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Master's Thesis of Public Administration

Impact of Restrictiveness of Rules of Origin (ROO) on Indonesia's Utilization of FTAs:

Focusing on FTAs with China, Japan and Korea

원산지제한규정이 인도네시아의 FTA 활용에 미치는 영향:

중국,일본,한국과의 FTA 를 중심으로

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Graduate School of Public Administration

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ABSTRACT

Since the beginning of New Millennium, East Asia began emphasizing Free Trade Agreements (FTAs) as a trade instrument and today is at the forefront of world FTA activity. Asia is ahead of North and South Americas in FTAs per country—on average Asia has 3.8 concluded FTAs per country compared with 2.9 for the Americas. Indonesia as the biggest country in South East Asia did not want to fall behind its neighboring countries, have initiated rapid FTA proliferation. Until now, Indonesia has concluded seven FTAs and is negotiating nine more new FTAs.

Despite such a rapid proliferation of FTAs, it is still unclear about how much these FTAs have been utilized by the business sector and what factors determine the utilization of FTAs. This study assesses the effect of trade restrictiveness on the utilization of FTA in Indonesia, focusing on three FTAs: ASEAN-China FTA (ACFTA), ASEAN-Korea FTA (AKFTA) and Indonesia-Japan Economic Partnership Agreement (IJEPA). The three East Asian countries are selected because of their unique variations.

This study finds that more restrictive rules of origin are highly associated with less utilization of FTAs.

Keyword: Indonesia, Utilization of FTA, ACFTA, AKFTA, IJEPA, Rules of Origin

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CHAPTER 1

INTRODUCTION

1.1 Background

Making the world trade flows smoothly and freely has become objectives of many countries since the end of World War II. Removing trade barriers and making the trade flow freely are believed to be the best way to improve everybody's welfare: Consumers and producers know that they can enjoy secure supplies and greater choices of the finished products, components, raw materials and services they consume; increase productivity and investment, reduce unemployment and increase economic growth. From the beginning of the General Agreement for Tariffs and Trades (GATT) in 1946 when 23 countries were bound to regulate their international trade through substantial reduction of tariff and other trade barrier, now 159 countries have joined the World Trade Organization (WTO). However, the gap of development between member countries in the WTO is too wide to be bridge. Hence, the last multilateral negotiations, Doha Round, still does not reach conclusion yet for 12 years since its beginning in 2001.

Stagnation of multilateral agreement does not stop countries efforts to reduce trade barriers and increases export performance among them. Hundreds of regional and bilateral free trade agreements (FTAs) have been made during the last two decades (1992-2012). Asian region is not an exception of this

global trend. Asia began emphasizing FTAs as a trade instrument in the late 1990s and today is at the forefront of world FTA activity. The Asian Development Bank (ADB)'s Asia Regional Integration Center (ARIC) FTA Database (www.aric.adb.org) provides information on the number of concluded FTAs in Asia between 2000 and 2010 (as of August 2010). The numbers of concluded FTAs in Asia as a group increased from only 3 to 61 during that time. Of these, 47 FTAs are currently in effect. The proliferation of FTAs in Asia is likely to be sustained: another 79 are either under negotiation or proposed. Asia is ahead of the Americas in FTAs per country—on average Asia has 3.8 concluded FTAs per country compared with 2.9 for the Americas (Kawai and Wignaraja, 2011).

There are at least five major drivers of rapid proliferation trends in the Asian region:

First, is to increase intra regional trade in the region. According to Kawai and Wignaraja (2011) Asia's advanced production networks (especially in three big economy China, Japan and Korea), which underlie its spectacular global export success, has increased intra-regional trade in Asia particularly in the production of parts and component. Meanwhile, ASEAN members are increasingly entering into FTAs as a means to expand trade and increase their participation in Asia's advanced production networks. Therefore, FTAs are a vehicle to support the deepening of production networks through trade and investment liberalization.

Second reason is to increase export performance and improve the welfare. Except for Japan (which averaged MFN rate = 3%), almost other countries in East Asian has relatively moderate to high import tariff. China for example has applied average MFN tariff rate 10%, or Korea applied average MFN slightly higher than 12%. Implementation of FTA will eliminate most of those rate and increase flow of trade among region.

Third reason is to create strong economic region and attract investment. Some of the East Asian countries are densely populated countries (such as China and Indonesia) have relatively abundant cheap labors which are good as a production base for labor intensive industry. By creating a single market through regional wide FTA (such as AFTA or EAFTA), it will also create a very large consumer market and attract investment to the region.

Fourth reason is stagnation of the multilateral trade negotiation. With the WTO Doha round stagnation, regional and bilateral FTA could be the only means for Asian countries to move forward for liberalizing tariff and hence increase trade and investment flow between them.

Fifth reason is Asian financial crisis phenomenon during year 1997-1998 has opened the eyes of the Asian leaders to the importance of the regional wide FTA. Before the crisis, China, Korea, Singapore, Thailand, and Indonesia were regarded as Asian Tiger countries because of its robust economic growth of above 5% a year. But when the crisis came, the economy of these Asian tiger countries was hit hard and even experienced negative growth for the first time since decades. South Korea's GDP was shrinking to -7%, Japan's and

Singapore's GDP were shrinking to -2%, Thailand's GDP shrinking to -11%, and Indonesia suffer the most with its GDP shrinking to -13% during 1997-1998. Only China managed to avoid crisis impact and experienced positive growth rate of 7.8% during Asian financial crisis time thanks to its stable exchange rate of Yuan and high growth of export. According to Zhang Yunling (1998), a long time of high growth has made Asian countries economies overheating and excess capacities exist in almost every country in the region along with imprudent lending and borrowing. This, in turn made debt structure vulnerable and the economies unsustainable.

However, this ASEAN+3 summit meetings failed to develop into a regional-wide FTA among the 13 countries, but rather developed into 3 separated bilateral FTA that is FTA between ASEAN member countries (10 countries as 1 entity) and China (ASEAN-China FTA), ASEAN - Korea Comprehensive Economic Partnership Agreement (AKCEPA) and ASEAN-Japan Comprehensive Economic Partnership (AJCEP). Furthermore, instead of unite into single wide-region FTA, some ASEAN member countries pursued bilateral trading agreement separately with the 3 East Asian countries, starting with Japan and Singapore FTA concluded in 2002, Japan continue expanding its bilateral trade agreement with Malaysia (2005), Indonesia (2007), and the rest of ASEAN member countries. Korea also concluded bilateral economic agreement with Singapore (2005) and Indonesia (under negotiation) and China concluded FTA with Singapore in 2008.

Despite this rapid proliferation of FTA in the East Asian regions, there are numerous studies assessing utilization of those FTA in Asian regions are quite low. Studies conducted by Takahashi and Urata (2009), Hiratsuka, et al. (2008), and Hayakawa, et al. (2009), using industrial level survey data found that Japanese company utilization rates of FTA ranges only between 33% and 12%. Similar results also visible for Korean company. Studies conducted by Inkyou Cheong and Jungran Cho (2009) from a survey conducted on 120 Korean firms, found only one out of five enterprises was found to be utilizing them. A more broad studies conducted by Kawai and Wignaraja (2011) utilize comprehensive surveys of 841 exporting firms in Japan, China, Korea, Singapore Thailand and Philippines, also shows only 28% of the companies surveyed is currently used FTA preferences. If utilization of FTA by the business is low, then FTA could not meet it desired goals to increase trade and investment flow and improve welfare.

Scholars in the international trade area have conducted many researches trying to explain what factors could determine utilization of a free trade by the company or business entity. There are numerous of factor that can explain utilization of FTA by firms both theoretically and empirically, and restrictiveness of the Rules of Origin (ROO) is one of key factors that are commonly used in many studies. The Rules of Origin, which is a set of criteria to determine which country one product is made or originated, is existed in every FTAs with additional function to judge whether one product could be given preferential tariff treatment or not. Economic justification for this Rules of Origin to be existed in the FTA is to avoid free-rider by

countries outside member of the FTA to enjoy the preference (FTA) tariff by transshipping or re-export product from one FTA member countries who has the lowest MFN tariff to the other FTA member countries.

Fortunately, WTO did not set standard for preferential ROO, so every FTA is free to set up their Rules on Origin. As a result every regional FTA has their unique pattern of ROO and difference in rigidity too. ROO that is too rigid will incur cost for the producer to meet the specification required and discourage the benefit of FTA.

1.2 Research Question

The main topic in this research is trying to study the effect of Rules of Origin (ROO) on Utilization of Free Trade Agreement by Indonesian business actors. Furthermore, this research is trying to answer several questions that needed to be studied more as follows:

1. Indonesia has concluded and implemented several FTAs so far. Does implementation of those FTAs improved flow of trade (export and import) of the Indonesian economy or not?

2. How restrictive is ROO in different FTAs that have been concluded by Indonesia?

3. Does restrictiveness in ROO affect Utilization of FTAs by business sector?

This research focus on Indonesia FTAs with 3 big East Asian Nation (China, Korea and Japan) under regional ASEAN-China Free Trade Agreement, ASEAN-Korea Comprehensive Economic Partnership Agreement, and bilateral Indonesia-Japan Economic Partnership Agreement.

1.3 Purpose and Significance of Research

While there are many studies examines utilization of FTAs and its effect in the trade and investment flow in America and Europe region, there are still limited studies on utilization of Asian FTAs, specifically ASEAN region. Especially in Indonesia, despite of many FTAs have been concluded and taken into force since 2010, industrial-level survey assessing firms utilization of FTAs are still not available. Therefore, this study of utilization in Indonesia featuring its unique economic structure has practical significance for the government effort to increase utilization of FTAs as well as academic significance to enrich the literature of the study in the field of FTA and ROO.

CHAPTER 2

LITERATURE REVIEWS

2.1. Rise of Regionalism in East Asia

Since the beginning of the new millennium, East Asian countries (includes North East Asia countries; China, Korea and Japan) and South East Asian countries are pursuing preferential trading agreement with its neighborhood or even cross continent countries, small or big countries, taking various form of bilateral, regional or multilateral PTA. What are the motives that move East Asian countries to leave multilateralism? What is pattern behind these fast growing PTA proliferations in the East Asian countries?

Aggarwal and Koo (2005) add to a view called institutional bargaining approach to more adequate analyze the shift of East Asian trading arrangement. Aggarwal and Koo judge the process of a shift from initial institution caused by external shock: first is political shock from the end of Cold War, made it easier for East Asian countries to consider regionalism; second is economic shock of Asian Financial Crisis 1997 made East Asian countries to recognize tighter institutionalization—create East Asian regional PTA—to provide a stable and secure market for their export. This was strengthened by the slow progress in multilateral arrangement (GATT/WTO).

