THE IMPACTS OF CAFTA (CHINA ASEAN FREE TRADE) ON SMEs

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ABTRACT

Due to CAFTA effective since 1 January 2010, Indonesia should widely open its domestic market to ASEAN countries and China. The free market opening is a realization of free trade agreement between the six ASEAN countries (Indonesia, Thailand, Malaysia, Singapore, Philippines, and Brunei Darussalam) and China, provides the following impacts on MSMEs: a) positive impacts of CAFTA on MSMEs, b) negative impacts of CAFTA on MSMEs, c) opportunities for MSMEs due to the presence of CAFTA, d) the facts and limitations of MSMEs

The number of MSMEs from 2010 through 2011 as the following 1) there were 250 MSMEs served in 2010, and there are 524 MSMEs served in 2011; 2) 5500 craftsmen were accommodated in 2010), while in 2011 there 7500 craftsmen accommodated, 3) in 2010 there were MSMEs in 7 provinces out of 33 Provinces were served; in 2011 there were MSMEs in 22 provinces out of 33 provinces were served, 4) total stocks in 2010 was IDR 3,000,000, in 2011 the total stock is IDR 5,200,000,000.

Keyword: China-ASEAN Free Trade Area (CAFTA), MSMEs

I. BACKGROUND

The 2010 CAFTA Free-Market (China-ASEAN Free Trade Zone) has been effective since 1 January 2010; hence, Indonesia should widely open its domestic market to ASEAN countries and China. The opening of the free market is the realization of a free trade agreement between the six ASEAN countries (Indonesia, Thailand, Malaysia, Singapore, Philippines, and Brunei Darussalam) and China, called as the ASEAN-China Free Trade Agreement (ACFTA = CAFTA). This agreement has actually been planned since 2002. The pros for CAFTA (ACFTA) states that it is merely mean the potential invasion of Chinese-made products to Indonesia, but it also creates the opportunities for Indonesia to increase its exports to China and ASEAN countries. The RI Trade Minister Mari Elka Pangestu said that the Free Trade agreement (FTA) would provide many benefits for exports and investments in Indonesia (Kompas, 5/1/2010).

The concerns about the negative impacts of ASEAN-China free trade also is also rejected by Anggito Abimanyu. According to him, the proportion of trade between Indonesia, ASEAN and China is only 20%. On the other hand, Ernovian G Ismy, the Secretary General of the Indonesian Textile Association expressed his concern over the implementation of the ASEAN-China free trade; among others is the changing business pattern, from entrepreneurs to traders. Basically, when trading is more profitable due to the lower price of imported goods, a lot of national and local creative industries will be closed down and hence they will become traders only (Republika, 4/1/2010). He said that the number of textile industries, from small to large industrial scale, could reach 2,000 units.

When each of the textile industry is able to absorb 12-50 workers, imagine the destruction of the industry because it will be a lot of entrepreneurs will turn from textile manufacturers to become traders. This will also provide in the reduced employment. The deep concern about the dominance of China to Indonesia is also conveyed by the RI Minister of Industry, MS Hidayat. According to him, within business-oriented CAFTA framework, China will be able do anything to affect Indonesia given its stronger economic than Indonesia (Bisnis Indonesia, 9/1/2010). Market participants in the small business sector understand and share the true risks and the impact of such a free trade.

II. PROBLEM

The problem that we study concern with what the impacts of the free market policy (CAFTA) on the Indonesian MSMEs?

