KENNESAW STATE UNIVERSITY
COLES COLLEGE OF BUSINESS
Bagwell Center for the Study of Markets and Economic Opportunity

Commentary

Title:

"Free Trade Agreements: Economics or Politics?"

Author(s):

Gohar Sedrakyan

September 2022

In light of a recent paper, Sedrakyan (2022),[1] which studied the impact of regional trade agreements on the change in trade of Indonesia, this Commentary tries to delve more into the role of Indonesia within the ASEAN free trade area (AFTA). This integrated zone has been the core driver of Indonesia's trade. The major policies impacting trade liberalization in Indonesia either came as cooperation within the AFTA or were free trade agreements (FTA) signed in the ASEAN Plus format, having AFTA at core. In other words, the main trade integration strategies that took place in Indonesia were conducted with the participation, to a significant extent, of the ASEAN agenda. Therefore, to get a general idea about the role of Indonesia in the AFTA zone is desirable.

There are ten member countries in the AFTA zone: Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. Although these countries operate in the highly integrated environment, a significant divergence is evident in terms of the level of trade among the member countries and overall economic development. Thus, according to World Bank statistics, GDP per capita, which reflects the share of national production per individual living in that country, in 2021 ranged from a low of $1,292 in Myanmar to a high of $66,176 in Singapore. Indonesia, with its GDP per capita at $3,855 was the fifth after Singapore, Brunei Darussalam, Malaysia and Thailand (*Figure 1*).[2] The AFTA has been in effect since 1992, with Indonesia joining in January, 1993. According to the studies in the area, although the FTAs are believed to accelerate trade and economic growth, Indonesia has been using these policy tools as an element of economic diplomacy (Soesastro and Basri, 2005; Syarip, 2020).[3,4] Other studies outlined Indonesia's political aspects at national and regional levels, where domestic politics, power relation, and regulatory regionalism were the driving forces behind this country's economic decisions (Saputro, 2017)[5].

Overall, Indonesia's factor endowments enable such influence. Thus, Indonesia has been an important player in the world trade. There are various contributing factors that form this role. With a population of over 275 million people it is the fourth most populous country in the world. Its population is also comparatively young – the median age is 31 years old and 70% of the population is of working age, making it a significant consumer market.[6] Indonesia's five major trading partners are China, United States, Japan, Singapore, and India. Combined, these five countries comprise over 50% of Indonesia's total trade. Interestingly, only one AFTA member country, Singapore, is among the top five major trade partners. All other countries, except for the United States, have agreements within the ASEAN Plus format.

[1] Sedrakyan, G.S. 2022. The impact of RTAs on trade in Indonesia. *The Bagwell Center for the Study of Markets and Economic Opportunity. Working Paper Series.* Kennesaw State University, https://coles.kennesaw.edu/econopp/docs/FTA-Indonesia-Sedrakyan.pdf.

[2] https://data.worldbank.org/indicator/NY.GDP.PCAP.KD?locations=ID.

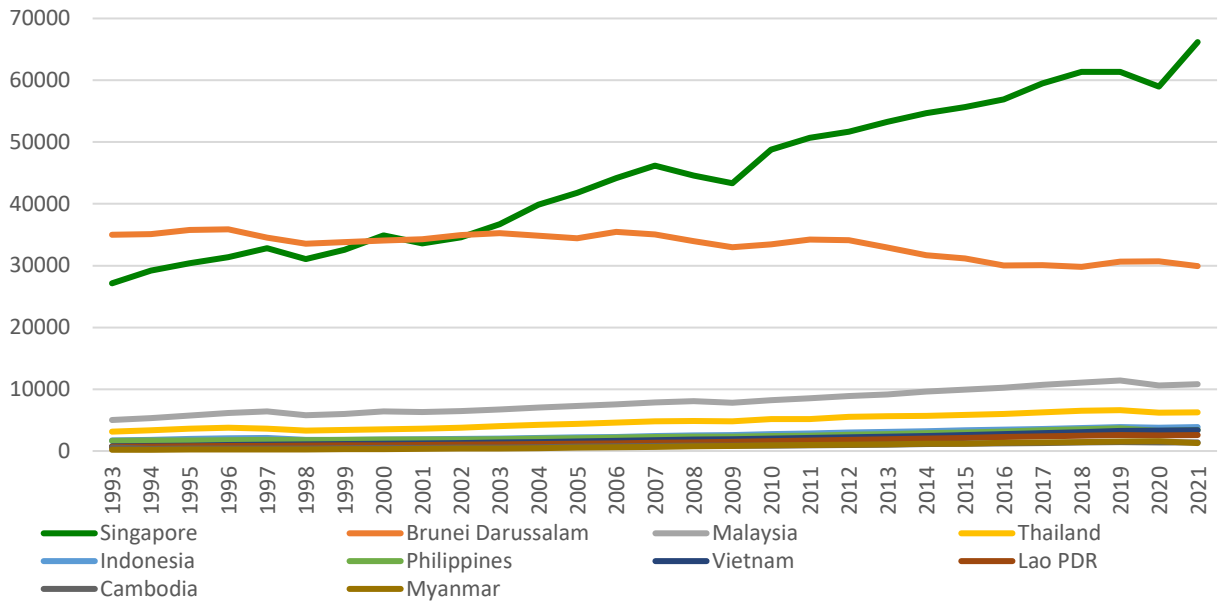
[3] Soesastro, H., Basri, M.C. 2005. The Political Economy of Trade Policy in Indonesia. *ASEAN Economic Bulletin*, 22 (1), 3-18.