Aggarwal and Koo (2005) put emphasis on the dynamic of two regional rivals—Japan and China—and South Korea as bridge to shaped pattern of the East Asian PTAs. Both China and Japan pursue the same goal to use regional

PTA as a means to place them self as regional economic leader, while South Korea pursued PTAs in order to strengthen its bargaining position. As for China, Cho Ko-Un (2009) argue that China also use PTA to wipe out 'China Threat' perception out of its fast growing economic and military power, to avoid hegemony rivalry with the US in the multilateral level and build supportive power starting from Asian region, specifically from ASEAN countries. Meanwhile, ASEAN members are increasingly entering into FTAs as a means to expand trade and increase their participation in East Asia's advanced production networks (Kawai and Wignaraja, 2011).

On the First ASEAN+3 Summit meeting in Kuala Lumpur, December 1997, the leaders exchanged views about forming regional-wide East Asian FTA. But until several Summit meeting, it still cannot decide when to start negotiation. Aggarwal and Koo (2005) analyze that for Japan, a trilateral agreement with China and South Korea is least attractive since it was worried about China's rising hegemony. Japan's first PTA guidelines announced in October 2002 make it clear that its long-term objective is to create a Trans-regional East Asian FTA since it would provide a larger buffer between China and Japan (Aggarwal and Koo, 2005).

2.2. Rules of Origin and Its Impact on FTA utilization

2.2.1. Types of ROO

Rules of Origin (ROO) are a set of criteria used to determine the origin (country) of a product for the purposes of international trade. There are two

types of Rules of Origin, non-preferential and preferential ROO. Non-preferential ROO are used to distinguish foreign from domestic products in establishing anti-dumping and countervailing duties, safeguard measures, origin marking requirements, and/or discriminatory quantitative restrictions or tariff quotas, as well as in the context of government procurement (Estevadeordal and Suominen, 2004). Preferential ROO is used in every Free Trade Agreement (FTA), first is to judge whether one product could be given preferential tariff treatment or not. Because only product that meet ROO criteria and given status originated from one FTA member countries are eligible for given tariff preference. Second is to prevent trade deflection from countries outside member of FTA to one of the member trough transshipment via one member of the FTA who has the lowest MFN tariff. Unlike non-preferential tariff which have ROO set by WTO, preferential ROO have no standard and is negotiated in the specific FTA.

Both non-preferential ROO and preferential ROO have two dimensions: sectoral, product-specific ROO and general, regime wide ROO.

a. Product-Specific ROO

In product-specific regime ROO, different criteria of origin are applied per commodity, usually on the basis of HS code 6 digits. FTA agreement that using this regime usually have long list of Product Specific Rules (200 pages or even more) attached to its agreement. Example of product-specific regimes

of ROO is NAFTA, Asean-Korea CEP, Indonesia-Japan EPA, Japan-Singapore FTA, etc.

Product-specific regimes recognize 2 main criteria to determine origin: wholly obtained or produce and substantial transformation. The wholly obtained or produced-category applies only to one PTA member, and asks whether the commodities and related products have been entirely grown, harvested, or extracted from the soil in the territory of that member, or manufactured there from any of these products. The rule of origin is met through not using any second-country components or materials. Most countries apply this strict and precise definition (Estevadeordal and Suominen, 2004).

The substantial transformation-criterion is more complex, involving four main components that can be used as stand-alone or in combinations with each other.

The first component of the substantial transformation criterion is a change in tariff classification (CTC) between the manufactured goods and the inputs from extra-PTA parties used in the productive process. The CTC may require the product to alter its chapter (2 digits under the Harmonized System), heading (4 digits), subheading (6 digits) or item (8-10 digits) in the exporting PTA member (Estevadeordal and Suominen, 2004).

The second criterion is an exception attached to a particular CTC (ECTC). ECTC is basically prohibition for some material which is non-originating from exporting PTA member to be used in the production process.

The third criterion is value content (VC), which requires the product to acquire a certain minimum local value in the exporting country. The value content can be expressed in three ways: as the minimum percentage of value that must have been added in the exporting country (domestic or regional value content, RVC); as the difference between the value of the final good and the costs of the imported inputs (import content, MC); or as the value of parts (VP), whereby originating status is granted to products meeting a minimum percentage of originating parts out of the total.

The fourth ROO component is technical requirement (TECH), which requires sufficient transformation to be taken in manufacturing process in the exporting countries. This criterion is usually used governing ROO of textile sector to prohibit minimum processing such as dyeing, cleaning, labeling, etc to acquire originating status.

b. Regime-Wide ROO

Unlike product-specific regimes ROO which different criteria of origin are specified to each product, regime-wide ROO set a general rules to be employed for all products. There are three main rules use in this regime-wide ROO: first is *de minimis* rule, which allow a certain percentage of non-originating input material to be used in the production process. Second rule is a roll-up or absorption principle, which allows material that have acquired origin by meeting specific processing requirements to be considered originating when used as input in a subsequent transformation. Third rule is accumulation principle, which allows material that is imported from another

FTA member to be used in the manufacturing process and treat them as their own originating material. There are three types of cumulation: bilateral cumulation that is use between the two FTA partners, diagonal cumulation allows countries that tied under the same set of preferential ROO to use product that originate in any part of the common ROO zone as if they originated in the exporting countries. As for full cumulation is more liberal than diagonal cumulation by allowing producer to use input material that is produced in the common ROO zone, even if this input material were not originating product: all processing in the zone is calculated as if it had taken place in the final country of manufacture (Estevedordal and Suominen, 2004).

This 3 rules of regime-wide ROO (de *minimis*, roll up, and cumulation) give more leniency for producer to use non-originating material compare to CTC. This is because Harmonized System (HS) code, which is the international standard use for product classification is not specially made for CTC based of ROO. Take automotive and machinery for example, many automotive component or input material is classified in the same Heading or even Sub-Heading with the final product.

However, this leniency in the regime-wide ROO is usually limited by another provision such as: minimum process criterion, which state processing that considered not sufficient for granted origin, such as dyeing, labeling, packaging, etc.

From the perspective of Administrative, institution issuing certification of origin (COO) could be divided by 3:

1) Self certification: in this certification method, producer or exporter itself who issued certificate of origin.
2) Public certification: in this certification method, a state institution (ministry or agency), a sector umbrella organization, or certain private institution is given authority to issue COO.
3) Combination of private certification and public certification.

The self-certification model can be seen as placing a burden of proof on the importing country producers; as such, it arguably minimizes the role of the government in the certifying process, entailing rather low administrative costs to exporters and governments alike. In contrast, the two-step system requires heavier involvement by the exporting country government and increases the steps—and likely also the costs—that an exporter is to bear when seeking certification (Estevadeordal and Suominen, 2004).

2.2.2. Impact of ROO on Utilization of FTA

There are some researches concerning importance of Rules of Origin (ROO) in its relation with Free Trade Agreement. Krueger (1999) observed the ROO may behave as a hidden barrier that can create a trade diversion effect: For example, Mexican firm exporting goods and product to U.S. are forced to utilize expensive American intermediate product in order to meet ROO and given preferential tariff. Study by Krishna (2005) show that FTAs are often not as liberalizing as it could because ROO are in themselves hidden protection: they create what look like tariffs on imported intermediate inputs

and affect the price of domestically made inputs as well. He also argue that since ROO are negotiated industry by industry, in that that manner, well organized industries could essentially insulate themselves from the effects of the FTA by devising suitable ROO. Krishna and Krueger (1995) viewpoint that the basic of ROO is to raise the production cost of the product which meets the binding ROO. Increases in the cost of production with ROO could be recognized as a partial reflection of restrictiveness of ROO, the more restrictive ROO raised the minimized level of cost.

Empirical approach estimates restrictiveness of ROO and its influence on market access is initiated by Estevadeoardal (2000). Estevadeoardal makes a Restrictive Index ranging from 1 to 7, where index 1 represent the least restrictive and 7 represent the most restrictive index. Using this restrictiveness index, he builds a model with two endogenous variables: the severity of the ROO and the length of the phase in period. Severity of ROO is determined by exogenous factors like the difference in the (MFN) tariffs between the countries as well as the extent of intra FTA trade.

Table 2-1. Estevadeoardal's Restrictiveness Index:

Restrictiveness Index (y*)	Requisites
7	- CC < y* < CC & TECH - WO
6	- CH & RVC < y* ≤ CC
5	- CH < y* ≤ CH & RVC - When RVC is a single standard RVC (> 50%)
4	- CS & RVC < y* ≤ CH - When RVC is a single standard RVC (≤ 50%)
3	- CS < y* < CS & RVC
2	- CI < y* ≤ CS
1	- y*≤ CI

Estevadeordal and Suominen (2004) comparing the restrictiveness index across economic sector of several FTA in Europe, US, Latin America and East Asia countries. They found that average restrictiveness of ROO is somewhat vary among region, Europe restrictiveness index of ROO falls between 4 and 4.5, US is more restrictive with index falls between 4.5-5, Latin America is quite lenient with restrictiveness falls between 4-4.5 and East Asian countries (Japan and Korea) are highest with restrictiveness index falls around 5. Furthermore, they found important variation in the degree of restrictiveness across economic sector, while there is also the similar restrictiveness level for each economic sector across regimes/region. Agriculture products and textiles and apparel marked by particularly high restrictiveness score in each regime.

Cadot et al. (2002) using Estevadeordal's index and the measure of tariff preferences in NAFTA to analyze the Mexican export to US. The study shows results that as ROO became more restrictive, the volume of Mexican export to the U.S. decreased. On the contrary, as margin of preferential tariff to MFN increased, the export volume increased. The increase in Mexican export to U.S. under NAFTA can be interpreted as exceeding of positive impact due to preferential tariff margin to the negative impact of ROO.