III. THEORETICAL REVIEW

A. CAFTA

1. **Definition**

   The China-ASEAN Free Trade Area (CAFTA) is the agreement between the ASEAN member countries and China to realize free trade area by eliminating or reducing trade barriers including both tariffs and non tariffs, improve market access services, investment rules and regulations, as well improve the aspects of economic cooperation in promoting the economic relations of ACFTA participants to improve the welfare ASEAN community and China[1].
2. **Objective of CAFTA effective on 1 January 2010 is to: [2]**
   a. strengthen and improve economic cooperation, trade and investment among member countries;
   b. progressively liberalize and promote trade in goods and services and create a transparent, liberal, and facilitative system;

[1] *ASEAN-China Free Trade Area. http://ditjenkpi.kemendag.go.id/*

[2] ibid

c. explore new areas and develop appropriate measures to perform economic cooperation among parties, and
d. facilitate more effective economic integration of the new ASEAN members (Cambodia, Laos, Myanmar, and Vietnam-CLMV) and bridge the gap of economic development among member countries

3. **Benefit**[3]
   a. The opening of market access for agricultural products (Chapter 01 to 08 2008 to be 0%) from Indonesia to China in 2004.
   b. The opening of the market access for export from Indonesia to China in 2005 with 40% higher than the Normal Track (± 1880 tariff posts), with the reduction tariff rates to be 0-5%.
   c. The opening of Indonesia's export market access into China in 2007 receiving 20% addition of the Normal Track (± 940 tariffs), with the tariff rate reduced to 0-5%.
   d. In 2010, Indonesia has obtained additional market access to exports to China due to the elimination of all tariffs in Normal Track for China.
   e. Until 2010 Indonesia have reduced 93.39% tariff (6683 tariff posts of totaling 7156 tariffs have been in the Normal Track), and it will be 100% eliminated in 2012.
4. **CAFTA on Goods Trading**
   In the CAFTA it is agreed that full liberalization is realized by 2010 for ASEAN 6 and China, as well as in 2015 for Cambodia, Laos, Vietnam, and Myanmar. The rate reduction in the ACFTA cooperation is implemented in three stages, namely:
   a. **Early Harvest Program (EHP)**
      The EHP products, among others involve:
      1) Chapter 01 to 08: livestock, fish, dairy products, plants, vegetables, and fruits (RI Ministry of Finance Decree No. 355/KMK.01/2004 - 21 July 2004 on the Decision of Customs Tariff on Imports of goods within the framework of ACFTA EHP .)
      2) Bilateral Agreement (Specific Products), among others, involve coffee, CPO, cocoa, rubber goods, and furniture (RI Minister of Finance Decree No. 356/KMK.01/2004 dated 21 July 2004 regarding the Decision of Customs Tariff on Imports of Goods Framework EHP Bilateral Indonesia-China FTA.
      The reduced rate started by 1 January 2004 and gradually to be 0% on 1 January 2006.
   b. Normal Track
      1) Threshold:
         a) 40% at 0-5% in 2005

[3] ibid

b) 100% at 0% in 2010 (Tariff on Some products, no more Than 150 tariff lines will be eliminated by 2012)

2) The number of NT II for Indonesia is 263 tariff heading (6 digits)

3) Legal enactment of NT for 2009 till 2012 has been issued by RI Minister of Finance No. 235/PMK.011/2008, 23 December 2008 on the Customs Tariff Decision in the ACFTA context.

c. **Sensitive Track**

1) Sensitive List (SL):

a) 2012 = 20%

b) Reduction to 0-5% in 2018

c) 304 products (HS 6 digits), among others, involve Leather Goods: handbags, wallets; Footwear: Sport Shoes, Casual, Leather, Glasses, Musical Instrument, Brass, stringed, strings, Toys: Dolls; Sporting Goods; Stationery; Iron and Steel, Spare parts, transport equipment; Glucocyde and Vegetable Alkaloids, Organic Compounds, Antibiotics, Glass, Plastic Goods

2) **Highly Sensitive List (HSL)**

a) 2015 = 50%

b) 47 HSL Products (HS 6 digits), among others, consist of Agricultural Products such as Rice, Sugar, Corn and Soybeans; Products Manufacture of Textiles and Textile products (ITPT); Automotive Products: Ceramic products, Tablewares.

