trade with competitors in other nations, which may be able to provide a particular product or service more quickly, efficiently, or at a lower cost. When operating costs are artificially lowered via subsides, however, sometimes efficient producers are unable to successfully compete. Appropriations are for the most part temporary, though in some cases they may be continued on a more long-term basis.

*Free Trade:* Free trade occurs when no restrictions are imposed by government regulators to impede the unhindered exchange of goods and services between trading countries. When exchange hindrances exist, for example, in the form of subsidies or tariffs, they shield local businesses from global competition rather than expose them to the flow of free exchange.

### Benefits and Threats of Free Trade

From the perspective of global business, there are two alternative points of view. The first view focuses on the benefits of the free exchange of good and services. The second perspective cautions that some domestic business ventures may be harmed by foreign competition.

#### Benefits of Free Trade

*Increases Production.* Free trade may lower input costs for domestic products, thus increasing profitability. It may also promote innovation and increased competitiveness. Free Trade encourages producers to specialize in products in which they have a "comparative advantage."

*Increases Efficiency.* With specialization, nations can exploit efficiencies resulting from economies of scale and increased output. Free trade enhances the potential usefulness and profitability of resources. International markets provide businesses with expansion opportunities, so that they can lower costs and improve profitability through increased productivity.

*Promotes Innovation.* Increased competition advances "new ideas, technology, or methods" that may lead to better ways to meet requirements, fulfill needs, or satisfy customer expectations.

*Benefits Consumers.* Local consumers benefit since they have a greater variety of products and services produced in foreign countries from which to choose. The increase of competition encourages domestic firms to also produce at minimal cost, which drives down prices of many goods and services.

*Employment.* Liberalization of trade results in losers and winners as resources move to the economic areas which are more productive. Jobs will develop in exporting industries, and employees may be transferred as imports compete with domestic industries in a changing business environment.

### *Weaknesses of Free Trade*

Although free trade has many advantages, it remains controversial because opponents and lobby groups attack free trade and the liberalization of exchange. The abolishment of trade barriers often lead to local unemployment, which can have a significant influence on large numbers of employees, their families, and the domestic economy. Consequently, it can be hard for these employees to find jobs in mature industries, and they need government assistance. Free trade may also create economic instability because trade cycles result from worldwide – rather than local – demand. This implies that local employees, organizations, and buyers have less control than before. New enterprises discover that it is challenging to grow in a threatening situation without government protection. It is more difficult to manage economies when firms must face rivals from foreign countries. Furthermore, there is a propensity for free trade to ignore the environment at the expense of prioritizing profit and controlling production costs in order to compete with rival foreign firms (Edge, 1999).

## ASEAN-China Free Trade Area (ACFTA)

The ASEAN-China Free Trade Area (ACFTA) is an agreement between the ASEAN countries and China to establish a free trade area by reducing or eliminating trade obstacles, improving market access to services, and encouraging increased investment. This agreement aims to enhance economic cooperation and relationships among member states for the purpose of improving the welfare of China and the ASEAN community.

The Heads of State of ASEAN and China signed the initial ASEAN-China Comprehensive Economic Cooperation on November 6, 2001 at Bandar Sri Begawan, Brunei Darussalam. A framework agreement on comprehensive economic cooperation between the parties was signed in Phnom Penh, Cambodia on November 4, 2002. A Protocol Framework Agreement was signed on October 6, 2003, in Bali, Indonesia, and a second protocol signed on December 8, 2006. In January 2007, an ACFTA services agreement was signed at the 12<sup>th</sup> ASEAN summit meeting in Cebu, the Philippines. An ASEAN-China investment agreement was signed at the fortieth meeting in August 2009 at Bangkok, Thailand. The liberalization of ACFTA was fully implemented in 2010 for six ASEAN members and China, and in 2015, the remaining ASEAN nations, namely Cambodia, Laos, Myanmar, and Vietnam joined the agreement.

### *Product Trade Agreement*

*Three Stages of Excise Reduction*

I.   Early Harvest Program (EHP) tariff reductions started on January 1, 2004, and became zero percent on January 1, 2006. EHP products include live animals, dairy products, plants, vegetables and fruits. A specific agreement with China included coffee, coconut oil, chocolate, rubber goods, and furniture.

II.  Normal Track
     Threshold: 40% of products at 0-5% by 2005; 100% at 0% by 2010. Remaining import duties may be collected on no more than 150 items, which will be eliminated by 2012.

III. Sensitive Track
     - Sensitive List (SL):
       (a) By the year of 2012 = no more than 20%.
       (b) Reduction to 0-5% by the year 2018.
       (c) There are 304 product types in this group, namely leather goods, eye glasses, musical instruments, dolls, transportation/exercise equipment, writing tools, iron/steel, spare parts, glycosides, vegetable alkaloids, organic compounds, antibiotics, glass, plastic goods.
     - Highly Sensitive List (HSL)
       (a) By the year of 2015 = no more than 50%.
       (b) There are 47 HSL product groups, namely agriculture products, textile products, automotive products, and ceramic tableware.