Kim and Cho (2010) estimated impact of ROO on FTA utilization in Korea FTAs (Korea-Chile, Korea-Singapore, Korea-EFTA, and Korea-ASEAN FTA). Kim and Cho (2010) use modified Estevadeordal's Restrictiveness Index to measure restrictiveness on Korea FTAs ROO (Korea-ASEAN FTA, Korea-Chile FTA, Korea-Singapore FTA), found Korea ROO are more complex than NAFTA since its cover 61 types. Kim and Cho classified ROO restrictiveness index as indicates on the table below:

Table 2-2. Types of Origin Criterion for Korean FTA and Restrictiveness Index by Kim

Restrictiveness Index	**Types of Origin Criterion**	**Korea-ASEAN FTA**
7	CC+ECTC+RM ; CC+ECTC+TECH ; CC+ECTC+TECH or CS*+TECH ; CC+RM ; CC+RM or RVC+RM ; CC+RM+TECH or RVC ; CC+RVC ; CC+TECH ; CC+TECH or RVC ; CC+TECH or RVC+TECH+RM; CH+RM or RVC ; CH+RM or RVC+RM; RM ; RVC+RM ; WO	786 (15.05%)

6	CC ; CC or CH* ; CC or CH*/CS+RVC ; CC or CH*+RVC ; CC or CH+RVC ; CC or CS* ; CC or CS*+RVC ; CC or CS+RVC ; CC or RVC ; CC or RVC+TECH ; CC or TECH ; CC+ECTC ; CC+ECTC or CH*+RVC ; CC+ECTC or CS*	246 (4.71%)
5	CH or CH*+RVC; CH+ECTC or CH*+RVC ; CH+RVC ; CH+RVC or CS*+RVC ; CH+RVC or RVC. RVC (>40%)	47 (0.9%)
4	CH ; CH or CS*+RVC ; CH or CS+SCTC+RVC ; CH or CS+RVC ; CH or CS+TECH ; CH or RVC+TECH ; CH or TECH or RVC ; CH+ECTC ; CH+ECTC or CS* ; CH+ECTC or CS* or CS*+RVC ; CH+ECTC or RVC ; CH+ECTC or TECH ; CS* or CH RVC. RVC(≤ 40%)	4,084 (78.16%)
3	CS*+RVC ; CS+ECTC or CS+RVC* ; CS+ECTC+RVC ; CS+RVC	-
2	CS ; CS or RVC ; CS+ECTC	61 (1.17%)
1		-
Total		5,224

Source: Kim (2010)

Building on the studies by Cadot *et al.* (2002) and Carrere and de Melo (2004), Kim and Cho (2010) employ regression where utilization rate for Korea's imports from ASEAN is function of the Margin of Preference (difference between preferential tariff and MFN), ROO Restrictiveness Index, average imports per-application, and sector-specific and time series dummy variable. The result shows that more restrictive ROO has negative impact on the utilization rates. Margin of preference also showed a significant and positive relation to the utilization of FTA while average value per FTA application did not show any significant relation. Variance in utilization of FTA also found in

some sector depending on location and trade relation to their respective FTA partners. For Korea export to Singapore and EFTA, chemical and rubber product and general machinery have high utilization. While for Korea imports from ASEAN shows high utilization for primary and processed primary products.

Parallel with finding by Kim and Cho (2010), another empirical study by Takahashi and Urata (2009) also confirmed relation between utilization and restrictiveness of ROO. Takahasi and Urata (2009) examines the use of Free Trade Agreements by Japanese companies based on firms level survey conducted in 2008 and find that utilization rate of FTA ranges between 32.9% (Japan-Mexico FTA) and 12.2% (Japan-Malaysia). The survey and statistical analysis results the obstacle to using FTAs include limited magnitude of foreign trade with FTA partner countries, difficulty in obtaining the certificate of origin that is required by FTA, lack of knowledge of FTAs, and the small tariff preference. They also suggested that to obtain greater benefit of FTAs, government should reduce the cost to obtaining ROO and established FTA with FTA trading major.

Hiratsuka, et al (2009) conducted studies to investigate what kinds of Japanese affiliates in ASEAN are more likely to use FTAs in their exporting. They use JETRO survey on more than 1800 Japanese firms and found that the highest level of FTA usage is in Singapore (43.2%), followed by Indonesia (35.9%), and Thailand (22.5%). When it comes to import, use of FTAs for import is prevalent in Oceania (33.3%), Indonesia (28.7%), and Thailand

(25.3%). From the survey it is also known that firms reasons for not utilizing ROO is that "importer are exempted from tariff" (investment policy for freeing import of machinery and other input material that did not produced domestically) and tariff are already low (gained by using FTA is offset by additional cost burden for certificate issuance and processing). The study finding the larger affiliate the firm has in respective FTA partner (by term of scale and magnitude of trade), more likely it is to utilize an FTA in its exporting. This result is analogous with the previous study by Takahashi and Urata (2008, 2009). Another interesting finding is that firms are exporting actively to developing countries (such as China) rather than developed countries such as Japan, could be implication that tariff margin is wider in developing countries so that exporter can enjoy large benefit from using an FTA.

Another approach toward ROO focuses on estimating ROO related cost, including administration costs generated when government agencies such as customs manage and investigates place of origin and compliance costs such as trade diversion examined by Krueger (1999) above.

Furthermore, Cheong and Cho (2009) study shows that from business perspectives, only one third of business know about ROO in details and hence can comply with it. Most of them are big business which had enough capital and human resources/specialist to deal with ROO process (administration and compliance). Korea business perception to the next Korea FTA should include less restrictive ROO.

Study on the impact of the implementation of ASEAN-China FTA (ACFTA), conducted by Ministry of Industry in 2010. Its purpose was to ensuring that domestic market and industry are not negatively influenced by the implementation of ACFTA. This study covered broad aspect including survey on the public awareness to the implementation of FTA. One of its findings is that some industries are still lack of information about ACFTA. Utilization of FTA E-form (for ACFTA) is still very low. The reason is because industries think that to get certificate of origin (COO) E-form they must going trough strict administrative procedure which spend lots of cost and time.

2.3. Foreign Direct Investment and its Impact on Utilization

Takahashi and Urata (2008, 2009) examine FTA usage by Japanese firms at the firm level by means of a questionnaire survey. They conduct an empirical studies using probit model with explanatory variable related to company characteristic, using three indicator: company size (big or small), company relationship (does company have overseas company affiliate or FDI or not), and the dummy sector to observe the use of FTAs by different trading product. Their findings are as follow; First, large firms are more likely to use FTA schemes, since they have abundant resources (especially labor to deal with administration of FTA scheme). This finding is consistent with Kohpaiboon (2008) at the sector level. Second, firms with close trade and FDI relationships with FTA partner countries tend to use FTA schemes.

2.4. The Role of FTA in Indonesia Trade Strategies

2.4.1. Role of Trade in Indonesia Economy

During 1970 to 1980 Indonesia economy is growing at remarkable speed of 7.5% per annum. Indonesia export of oil and gas and global energy crisis in 1970s which increase price of oil is the major driver for growth at that time. But during early 1980s, slowing economic activity in industrial countries and a surplus of crude oil supply in the world has reduced the oil price sign significantly. This has reduced Indonesia export earning and budget revenues and therefore GDP growth is slowed to around 3.8% per annum during 1980-1985.

In response to this situation, Indonesia government undertook some adjustment programs to increase economic efficiency. No less than twenty-four packages of economic reforms were introduced from 1983 to 1995, aimed at increasing economic efficiency and encouraging investment as well as non-oil export (Soesastro and Basri, 2005). The measure has successfully declined the level of protection, shift from import substitution to export orientation, particularly in manufacturing sector, and increase annual growth rate to 6.3 percent during 1985-1990.

According to Soesastro and Basri (2005), from 1985 to 1995 growth of export was driven by the increase of market share (competitiveness factor), all of Indonesia major export products; plywood, textiles, foot wears, garments, palm oil, printing and writing paper and electronics experienced an increase in RCA (Revealed Comparative Advantage). However, from 1995 to 2001 the

growth of export was dominated by demand factor but actually a declined in the market share (reduced in RCA). For example in 1994 Indonesia ranked first in textile import to EU with 22.6% share, but in 2001 Indonesia ranked third after China and Thailand with a share of 10.5%.

Basri and Hill (2004) argued that trade liberalization in the mid 1980 is successful due to real exchange rate depreciation trade shocks in the collapse of the oil price. This factor has increased non-oil export and less pressure for import protection. But then the situation changed; rupiah real exchange rate appreciated, minimum wage raised, pervasive corruption and high-cost economy emerged, led to the erosion of Indonesia's manufacturing sector competitiveness. Therefore, forming FTAs or PTAs is indeed important to counter balance protectionist measures and maintain momentum for trade and economic reform.

Indonesian Chamber of Commerce (KADIN) also pushed the government of Indonesia under President Bambang Yudhoyono in the beginning of his first presidential term (2004) to engage in bilateral FTAs with Indonesia main trading partner. Since the Coordinating Minister for Economic Affairs was the outgoing chairman of KADIN, it was logical that government would adopt it as its policy. The Minister for Trade at that time, Mari Elka Pangestu was prominent researcher in international trade area and in her view Indonesia cannot but follow suit as its neighbors are already forming bilateral FTAs, and not simply follow but aim to produced high-quality FTAs (comprehensive partnership).

Brenton and Ikezuki (2003) observed that developing countries are becoming more important markets for Indonesia. Indonesia's manufacturing export to non-OECD countries has risen significantly from 41% of those to OECD countries in 1990, to around 80% in 2001. Noted also export to East Asia increase significantly from 15% in 1990 to 26% in 2001. This further suggest that it is in Indonesia's interest to see that tariff in developing countries are being reduced.

There were several reasons that government of Indonesia view FTAs as an important policy agenda:

- FTA could create business climate and increase industrial competitiveness.
- As an opportunity to greater market access (hence increasing export), especially to the East Asian countries and some other developing countries.
- To secure supply for intermediate product (to be used as input material for domestic industries, for example: heavy-weight machinery, wheat, etc.).
- To Attract Foreign Investment.
- To cope with neighbor countries which have started FTAs. There is also fear that if Indonesia didn't involve in current FTA trends it will left behind (or get negative impact of trade diversion).

2.4.2. Indonesia primary goods of trade and major trade partner

From the export side, 63% of all Indonesian export is from manufacturing sector. Crude Palm Oil (CPO) or Olein (refined CPO) is number one manufacture export product, mainly exported to China. Other main

manufacture export product is textile and clothes (mainly to Europe, Japan, and US), Electrical and optical product (Japan, Netherland and Asia), rubber and paper product.

Indonesia also exports in quite big number for Coal and Natural gas (including Liquid Natural Gas and Liquid Petroleum Gas).