B. MSME

1. Definition of Micro, Small and Medium Enterprises (MSMEs)

According to 2008 Law No. 20:

1) **Micro enterprise** refers to the productive micro business that individuals and or institutions own with the characteristics as set forth in this Law, which produce sales revenue exceeding IDR 100,000,000 (one hundred million rupiah) per year.

2) **Small Enterprise** concerns with the independent productive economic business, run by individuals or business entity that is not a subsidiary or branch of company, which is owned, controlled, or become the direct or indirect part of the medium or large business fulfilling the criteria of Small Business as defined in this Law, namely small-scale productive business and meetig the criteria of net worth at least IDR 200,000,000 (two hundred million dollars), excluding land and building as a place of the business or produce the sale of maximum IDR 1,000,000,000 (one billion rupiah) per year and can obtain maximum bank loan n of IDR 50,000,000 (fifty million rupiahs) up to IDR 500,000,000 (five hundred million rupiah).

3) **Medium Enterprises** refers concerns with the independent productive economic business, run by individuals or business entity that is not a subsidiary or branch of company, which is owned, controlled, or become the

direct or indirect part of the small or large business with a total net worth or annual sales as stated in this law, namely productive enterprises meeting the criteria of net business wealth higher than IDR 200,000,000 (two hundred million rupiahs) up to the maximum amount of IDR 10,000,000,000 (ten billion dollars), excluding land and building as business place, as well as receiving bank loans of IDR 500,000,000 (five hundred million rupiah) up to IDR 5,000,000.000 (five billion rupiah).

IV. DISCUSSION AND ANALYSIS

A. The Impacts of CAFTA on MSME

a. Positive Impact of CAFTA on MSME

Following are some positive impacts of CAFTA on MSME, (Leni Dewi Anggraeni)

1. CAFTA will create opportunities for Indonesia to invite investment. The investment can exploited to export goods to the non CAFTA member countries.
2. CAFTA can increase trade volume. This is motivated by the tight competition among producers. Hence, both producers and importers are able to increase their trade volume, which is inseparable from the product quality of the sources.
3. CAFTA will provide positive influences on the SOE's (State-owned Enterprise) 2010 earnings projections in aggregates. In addition, net income factor, the percentage of earnings pay out ratio also determine total dividends on the SOE profits. There is an optimism due to the CAFTA enactment. The SOE will be able to take advantage of cheaper capital goods and to sell products to China at a lower rate (the presentation of RI Minister of Finance, Sri Mulyani, in the ACFTA meeting with the House Representatives Commission VI at Parliament Building on Wednesday (20 / 1). The biggest share (91 percent) of government revenue on SOE's profit currently comes from state-owned mining sector, financial and banking services, and telecommunication. The SOEs require quite significant imports of capital goods and they can sell some of the products to China market.

b. Negative Impact of CAFTA on MSME

Following are some ACFTA negative impacts on MSMEs[4]:

1. Invasion of foreign products particularly from China potentially lead to the destruction of SME sectors targeted. Whereas before 2009 only Indonesia has undergone the de-industrialization process (industrial decline).

[4] Leni Dewi Anggraen , http://www.scribd.com/doc/25830743/dampak-ACFTA-terhadap-perekonomian-Indonesia