[4] Syarip R., 2020. Defending Foreign Policy at Home: Indonesia and the ASEAN-Based Free Trade Agreements. *Journal of Current Southeast Asian Affairs*. 39 (3), 405-427.

[5] Saputro, E. 2017. Introduction: Indonesia and the Dynamics of Regional Financial Cooperation. In: Indonesia and ASEAN Plus Three Financial Cooperation. *Palgrave*, Singapore.

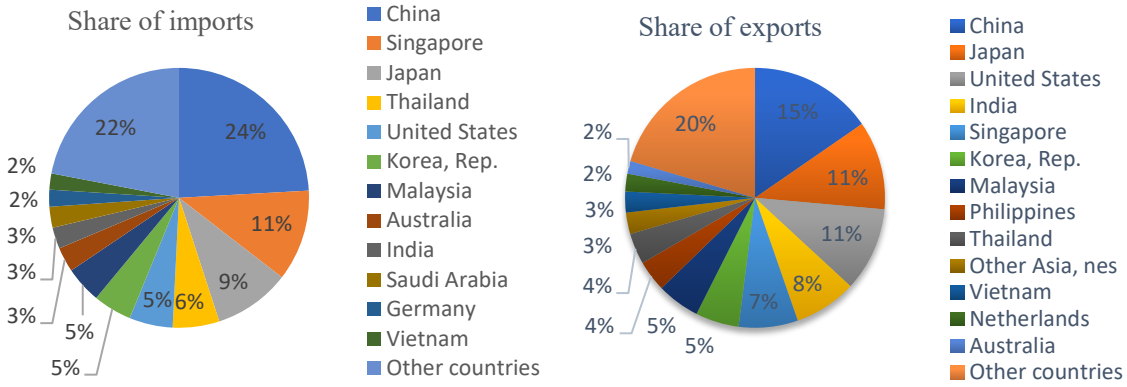
[6] https://worldpopulationreview.com/countries/indonesia-population.

Figure 1. GDP per capita (constant 2015 US$)



The following pie charts disaggregate trade statistics by exports and imports with various trading partners (*Figure 2*). These countries are chosen based on their contributed share of imports/exports, in descending order of trade with Indonesia. The left pie chart shows the distribution of imports to Indonesia. Not surprisingly, Indonesia has trade agreements with the majority of its primary trading partners. Some trade partners cooperate with Indonesia within the ASEAN free trade zone agreements (e.g., Singapore, Vietnam, Philippines). Others have signed either multilateral agreements in the ASEAN Plus format or cooperate through bilateral agreements. Most importantly, the pie charts reflect that the share of other countries' contribution to trade is much more limited relative to the contribution of the five major economies listed above.

Figure 2. Distribution of imports and exports by trade partners of Indonesia, 2019

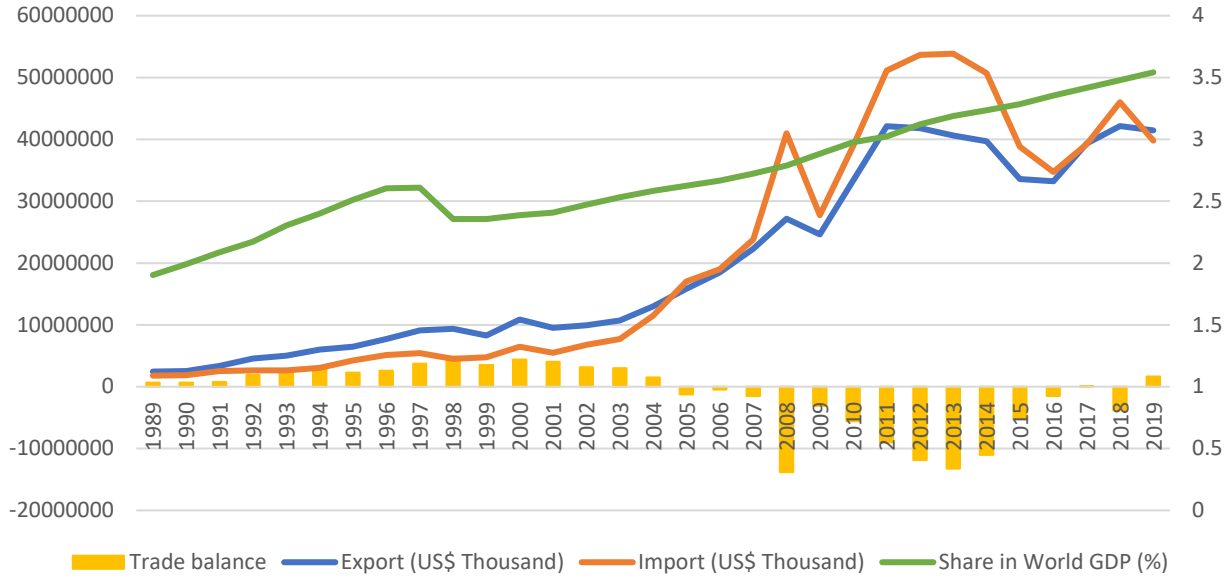


According to statistics from World Bank's World Integrated Trade Solutions (WITS) database, as of 2019 almost 30% of global exports of machines and electronics relate to Indonesia.