Table 2.3. Indonesia Primary goods of Trade

	in Thousand of USD	
COMMODITIES	**2012**	
	TOTAL	**% Share**
Agricultural products	5,584,277	3.0%
Manufacture products	118,314,955	62.8%
Palm oils	17,685,128	9.4%
Textile and textile products	12,510,222	6.6%
Electrical and optical products	11,157,423	5.9%
Processed rubber	10,368,181	5.5%
Base metal products	9,303,974	4.9%
Paper and paper products	3,938,383	2.1%
Other manufacture products	43,079,735	22.9%
Mining and other sector products	61,773,173	32.8%
Coal	26,248,271	13.9%
Natural gas	17,670,963	13.3%
Crude oil	12,723,142	6.7%
Unclassified exports	2,823,951	1.5%
Total, fob	188,496,357	100.0%

Source: Bank Indonesia

Table 2-4. Indonesia Major Trading Partner, 2011.

Rank	Trading Partner	2006	2007	2008	2009	2010	2011	
		Value	Value	Value	Value	Value	Value	Share
1	ASEAN	18,839,410	22,547,734	28,045,922	25,620,759	33,646,449	39,665,056	20%
2	Japan	22,375,535	25,561,608	28,237,200	19,299,659	25,487,404	32,494,902	16%
3	China	8,653,015	10,030,100	11,943,684	11,572,849	15,575,316	23,334,483	12%
4	EU	12,150,383	13,499,199	15,276,935	13,595,674	16,812,063	20,308,658	10%
5	United States	11,692,952	12,204,571	13,521,866	11,302,578	14,954,611	17,702,388	9%
6	South Korea	7,964,405	8,244,418	9,283,423	8,225,553	12,522,041	14,660,195	7%
7	India	3,565,625	4,550,943	7,011,269	7,561,412	9,662,084	13,474,347	7%
8	Australia dan Oceania	3,335,930	4,374,176	5,100,843	3,999,800	5,083,855	6,554,309	3%

Sources: Bank Indonesia

ASEAN as a whole become number 1 Indonesia trading partner replacing Japan since 2009. Among the ASEAN countries, Singapore become main trading partner with 8.2% of total export share followed with Malaysia with 5.2% of total export share. Singapore becomes hub for many Indonesian products to be re-exported to other country because of the unique location of and its very efficient ports. Japan is still number 1 export destination country for Indonesian product but its share is decreasing due to low growth of Japanese economy. Indonesia export to China on the other hand is increasing very fast so that China become number second export destination country replacing United States position with export share around 12% of the total Indonesia export in 2011. Indonesia major trading partner after China is European Union with 10% of total export share, United States with 9% of total export share, and South Korea with 7% of total export share.

2.5. ASEAN-Korea CEPA

2.5.1. Background

Considering significant trade ties between ASEAN and Korea and with the view of deepening economic relations between two sides, the Leaders at the ASEAN-Korea Summit in October 2003, in Bali, Indonesia agreed to explore the possibility of establishing a Free Trade Area (FTA) between two sides. The negotiations on the AKFTA commenced in early 2005, which is later than ACFTA and AJCEP, and took 2 years before the ASEAN-Korea Trade in Goods Agreement was signed on 24 August 2006 by ASEAN Member States, except for Thailand and Korea. Due to concerns about agriculture, particularly the deal's provisions on rice and livestock, Thailand negotiated separate arrangements with the Korean government to join the pact in early 2009.

Partnership covers broad aspect such as:

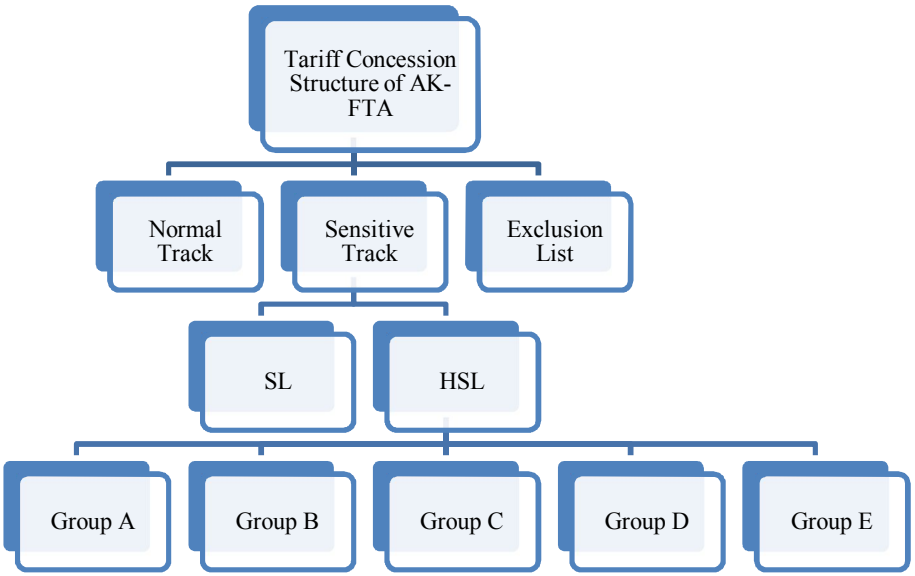
1. Trade Liberalization
    a. Trade in Goods (concluded and ratified in 2007)
    b. Trade in Service (concluded and ratified in 2007)
    c. Investment
2. Economic Cooperation: 19 sector such as: Custom Procedures, Tourism, ICT, IPR, etc.
3. Dispute Settlement Mechanism between ASEAN and Korea

4. Build ASEAN-Korea Center to further strengthen and facilitate economic trade and investment cooperation as well as culture (promotes *hallyu*) and tourism.

2.5.2. Modality

Tariff concession of AKFTA is basically similar to Common Effective Preferential Tariff/ ASEAN Free Trade Agreement (CEPT/AFTA). Reduction of tariff is taken gradually, for specified period. There are also Normal Track and Sensitive track categories, which the later takes more time to reduce the tariff. And also Exclusion List, where product categorized in this list will still maintain its tariff (same as MFN).

Figure 2-1 Tariff Concession Structure of Korea-ASEAN FTA



Coverage of the product:

1) Normal Track (NT). Cover min. 90% of all products (HS 6 digit).
2) Sensitive Track (ST). Maximum 10% of all product (HS 6 digit) and 10% of import value individual ASEAN countries from Korea and vice versa.
3) Highly Sensitive Track (HST). Maximum 200 post tariff (HS 6 digit) or 3% of all post tariff or 3% of import value.
4) Exclusion List (EL). List of product that is exempted from tariff concession and will remain MFN. Max 40 post tariff.

2.5.3. Schedule of tariff reduction

i. Table 2-5. Normal Track (NT) Tariff Schedule in AKFTA

X = tariff applied MFN	**AKFTA Preference Tariff Rates**				
	2006	**2007**	**2008**	**2009**	**2010**
X ≥ 20%	20	13	10	5	0
15% ≤ X < 20%	15	10	8	5	0
10% ≤ X < 15%	10	8	5	3	0
5% ≤ X < 10%	5	5	3	0	0
X ≤ 5%	Standstill			0	0

Source: *Agreement on Trade in Goods under the Framework Agreement on Comprehensive Economic Cooperation among the Governments of the Republic of Korea and the Member Countries of ASEAN*, Annex 1.

For the full schedule of tariff reduction submitted by Republic of Korea, see table below:

Korea		ASEAN 6
Will reduce at least 70% of its tariff line to 0% by the time entry into force		Will reduce at least 50% of its tariff line to 5-0% by the time entry into force (1st January 2007)
Will reduce at least 95% of its tariff line to 0% by the time 1 January 2008		Will reduce at least 90% of its tariff line to 0% by the time 1 January 2009
Will reduce all of its tariff line to 0% by the time 1 January 2010		Will reduce all of its tariff line to 0% by the time 1 January 2010 with flexibility of 5% tariff line should have been reduced to 0% at the least 1 January 2012
		Will reduce all of its tariff line to 0% at the least 1 January 2012.

ii. Sensitive List. ASEAN-6 and Korea will reduce tariff lines include in Sensitive List to the level of 20% at least by 1 January 2012 and further reduce to 0-5% by the time 1 January 2016.

iii. Highly Sensitive List (HSL). Divided into 3 categories:

(1). Category A : reduce to 50% by the time 1 January 2016

(2). Category B: reduce by 20% by the time 1 January 2016

(3). Category C: reduce by 50% by the time 1 January 2016

Indonesia submits an indicative schedule for SL/HSL reduction tariff in 2010 to ASEAN Secretariat, which cover 862 tariff lines (HS 10 digit). 90% of it was industrial sector.

2.5.4. Rules of Origin

Rules of Origin (ROO) in KAFTA agreement are Product-Specific regimes, which means criteria of origin is assigned to products (HS 6 digit level) written on a long-listed of Product Specific Rules list attached to the main agreement (Appendix 2).

Criteria of Origin is met under certain rules below:

1. Wholly Obtained or Produced Criterion. Used in the live animal, fish and plants product and mineral obtained in the territory of a Party.
2. Value Content: Except those under PSR list, a good that have Regional Value Content (RVC) of not less than 40% could be deemed as originating.

   Method to calculating RVC is based on either built-up or built-down method.

   (i) Built-down method

   $$RVC = \frac{VOM}{FOB} X\ 100\%$$

   (ii) Built-up method

   $$RVC = \frac{FOB - VNM}{FOB} X\ 100\%$$

   Where VOM and VNM means the value of originating and non-originating materials, respectively.
3. Product Specific Rules (PSRs): agricultural, forestry mineral, fiber clothing, chemical, etc.
   a. Change in Tariff Classification (CTC) criterion (unit change: CC, CTH, CTSH)

b. Regional Value Content (RVC): 35-70%

c. Specific Process Criterion (cutting-sewing, dyeing-textile printing)

4. Direct Consignment: A good must be transported directly between the territories of the exporting Party and importing Party.
5. Inward Processing principle. Certain product shall be considered as originating even if the production process or operation has been undertaken in an area outside territories of Korea and ASEAN on materials exported from a Party and subsequently re-imported to that Party.
6. De *minimis* rule. A good that does not undergo a change in tariff classification (except for textile sector, HS 50-63), could be considered originating if the value of non-originating material used in its production do not exceed 10% of the value goods (FOB). As for the textile product (HS 50-63), could be considered originating if the weight of non-originating material used in its production do not exceed 10% of the weight of goods.
7. Diagonal Accumulation.

2.6. ASEAN-China FTA (ACFTA)

2.6.1. Background

In November 2001, China and the 10-member Association of South East Asia Nations (ASEAN) began negotiations to set up a free trade area. One year later, a framework agreement for the planned FTA was signed. The FTA, a

zero-tariff market of more than 1.7 billion people, has been targeted to come into force in 2010 for the six original ASEAN members (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) and in 2015 for the other four (Burma, Cambodia, Laos and Vietnam).