2. The foreign product-invaded domestic market with competitive quality and price will encourage MSME entrepreneurs to perform business shifting, from SME producers in various economic sectors to become importers or traders only. Such symptoms begin to appear since the beginning of 2010. For example, herbal traders are very pleased with the flood of legal Chinese herbal products with cheaper price and higher efficacy than local herbs. As a result, local herbal manufacturers are threatened to be out of business.
3. The domestic economy character will become less independent and weak. All sectors will depend on foreign supply. Even "simple" products , like needles should be imported. When so many economic sectors are dependent on imported products, while the vital sectors of the domestic economy has also been penetrated and controlled by foreign parties, what can be expected from the Indonesian economic strength?
4. When their domestic competitive edge is weaker, how Indonesian MSMEs' products will have greater strength to compete in ASEAN and China markets? The data showed that the trend growth of Indonesian non-oil exports to China from 2004 to 2008 was only 24.95%, while China's export growth trend to Indonesia recorded at the level of 35.09%. Even when Indonesia's exports can be boosted, the most potential to grow is to export raw materials rather than processed products with higher value-added, such industrial products. This pattern is even preferred by China who are being "thirsty" for raw materials and energy sources to drive its economy.
5. The roles of MSMEs' production will be lost and replaced by imported products. Consequently, the availability of job opportunities will increasingly decrease. Yet new labor force grow by more than 2 million people, while during the period of August 2009 the number of open unemployment in Indonesia reached 8.96 million people.

Several MSME sectors exposed to the CAFTA negative impacts involve[5]:

1. Accessory Supplier
   The accessory suppliers are suffering from declining sales due to cheaper imported products from China.
2. Garment
   Garment companies decline, even the distinct batik clothes of Indonesia. China-made garment products are considered as cheaper since the labor costs are very cheap, although its stitching quality is lower compared to Indonesian products.
3. Textile

[5] Bank Indonesia.2009.*Survei: Dampak Asean China Free Trade Area (ACFTA) Terhadap UMKM Di Provinsi Riau*. http://www.bi.go.id

One of the CAFTA-affected products are textiles. Indonesia has greater number of population; and it is good market potential; however, due to Chinese cheaper textile invasion will create declining level of Indonesian textile sales.

4. Rattan Craft

   The problem that the rattan industry encounters is the difficulty of rattan raw materials. Since the higher global market price of rattan, rattan producers tend to sell raw rattans. Lack of raw materials has caused rattan industry unproductive. The government is difficult in addressing the problem since no regulation control raw rattan sale.

B. MSME OPPORTUNITY DUE TO CAFTA ENACMENT

Here are opportunities for MSMEs in the presence of CAFTA:

1. With more open market access, there will be increasing in trading volume of superior product from every of the six ASEAN countries (Indonesia, Malaysia, Philippines, Singapore, Thailand, and Brunei Darussalam) to China, and vice versa. In addition, it will increase production capacity, marketing, human resources and institutions. Employers can reduce the excessive inventories due to production excitement. We can increase to make complement products that China cannot able to produce. And, the important thing is how to increase efficiency, productivity and creativity in order to increase sustainable competitiveness, which in turn will generate increasing profit margins.
2. Prices of goods and services become less expensive in the market place, with more and more diverse preferences.
3. The opportunities of natural resource-based manufacturing industries increase.
4. Specific agricultural commodities and products and natural resource products (oil palm, rubber, cocoa, coffee, etc.) from Indonesia tend to increase.
5. Export market access to China with a lower tariff rate for national products improves
6. Cooperation among business actors in both countries improve due to the establishment of “Strategic Alliance”.
7. Access to service markets in China for national service providers improve.
8. Foreign investment flows from China to Indonesia increase.
9. Opening in the transfer of technology (TOT) among businessmen in both countries improve.

C. CAFTA CHALLENGE FOR MSMEs

Following are the challenges for SMEs due the enactment of CAFTA[6]

1. Improving production efficiency and effectiveness to compete with Chinese products.
2. Creating a conducive business climate in improving competitive edge

[6] ibid

3. Applying transparent, efficient, and friendly-business community-based rules and regulations of investment
4. Improving skills in mastering information technology and communication, including marketing campaign and lobbying.

D. HOW FAR IS THE MSMEs' READINESS IN FACING CAFTA

1. Although MSMEs play very strategic roles, but they still have many shortcomings and challenges.
2. Not all MSMEs have the readiness to face CAFTA.
3. Weaknesses are still found in their management and human resources, technology and production, marketing, competitiveness, production, and capital.
4. Competing culture and paradigm that still needs improvement.
5. In case the bank is able to identify the MSME's weaknesses and able to help to fix it up to be bankable, the bank customers are potential as the source of bank revenue in the long term.