The same source suggests that over 20% of global imports of fuel relate to Indonesia. Although Indonesia trades with over 227 countries, due to the high trade concentration with large players, the barriers to entry this promisingly large market are significant. The high concentration of trade among five large players and other realities outlined above give bargaining power to Indonesian policy makers, who may turn economic policies into the tools of political influence.

According to the analysis of trade statistics with some of the trade partners Indonesia was better off before signing an FTA with them. This refers to both-AFTA and ASEAN Plus- types of FTAs. Overall, AFTA has been gaining importance. It has developed a significant presence in the world production of output during the period of its existence. In 1989, before AFTA formation, member countries comprised only 1.9% of World GDP, a share which has consistently grown over the last 30 years, increasing to 3.5% in 2019 (*Figure 3*). Indonesia, before officially joining the AFTA in 1993, had trade surplus with all AFTA partners except for Malaysia. However, this outcome continued for only a short time horizon, as it has reported a trade deficit with its AFTA partners in almost all years since 2005. This negative balance of trade with AFTA partners was reversed only in 2017 and 2019 (*Figure 3*).

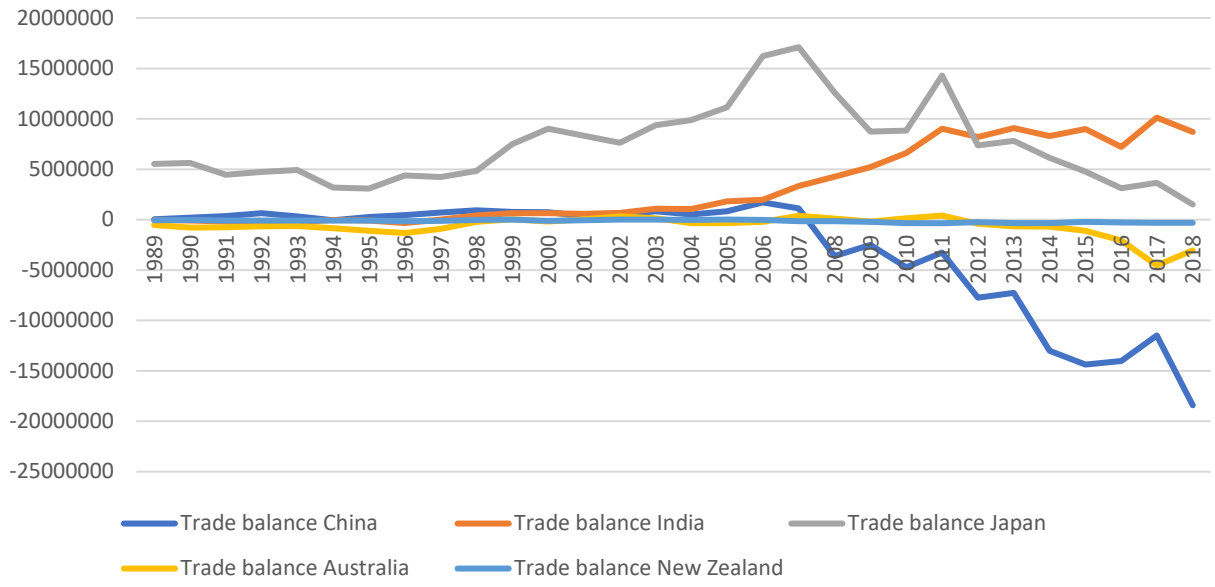
*Figure 3. Trade balance of Indonesia and its ASEAN partners (in thousand USD) and share of ASEAN in World GDP (%)**



**Right vertical axis reflects the share of ASEAN in World GDP (%)*

Sedrakyan (2022) evaluated the dynamics in trade, disaggregated by exports and imports, of Indonesia over the three decades from 1989 through 2019 and determined that trade balance in Indonesia did not benefit from the ASEAN free trade area (*Figure 3*) and ASEAN Plus (*Figure 4*) formats of trade agreements. In fact, the ASEAN Plus format had a negative impact on trade in Indonesia, since it not only diverted trade to some other partners (mainly those operating with the partial scope agreements), but also caused a major contraction in trade. Discussing the full array of findings of that article (available in the faculty research section of the Bagwell Center's webpage) is beyond the scope of this Commentary.

Figure 4. Trade balance of Indonesia with selected ASEAN Plus partners (in thousand USD)



To summarize, it appears that one of the major achievements of economics - and the macroeconomic policies based on those values - is to remain a social science discipline, uninfluenced by political biases. Those political biases may have the forms of short-term shocks, but in the long term the laws of macroeconomics and international trade will prevail and the economic developments will move in the direction they should.