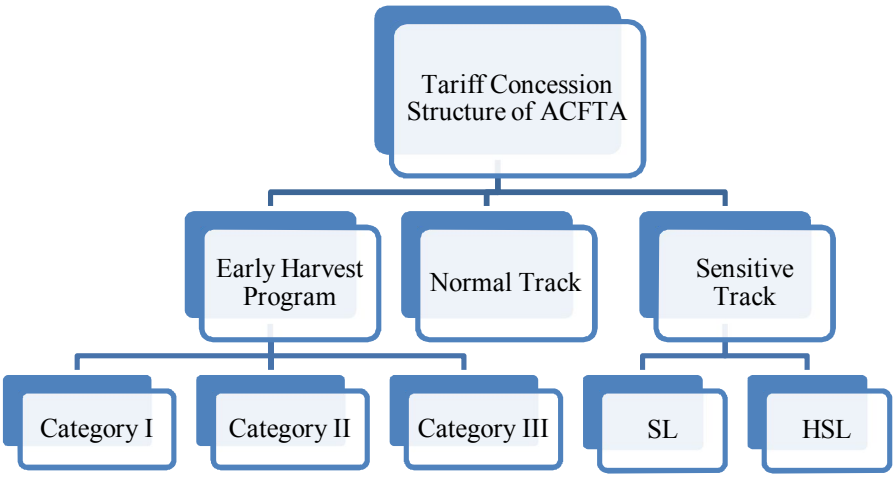
For China, ASEAN is promising trading partner as they have big population and also rich in natural resources, especially Indonesia and Malaysia which is oil and gas exporter country is important to maintain China economic growth. In a geopolitical perspective, ASEAN also very important to China as they are sharing border (a stable regional politic will be good for business climate), and if China win support from ASEAN, China also could gain influence in international politics.

For ASEAN, China is also an important trade partner especially since economic growth of developed countries is slow downed, China on the contrary is showing a miracle speed of growth. China even initiated Chiang Mai initiative in 2010 to prevent future Asian Financial Crisis who suffered many ASEAN countries during 2008-2010. China is showing its consent as a good leader in the region.

2.6.2. Modality

Tariff concession of ACFTA is similar to CEPT/AFTA and AKFTA in regards to reduction of tariff is taken gradually for specified period. The difference is in ACFTA there is one new category which is Early Harvest Program. Product categorize in Early Harvest Program are subject to the tariff reduction as soon as the agreement is ratified.

Figure 2-2. Tariff Concession Structure of ASEAN-China FTA



Coverage of the product:

1. Early Harvest Program: Cover all products from Chapter 1-8 at the 8 digit level of HS Code. This categorize are started to implemented early, according to the agreed time table which is between January 1, 2004 and January 1, 2010. It has 3 sub categories:

    a. Category 1: for China and ASEAN 6, applied to product with applied MFN tariff rates higher than 15%. As for CLMV countries, applied to product with applied MFN tariff higher than 30%

    b. Category 2: for China and ASEAN 6, applied to product with applied MFN tariff rates is between 15% and 5%. As for CLMV countries, applied to product with applied MFN tariff is between 30% and 15%

c. Category 3: for China and ASEAN 6, applied to product with applied MFN tariff rates is between below 5%. As for CLMV countries, applied to product with applied MFN tariff is below 15%

2. Normal Track: cover minimal 90% of all products (HS 9 digit).

3. Sensitive and Highly Sensitive Track: covers not more than 10% of all products.

2.6.3. Schedule of Tariff Reduction

For China and ASEAN 6 countries, tariff of product categorize as Early Harvest Program and Normal Track are subject to be reduced gradually starting January 1, 2005 until January 1, 2010. As for CLMV countries, product categorize as Early Harvest Program and Normal Track are subject to be reduced gradually starting January 1, 2005 until January 1, 2015.

Table 2-6. Normal Track (NT) Tariff Schedule for ACFTA

X = tariff applied MFN	ACFTA Preference Tariff Rates			
	2005	2007	2009	2010
$20 \leq \mathbf{X}$	20	12	5	0
$15 \leq \mathbf{X} < 20$	15	8	5	0
$10 \leq \mathbf{X} < 15$	10	8	5	0
$5 \leq \mathbf{X} < 10$	5	5	0	0
$\mathbf{X} \leq 5$	Standstill		0	0

Source: *Modality for Tariff Reduction and Elimination for Tariff Lines Placed in Normal Track.* Annex 1

2.6.4. Rules of Origin

Rules of Origin in the China-ASEAN FTA are much more compact and loose compared to AKFTA. ROO has no list of PSR, and applied the Value Content as the main criteria to determine origin (same as CEPT/AFTA). Therefore, ACFTA ROO could categorize as regime-wide ROO. Criteria for Origin as written in Annex 3 of Agreement is as follows:

1. Wholly Obtained Product or Produced in Party territories. For Live Animals, Plants, Fish, Mineral and other natural substances

2. Value Criterion. For product not wholly obtained could deemed to be originating if originating value content (RVC) is not less than 40% of the total value of the product (FOB). The non-originating content is calculated as follows:

$$\frac{Value\ of\ Non\ Originating\ Material + Value\ of\ material\ of\ undetermine\ origin}{FOB\ Price}\ X\ 100\%$$

   Therefore, Originating content: 100% - non-originating = at least 40%

3. Diagonal Cumulative. Allow material produce in the other Party member to be treated as originating.

4. Minimal Operation: ensuring preservation, facilitating shipment or transportation, packaging.

5. Direct Consignment.

2.7. Indonesia-Japan EPA

2.7.1. Background

Indonesia has actually 2 different FTAs with Japan, first is regional FTA under ASEAN-Japan Comprehensive Partnership (AJCEP) and the latter is bilateral FTA under Indonesia-Japan Economic Partnership Agreement (IJEPA). Japan signed a general framework for a bilateral free trade agreement with 10 ASEAN countries in October 2003, began negotiation with ASEAN in 2004 and signed the agreement on November 2007.

For the Japanese government, this FTA was an important target as it tries to achieve a stronger position in Asia vis-à-vis China (which has first began moving to create ASEAN-China FTA in 2002), and with Korea and United States which has finalized the US-Korea FTA talks in April 2007 jolted Tokyo into higher gear to get this deal completed. Another reason is to make ASEAN become major regional manufacturing hub for Japanese corporations (especially car and electronics).

IJEPA formally began negotiations in July 2005. It took two years before the pact was signed on 20 August 2007 and went into effect on 1 July 2008. Different from AJCEP which is more politically driven, this bilateral agreement is initiated by Japanese auto and auto-parts industries aimed to further eliminate tariff on goods such as automobiles and auto part, steels, and textiles as noted in the IJEPA study group report in 2005. Japanese has been the biggest investor for Indonesia for years, especially in automotive sector, Japan choose Indonesia and Thailand as their base manufacturing for their

auto and auto-parts industry. Indonesia side also expressed its interest in tariff elimination of various organic chemicals, plastic bags, textiles and footwear where Japan maintain tariffs including significant specific duties on some products.

Both sides emphasized that in order to built win-win relationship, it is important to take development gap between two countries, so that Japan should giving support and strengthen Indonesian industries by giving (a) transfer of knowledge, (b) human resources development, (c) enhancement of competitiveness of Indonesia's SMEs, (d) support partnership between local industries and Japanese manufacturer. Japan gave it support to Indonesian industry in the scheme called MIDEC. In the service sector also Japan allowed Indonesian nurse and elder-care to work in Japan (they must have passed language test).

2.7.2. Schedule of Tariff Reduction

Schedule of tariff reduction (Annex 1 of Agreement) in IJEPA is more complicated compared to AKFTA and ACFTA. Products covered by IJEPA are categorized into 10 categories as follows, and gradual tariff reduction takes place within 0-16 years since date of entry into force according to the category.

Table 2.7 Tariff Reduction for IJEPA

Category	Tariff Reduction
A	Shall be eliminated as from the date of entry into force of this Agreement;
B3	Shall be eliminated in four equal annual installments from the Base Rate to free as from the date of entry into force of this Agreement
B5	Shall be eliminated in six equal annual installments from the Base Rate to free
B7	Shall be eliminated in eight equal annual installments from the Base Rate to free
B10	Shall be eliminated in 11 equal annual installments from the Base Rate to free,
B15	Shall be eliminated in 16 equal annual installments from the Base Rate to free,
P	Shall be as provided for in the terms and conditions set out in the note indicated in Column 5 in each Party's Schedule;
Q	Shall be as provided for in the terms and conditions set out in the note indicated in Column 5 in the Schedule of Japan;
R	Shall be subject to negotiations provided for in the terms and conditions set out in the note indicated in Column 5 in the each Party's Schedule
X	Shall be excluded from any commitment of reduction or elimination of customs duties and commitment of negotiation referred to in subparagraph

2.7.3. Rules of Origin

The ROO of IJEPA is somewhat very restrictive compare to ACFTA and AKFTA. It employs a Product-specific regime of ROO. IJEPA contain criteria of origin as follows:

1. Wholly Obtained Product or Produced in Party territories. For Live Animals, Plants, Fish, Mineral and other natural substances
2. Change in Tariff Classification, as rules out in the PSR list in Annex 2 of the Agreement.

3. For PSR set out in Annex 2 (PSR list of IJEPA) using the minimum Value-added criteria. The formula for counting Value added are (only) by built-up method as follows:

$$RVC = \frac{FOB - VNM}{FOB} X\ 100\%$$

4. Allow for Bilateral Cumulation.

5. No de *minimis* rule.

6. Minimal operation: preservation, packaging, disassembly.

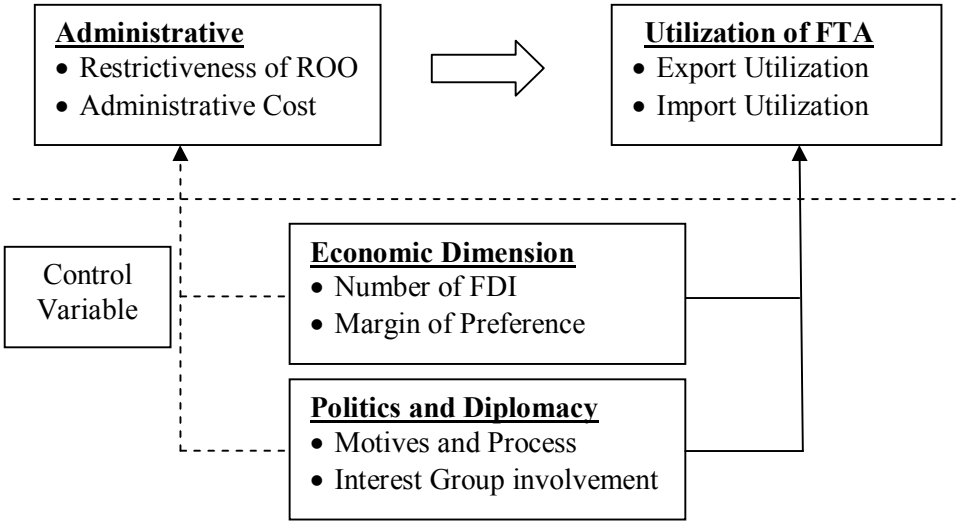
7. Direct Consignment.