### Service Trade Agreement

A service agreement came into effect in July 2007. It was expected that the service agreement would stimulate investment in sectors such as: "(a) business services, for instance, computer related services, real estate services, market research, organizational consulting; (b) construction and engineering related services; (c) tourism and travel related services; (d) shipment services; educational services; (e) telecommunication services; (f) health-related and social services; (g) recreational, cultural, and sporting services; (h) environmental services; and (i) energy services" (Ditjenkpi, 2010).

### Research Methodology

Quantitative method was used in this research for the analysis of import-export prices. Sources of data were obtained from the official website of the Central Bureau of Statistics of Indonesia. The data analysis techniques were linear regression and paired t-test samples. The research sample involved the total fee of export-import data every month from January 2005 to December 2014. The export-import data is divided into two parts, namely the period from January 2005 to December 2009 was used to measure the performance of the number of export-import data prior to the implementation of the ASEAN-China free trade area, while import-export data from January 2010 to December 2014 was used to measure the performance of exports and imports after the ASEAN-China Free Trade Area. This was applied as follows:

A. Testing the Balance of Trade Before and After Implementation of ACFTA

   Data analysis was carried out in three stages:
   1. First stage: calculate averages before and after the implementation of ACFTA.
   2. Second stage: calculate standard deviations before and after the implementation of ACFTA.
   3. Third stage: analyze performance differences that occurred using paired t-test with a significance level ($\alpha$) = 0.05/2

Testing Criteria:
   I.   If the significance of t > 0.05/2, then $H_0$ is accepted, meaning there is no significant performance difference before and after implementation of ACFTA.
   II.  If the significance of t < 0.05/2, then $H_0$ is rejected, meaning that there is a significant performance difference before and after the implementation of ACFTA (Santoso, 2013; Setia, 2009).

B. Graphing a Regression Line of Exports and Imports to and from Indonesia and ACFTA Members Before and After Implementation of ACFTA

   Regression graphs were prepared in three stages:
   1. First stage: input import and export data for each country for a 10-year period (both before and after ACFTA came into effect) on the X and Y coordinates.
   2. Second stage: plot the ordered pairs of the data for each year.
   3. Third stage: graph the average line of fit, or the regression line.

**Linear Regression Formula**

Linear regression is a tool which can be used to predict future requirements based on data from the past, or to understand the influence of an independent variable on a dependent variable. Linear regression has two categories: simple regression, and multiple regression. The use of simple regression is only for independent and dependent variables. However, multiple regression is used for one independent variable and two or more dependent variables.

Siregar (2014) formulated the regression equation as follows:

$Y = a + bX$

Y = Dependent variable

X = Independent variable

a and b = Constant a

The formula to find the value of constant **a**:

$$a = \frac{\sum Y - b. \ \sum X}{n}$$

n = Total of data

The formula to find the value of constant **b:**

$$b = \frac{n . \sum XY - \sum X. \ \sum Y}{n. \sum X2 - (\sum X))^2}$$

**Paired Sample T-Test**

The Paired Sample T-test is a statistical method used to contrast two population means when two samples are related. In 'before-after' studies, a control group and matched pairs samples are used in a paired sample t-test.

The formula for a paired sample t-test is shown below:

$$t = \frac{\sum d}{\sqrt{\dfrac{n \ (\sum_d 2 - (\sum d)^2}{n - 1}}}$$

**Test Results and Discussion**

*Balance of Trade Analysis*

*Paired Sample Statistics* showed that the mean Balance of Trade before ACFTA was negative, as much as $ -5.6634E9, or equal to USD$ -5,663,400,000. The mean after ACFTA was also negative, as much as $-2.2825E10 or equal to $-22,825,000,000. The negative Balance of Trade after the implementation of ACFTA was two times larger than before implementation. The mean of total imports for 2010-2015 was larger than the mean of total imports for the years 2005-2009. In other words, imports were much larger than exports after the implementation of ACFTA. The Balance of Trade before and after the implementation of ACFTA was negative for Indonesia. In other words, the difference between total exports and total imports of Indonesia for six other countries such as Brunei Darussalam, China, Malaysia, Philippines, Singapore, and Thailand was still negative and two times larger after the implementation of ACFTA.