E. GOVERNMENT PROTECTION FOR MSMEs

There are ten policies that the government perform in anticipating the enactment of CAFTA in 2010. Such policies were launched referring to WTO rules as the following (Euis Amalia, 2010):

1. To and revise all of the expired Indonesian National Standard (SNI) and obligatorily implement by previously sending notification to WTO
2. To utilize the Anti-Dumping Committee (KADI) in dealing with any cases of alleged dumping practices and providing direct subsidies from trading partner countries
3. To effectively utilize the Indonesian Trading Security Committee (KPPI) in preventing the surge of imported goods in domestic market
4. To improve government lobby government in securing exports from Indonesia including the threats of dumping and subsidies from trading partner countries
5. To accelerate the implementation of Presidential Instruction No. 5 of 2008 on the Economic Focus of 2008-2009
6. To harmonize import duty (BM) of applicable tariff headings in general; hence the BM is effective for the upstream and downstream products to boost investment and competitiveness
7. To streamline the duties and functions of officers, including reviewing the possibility of red line application for products susceptible to illegal smuggling
8. To restrict / prohibit exports of raw materials to meet the need of energy for domestic industry so as to encourage the growth of processing industries in the upper level while strengthening the competitiveness of local industry
9. To maintain the Government Regulation (PP) on Income Tax Facilities for Investment in Particular Business Fields and /or in Specific Areas.
10. To continue the policy of *Permendag* (Regulation of RI Minister of Trading) No. 56 of 2008 regulating the port restrictions for five specific products including footwear, electronic goods, toys, garments, and food and beverages.

V. CONCLUSION

Due to CAFTA effective since 1 January 2010, Indonesia should widely open its domestic market to ASEAN countries and China. The free market opening is a realization of free trade agreement between the six ASEAN countries provides the following impacts on MSMEs:

a. Positive Impacts of CAFTA on MSMEs

1. CAFTA will create opportunities for Indonesia to invite investment. The investment can exploited to export goods to the non CAFTA member countries.
2. Increasing the volume of trading, hence producers and importers are able to increase the volume of trading
3. Improve the SOE's 2010 aggregate earnings projection .

b. Negative Impact of CAFTA on MSMEs

1. The destruction of MSME sectors targeted.
2. Encouraging MSME entrepreneurs to perform business shifting, from SME producers in various economic sectors to become importers or traders only These symptoms has found since the early 2010.
3. The domestic economic condition will be less independent and weaker. Everything depends on imported products.
4. The role of SMEs production will be cut and replaced by imported products. As a result, job opportunities decrease.

c. Opportunities for SMEs in the presence of CAFTA:

1. There is an increase in trading volume of superior product from every of the six ASEAN countries and vice versa.
2. There is an increase in production capacity, marketing, human resources, and entities.
3. Prices of goods and services become less expensive in the market place, with increasingly diverse preference.
4. Natural resource-based manufacturing industrial opportunities increases.

d. CAFTA Challenges for MSMEs

1. Improving production efficiency and effectiveness to compete with Chinese products.
2. Creating a conducive business climate to improve competitiveness
3. Applying transparent, efficient, and friendly-business community-based rules and regulations of investment
4. Improving skills in mastering information technology and communication, including marketing campaign and lobbying.

e. Facts and limitations of MSMEs

Following is the total of MSMEs from 2010 to 2011 (Smesco SMEs)

SME	2010	2011
Total SMEs served	250 SMEs	524 SMEs
Total craftmen accommodated	5.500 craftmen	7,500 craftmen
Total provincial SMEs served	7 out of 33 provinces	22 of 33 provinces
Total Stock	IDR 3,000,000,000	IDR 5,200,000,000

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