CHAPTER 3

DATA AND METHODOLOGY

3.1. Framework Analysis

Figure 3-1. Research Framework



Main Analysis will be made to answer question: does Administrative dimension (restrictiveness level of ROO) have a significant impact in the utilization of FTA or not. Writer prejudice is that administrative dimension played the most important role on whether or not business sector would utilize FTA (or prefer to pay MFN tariff as business as usual). Many scholar such as Krishna (2005), Estevadeoardal, Cadot and De Melo (2006), Kim (2010) emphasized the role of ROO to the utilization of FTA and it economic impact to trade performance (increased export/import). Administrative dimension could be analyzed by assessing how restrictive is ROO. The more restrictive ROO, the harder producer can comply with the rules to get the preferential

treatment. The more restrictive ROO also means additional cost could incur in order to comply and hence reduce benefit of getting preferential tariff when they utilize FTA.

However, Restrictiveness of ROO alone cannot explain all about utilization of FTAs by business sector. According to several previous studies, there are other economic factors such as number of foreign direct investment (FDI) and margin of preference (MOP) as well as political and diplomacy factors such as motive and process of the negotiation and whether there is particular interest group (business sector) involved in the negotiations or not. Unfortunately we are lack of data availability to do multivariate regression analysis to cover all of economic and political diplomacy dimension effect on utilization. Therefore, in this study we focus only on Restrictiveness of ROO (administrative dimension).

3.2. Data Source

For this study, we use secondary data from Indonesia Ministries (especially Ministry of Trade and Ministry of Industry), Indonesia Statistical Office, ASEAN-Korea Center, and other International Organization such as WTO (Comtrade and International Trade Statistics), ARIC (Asia Regional Integration Center), etc.

We get ROO comparison between 3 FTAs (ACFTA, AKFTA and IJEPA) from ASEAN Secretariat at the 4th meeting of the APWGROO. The list

consists of 2600 tariff subheading from Chapter 1-87 on the four sectors: Agriculture, Chemical and Plastics, Textile and Garment, and Automotives. We then coding the ROO based on Estevadeordal's index to get the Restrictiveness Index for each FTA.

3.3. Research Methodology

For this study, analysis is made by reviewing various publications and previous researches written by prominent scholars (desk study). News release, statistics and other authoritative material and reports from Government ministries or agency are taken as source of data.

Theses, books, various journals, paper works and publications from research institutes concerning FTA and international trade are compared to understand the relation between variables, to choose variables that is assumed to have significant impact on utilization and built analytical framework on how to analyze factors that determine the utilization of FTAs.

Descriptive statistics, Graphs and trends, and Correlation test will be conducted to explain and verify connection between variable.

CHAPTER 4

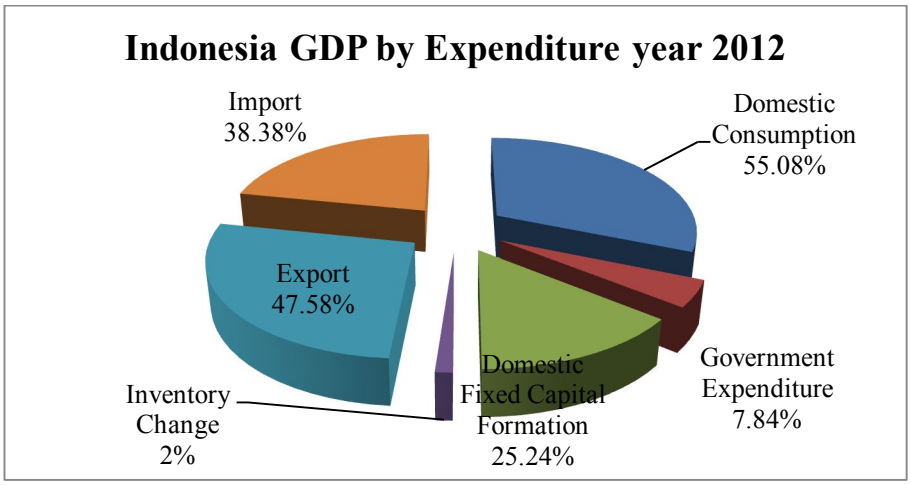
DATA ANALYSIS

4.1 FTA Impact to Trade Performance

Since 2005, Indonesia has concluded and ratified 7 regional and bilateral FTAs with their biggest trading partner, including ASEAN, Japan, China, Korea, India, Australia and New Zealand. Several more FTAs are under progressing such as with EU, APEC, EFTA, etc. It is natural that we expect that trade performance, which is export and import of goods will be increasing significantly as an effect of this ratifying agreement.

In fact, Indonesia trade performance show good result during last decade. Trade share (export and import) in Indonesia GDP is increasing from 73.4% of the total GDP in 2004, now trade share is accounted for 86% of the GDP in 2012. In line with trade, Domestic fixed capital formation also showed increasing result from 21% of the GDP in 2004 to 25% of the GDP share in 2012. On the contrary, the role of Domestic Consumption in the economy is showing a declining, from 61% from the total GDP in 2004, now is only accounted for 55% of the total GDP in 2012. These figures show economic growth of Indonesia in recent years was fueled by trade and investment rather than its huge domestic consumption.

Figure 4-1. Indonesia GDP Share by Expenditure (as % total GDP)



Source: Indonesia Statistical Office

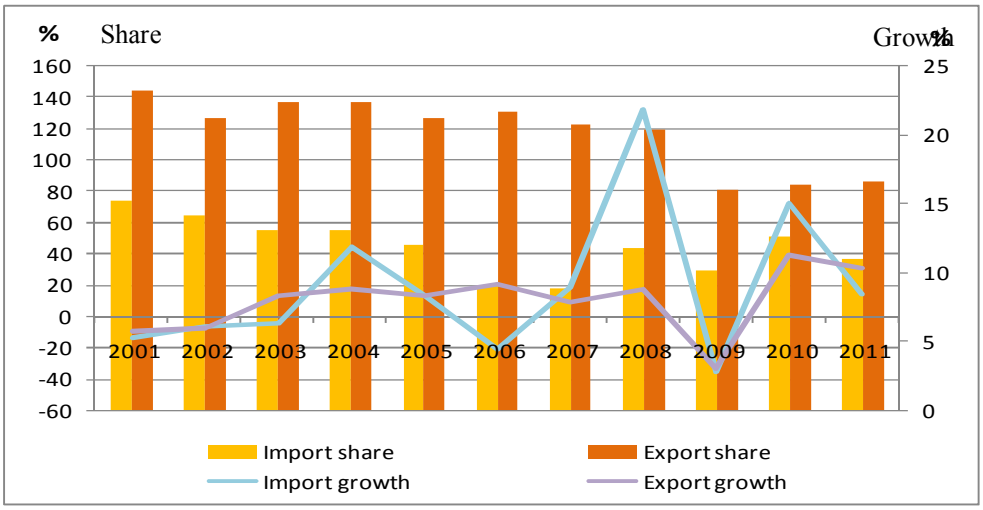
Among other nation trade between Indonesia to East Asian Nation, namely Japan, China and Korea also show increasing result, but not significant.

Figure 4-2. Indonesia Total Export to Japan, Korea and China, 2007-2011

Source: Indonesia Statistical Office

According to Deni Friawan during evaluation of IJEPA in 2012, Japan, which is one of the Indonesia main trading partners, its role in the Indonesia trade tends to decrease.

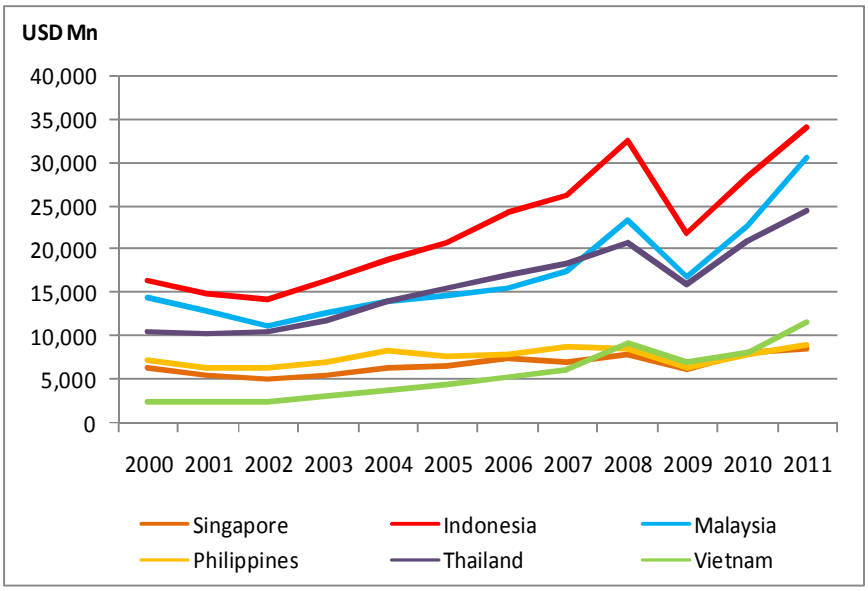
Figure 4-3. Indonesia Trade with Japan Performance



Source: Deni Friawan, taken from CEIC Database

Also according to Deni Friawan, even among ASEAN member countries whose also have FTA with Japan under AJCEP, export growth from Indonesia to Japan is less than average export growth of other ASEAN countries, except for Philippines.