The study results found that there was a significant relationship between the Indonesian Balance of Trade before and after implementation of ACTFA; the result of a 2-tailed test was a value of 0.035. Since the significance for each individual tail of 0.0175 (0.035/2 = 0.0175) was smaller than the significance level of 0.025 (0.05/2), the Null Hypothesis was rejected. There was a significant difference in the Balance of Trade after the implementation of free trade among the ASEAN countries and China.
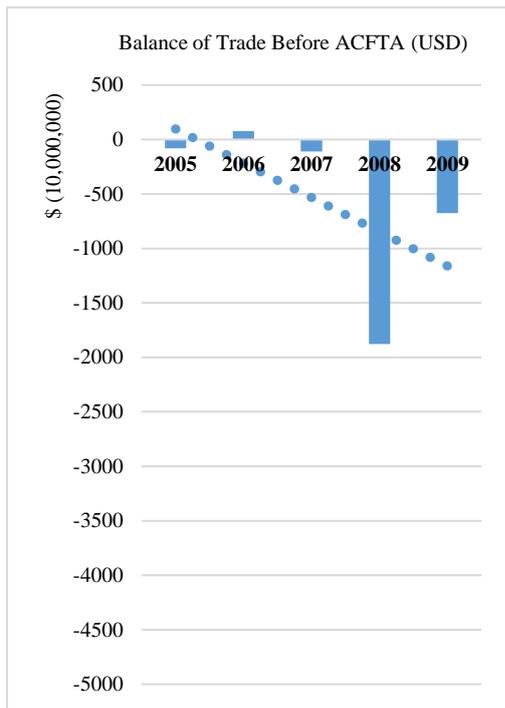
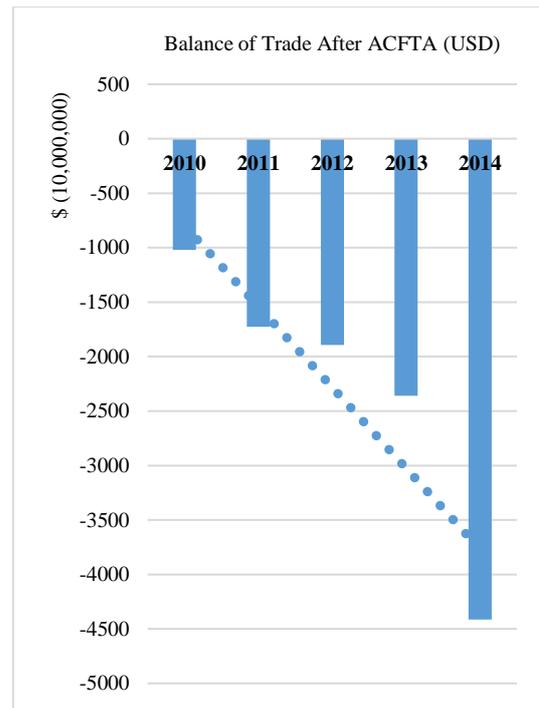**Figure 1**. Trend Line Before ACFTA



**Figure 2.** Trend Line After ACFTA

The Indonesian Balance of Trade shows that the linear regression line both before and after ACFTA moved from left to right yearly. The similarity in performance was seen through the negative direction of the trend line over time. Nevertheless, performance, as seen through the line, was steeper after the implementation of ACFTA. This means that the increase in imports was much larger than in exports after implementation of ACFTA. The performance ratio of exports and imports before ACFTA was smaller than after ACFTA. Regression analysis before ACFTA showed that the straight line of ($Y'= a + bX)$ predicts 2014 export at about US$25 billion dollars, and regression analysis after ACFTA in a straight line of ($Y'= a +bX$) is about $37.5 billion dollars.

This means that ACFTA made a difference in economic performance. These findings are in harmony with the conceptual theory which states that free trade has advantages and disadvantages. In this case, ACFTA brought about a disadvantage by increasing the amount of the negative trade balance. The trade balance is represented by the distance between the export line and the import line. Though the Balance of Trade before ACFTA was negative, but it was still better than the negative of Balance of Trade after ACFTA, simply because the amount was much smaller before ACFTA. It show that without ACFTA, the 2014 Balance of Trade would have had a deficit of about $25 billion dollars instead of $37.5 billion dollars.

**Conclusion**

Since the significance for each individual tail in the results was 0.0175 (0.035/2 = 0.0175), which is smaller than the tested significance level of 0.025 (0.05/2), the Null Hypothesis was rejected. After implementation of ASEAN-China Free Trade Area, there was a significant difference in the Indonesian Balance of Trade, which is shown in a linear regression line both before and after ACFTA that moved from left to right annually. A similarity in performance was found in the negative trend line direction over time. Nevertheless, performance was worse after the implementation of ACFTA. This means that the increase of imports was much larger than the increase of exports after ACFTA. The performance ratio of exports and imports before ACFTA was smaller after implementation of ACFTA. The linear regression line, both before and after ACFTA, moves from left to right every year, and the line was steeper after ACFTA. Moreover, the difference between exports and imports was much bigger after

ACFTA. The Balance of Trade was negative before and after free trade, but after free trade (2010-1014), it became worse.

These results show that ACFTA was a threat or a disadvantage for Indonesia. In sum, the linear regression showed that implementation of ACFTA increased Indonesia's negative in balance of trade from about $25 billion dollars to about $37.5 billion dollars after ACFTA was implemented. Therefore, this implies that Indonesia needs to improve the competitiveness of its products with respect to foreign products. Nonetheless, since the scope of this research applies only to ASEAN countries, the researcher suggests that future studies explore the type of impact this venture may have on other ACFTA member nations, as well as in the immediate region.

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