Figure 4-4. ASEAN export growth to Japan



Source, Deni Friawan (2012)

Table 4-1. Indonesia Export to East Asian Countries Compared to the World

Country	2006		2008		2010		2011	
	Value	Share	value	Share	value	share	value	share
Japan	22,375,535	**22%**	28,237,200	20%	25,487,404	16%	28,968,748	**15%**
Korea	7,964,405	**8%**	9,283,423	7%	12,522,041	8%	14,269,733	**8%**
China	8,653,015	**8%**	11,943,684	9%	15,575,316	10%	21,523,958	**11%**
ASEAN	18,839,410	**18%**	28,045,922	20%	33,646,449	21%	40,408,472	**21%**
ROW	45,695,421	**44%**	62,095,870	44%	70,843,282	45%	83,325,446	**44%**
TOTAL	103,527,786		139,606,099		158,074,492		188,496,357	

Source: Indonesia Central Bank Statistic

From the figure above, from 2006-2012, we could see that Indonesia export grows speed to Japan is less than export grows to other countries (marked by its share of export is decreasing from 22% to only 15%). From this figure, we could argue that IJEPA is failed to increase export performance from Indonesia to Japan, but it could also be seen that slow export grow to

Japan is naturally as a result of economic stagnation in Japan in the last decade. On the contrary, the role of China and ASEAN countries in Indonesia trade is increasing as their share in Indonesia export is increasing. Indonesia export share to China is increase from 8% in 2006 to 11% of the total trade in 2011. With this number, China replaced US as a Second biggest trading partner for Indonesia. Indonesia export to ASEAN countries also increase significantly from 18% in 2006 to 21% of the total trade in 2011. While for Korea, trade share is remain the same for the last 7 years. We could state here that AKFTA has also failed to increase trade between Indonesia and Korea.

4.2 Utilization of Three FTA in Indonesia

In line with the trade performance, we could analyze the impact of one FTA by looking at how much the FTA scheme is utilized by exporter/importer in the country. If utilization of one FTA is low, then we could say that export/import growth is merely because of *business as usual* (BAU) and not because of the impact of the implementation of FTA.

To measure the utilization in 2 FTAs, namely ASEAN-China FTA and ASEAN-Korea FTA we use secondary data from Directorate General of International Trade, Ministry of Trade, Republic of Indonesia which is the sole public agency responsible to issue certificate of origin (COO) required by the FTAs. And to measure utilization of Indonesia-Japan EPA, we get the data from IJEPA evaluation report by Deni Friawan.

We calculated utilization of FTA as a ratio of trade value (export/import) using FTA preferential scheme divided by total trade.

Certificate form AC is required to applying for ASEAN-China FTA, certificate form AK is to applying for ASEAN-Korea FTA and certificate form IJ is to applying for IJEPA.

Figure 4-5. ASEAN-China FTA Export Utilization

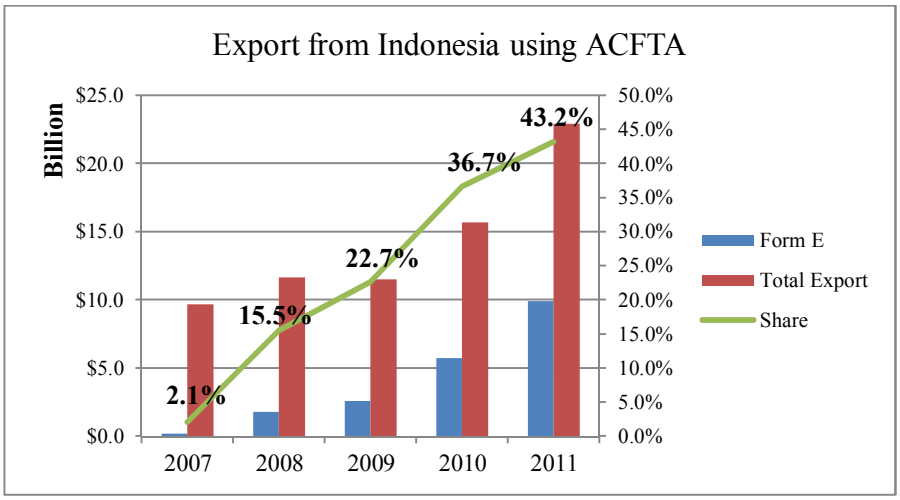
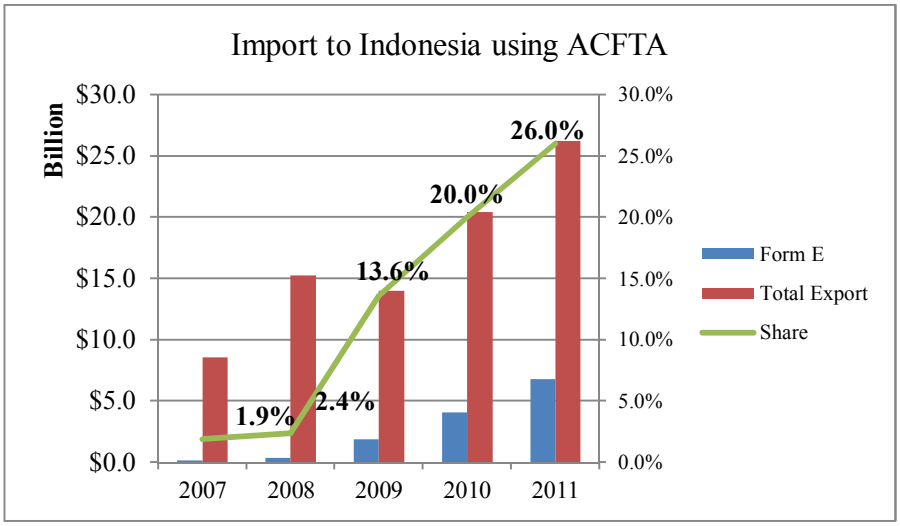


Figure 4-6. ASEAN-China FTA Import Utilization



Source: DG of International Trade Cooperation, Ministry of Trade, Republic of Indonesia

Figure 4-7. ASEAN-Korea FTA Export Utilization

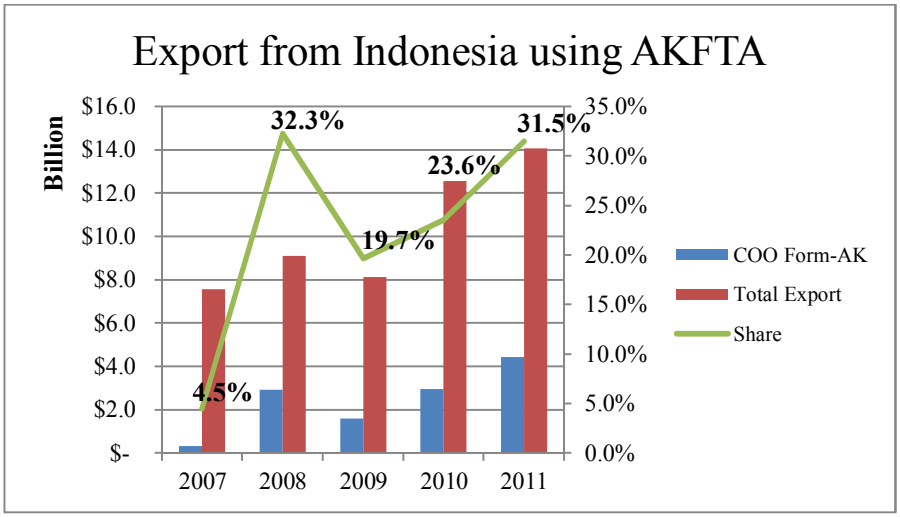
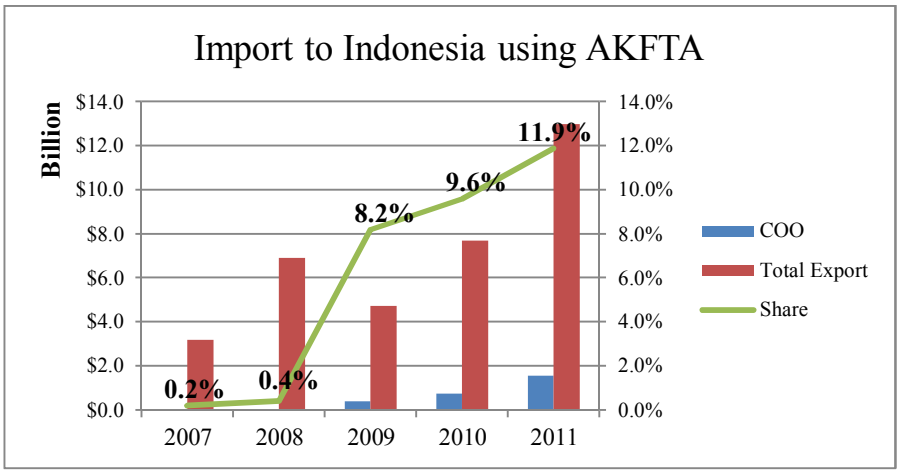
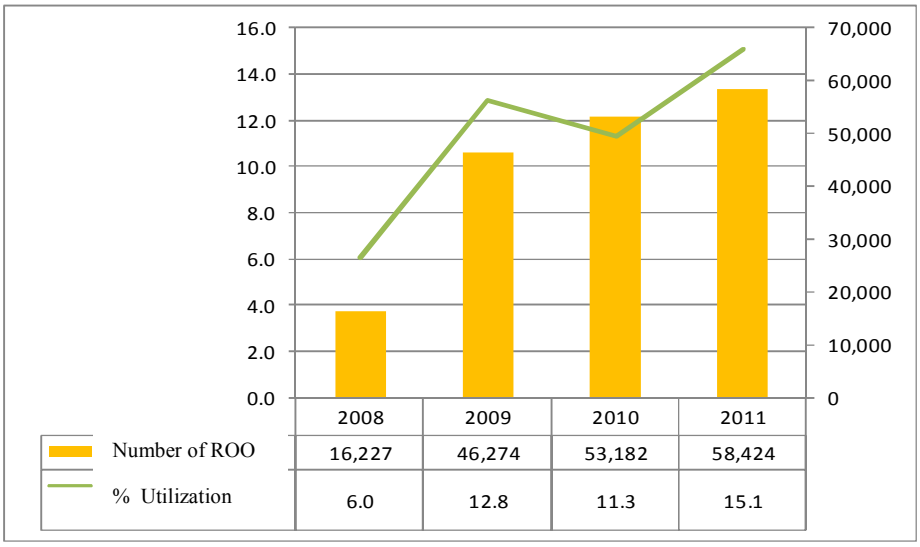


Figure 4-8. ASEAN-Korea Import Utilization



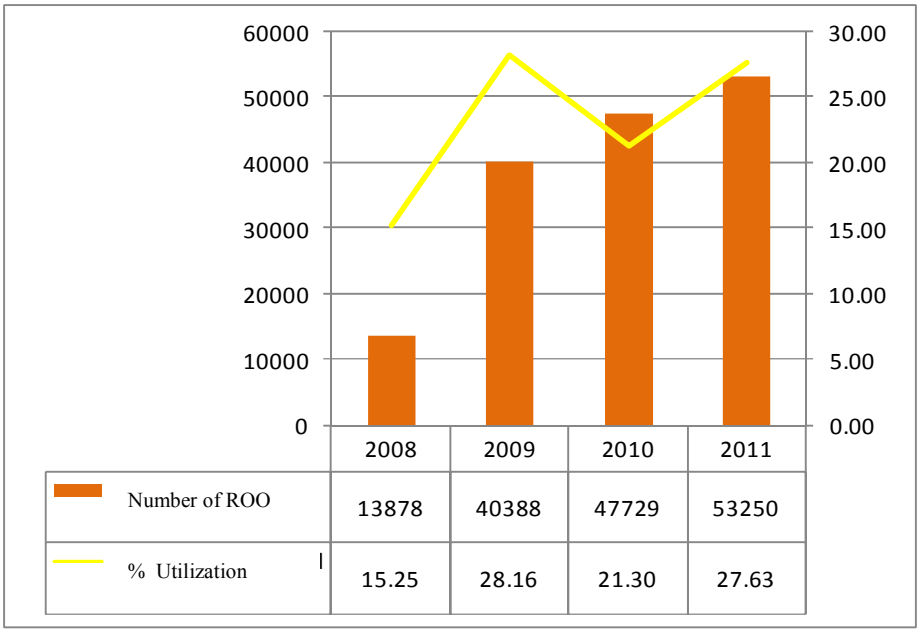
Source: DG of International Trade Cooperation, Ministry of Trade, Republic of Indonesia

Figure 4-9. Indonesia-Japan EPA Export Utilization



Source: Deni Friawan, Evaluasi IJEPA (2012)

Figure 4-10. IJEPA Utilization in Manufacturing Export



Source: Deni Friawan, Evaluasi IJEPA (2012)

From the figure above we could see that ASEAN - China is the most utilized FTA among others by export (ACFTA 43.2%, AKFTA 31.5%, and IJEPA only 15.1%). By import, ACFTA is the most utilized (26%) followed by AKFTA (11.9%).

If we narrow the utilization by manufacturing sector only, we will see export utilization of IJEPA is increasing to 27.3% in the year 2011. It even reached 28% in year 2009. This means that manufacturing sector is quite aware of IJEPA.

4.3 Administrative Dimension: Impact of ROO on Utilization of FTA

According to some scholars, economic effect of concluding an FTA is determined by ROO, in particular with the respect to the market access. As Krishna (2005) said ROO create what look like tariffs on imported intermediate inputs and affect the price of domestically made inputs as well. Well organized industries essentially could insulate themselves from the effects of the FTA by devising suitable ROO. Theories say that more restrictive of the ROO, would increase cost in production and reduce utilization of FTA.

To measure restrictiveness index, we use Estevadeordal's ROO Restrictiveness Index. This index score ranged from 1 to 7; the higher the number of index means the most restrictive is ROO. Restrictiveness criteria that Estevadeordal's index is good for Product-Specific Regimes of ROO

which criteria of origin is attached per product and put emphasis on transformation of product classification (Harmonized System or HS is product classification that is widely used in ASEAN FTAs). AKFTA, AJFTA and IJEPA ROO is categorized as Product Specific Regimes, but ACFTA even they have specific ROO rules to some product, but the number is so small so they are categorized as wide-regime of ROO. We also assess AJFTA ROO restrictiveness index, even it is not ratified by Indonesia in order to compare with IJEPA ROO.

Table 4-2. Restrictiveness Index of 4 FTAs

Restrictiveness Index (y*)	Estevadeordal's RI criteria	Number of Product (HS 6 digit)			
		AKFTA	ACFTA	AJFTA	IJEPA
7	- CC < y* < CC & TECH - WO	479	7	845	897
6	- CH & RVC < y* ≤ CC	3	1	602	533
5	- CH < y* ≤ CH & RVC - When RVC is a single standard RVC (> 50%)	6	0	23	91
4	- CS & RVC < y* ≤ CH - When RVC is a single standard RVC (≤ 50%)	2106	2590	1122	862
3	- CS < y* ≤ CS & RVC	2	0	0	3
2	- CI < y* ≤ CS	7	0	7	213
1	- y*≤ CI	0	0	0	1
	WEIGHTED AVERAGE	**4.55** Moderate	**4.00** Lenient	**5.44** Restrictive	**5.31** Restrictive

Source: Writer calculation based on data from ASEAN Secretariat

Explanation:

CI = Change in Tariff Classification (HS 8 or 10 digits)
CS = Change in Tariff Subheading (HS 6 digit)
CH = Change in Tariff Heading (HS 4 digit)
CC = Change in Tariff Chapter (HS 2 digit)
RVC = Regional Value Content
WO = Wholly Obtained

We assessed around 2600 tariff lines each FTA from HS chapter 1-87. ROO data is taken from ASEAN secretariat during 4th meeting of APWGROO, which compare ROO in 4 sectors to analyze the degree of convergence between 5 ASEAN FTAs. The result is showed in the table 4-6 above.

In ACFTA most ROO criteria is based on "RVC of at least 40%" – similar with that of ASEAN FTA (AFTA) – resulted in a very slow restrictiveness index of 4. In AKFTA, majority of tariff line in is laid on "RVC of at least 40%" criteria, which is equal to 4 in restrictiveness index. However there were also some tariff lines, mostly from Agricultural Sector, required Wholly Obtained which is very restrictive. This result to the moderate level of restrictiveness index (4.55). Japanese FTA, whether it is AJFTA or IJEPA is the very restrictive in ROO (5.44 and 5.33 consecutively). IJEPA, accordance with the objectives of its formation, have very low restrictiveness index on auto and auto parts sector (restrictiveness index in this sector is only 2). On the other hand, it is also more restrictive on some sector such as agriculture.

Table 4-3. Relation between Restrictiveness Index and Utilization

Agreement		Utilization					Average Utilization	Restrictiveness Index	
		2007	2008	2009	2010	2011			
ACFTA	Export	1.9%	15.5%	22.7%	36.7%	43.2%	24.0%	**4**	High utilization
	Import	1.9%	2.4%	13.6%	20.0%	26.0%	12.8%		
AKFTA	Export	4.5%	32.3%	19.7%	23.6%	31.5%	22.3%	**4.55**	Moderate utilization
	Import	0.2%	0.4%	8.2%	9.6%	11.9%	6.1%		
IJEPA	Export	-	6.0%	12.8%	11.3%	15.1%	9.0%	**5.31**	Moderate utilization
	Import	-	-	-	-	17.8%	17.8%		

Source: Writer calculation

Table 4-3 above compare each of FTA utilization with their restrictiveness index. Since utilization is different across time, which is very natural because in the beginning of FTA implementation there were few companies who conscious about FTA (asymmetric information). Naturally utilization is increasing across time because more company is aware and plan to utilize FTA, but in the case of AKFTA, it showed interesting result: Export utilization in the second year of implementation jumped very high to 32% and then goes down again to 19.7% in the third year.

To compare different utilization across time, we calculate average utilization for each FTA. Average export utilization for ACFTA is 25% and average import utilization is 12.8% (total average is 36.8%). For AKFTA, average export utilization is 22.3% and average import utilization is 6.1% (total average utilization is 28.4%). For IJEPA, average export utilization is only 9%. For import utilization of IJEPA, we use data from Indonesia Statistical Office (which is only available for 2010 and 2011 only). Average import utilization using IJEPA scheme is 17.8% (so the total average utilization of IJEPA is 26.8%).

If we compare utilization of Japan FTA assessed by Takahashi and Urata, utilization rates of Japan FTA is ranged between 32.9% (Japan-Mexico FTA) and 12.2% (Japan-Malaysia FTA), we could make criteria as follow:

- Utilization u* > 30% = high

- Utilization 20 < u* < 30% = moderate
- Utilization u < 20% = low

Then ACFTA could categorized as highly utilized, AKFTA and IJEPA are categorized as Moderate utilize.

If we calculate correlation test between Restrictiveness index (RI) and average utilization (Av Util) of the three FTAs (ACFTA, AKFTA and IJEPA) we will get results as table 4-8 show us below:

Table 4-4. Correlation test between Restrictiveness Index and Average Utilization.

	RI	Av Util	Corr
ACFTA	4	36.8%	**-0.89074**
AKFTA	4.55	28.4%	
IJEPA	5.31	26.8%	

Table 4-4 above show correlation coefficient value between restrictiveness index and average utilization is -0.891. Statistically, this proved that there is negative and significant correlation between ROO restrictiveness index and utility of FTA. The less restrictive is ROO, the more business utilize the FTA.

When we try to calculate correlation test between utilization and the export performance (export growth) to China, Korea and Japan, we also found positive and significant relation (result shown in table 4-9 below). This suggest that the more utilize FTA, the more speed in export growth.

Table 4-5. Correlation test between export utilization and export growth 2008-2011.

	Av Export Util (2007-2011)	Av Ex growth (2008-2011)	Correlation Coefficient
ACFTA	24.0%	25.1%	**0.93**
AKFTA	22.3%	17.6%	
IJEPA	9.0%	9.3%	

CHAPTER 5

CONCLUSION

5.1 Summary of the Study

Parallel to the previous studies by many scholars, this study also showed that FTA utilization behavior is negatively and significantly affected by Restrictiveness of ROO. More restrictive ROO of the FTA, the less FTA is utilized and vice versa.

Assessment on ROO between ACFTA, AKFTA and IJEPA including 2600 tariff line (HS 6 digit) showed result that overall, IJEPA ROO is the most restrictive (average restrictiveness index = 5.3), followed by AKFTA ROO with moderate restrictiveness (index = 4.5) and AKFTA is the most lenient (index = 4). However, in some sector (Auto and auto parts product and Machinery) IJEPA ROO could be very lenient with restrictiveness index = 2. This was consistent with the goal of Japanese car makers, backup by Japanese government to initiate bilateral IJEPA with Indonesia even when they are also negotiating ASEAN-Japan FTA at the same time.

Indonesian Exporter utilized ACFTA the most, followed by AKFTA and IJEPA. This result is reasonable because ACFTA ROO is the most unrestrictive, hence compliance cost is low. On the other hand, average import

tariff (by MFN) to China is still high, so Indonesian exporter find huge benefit on using ACFTA. On the contrary, IJEPA ROO is most restrictive hence incur high cost to comply but Japan average MFN tariff has already very low, so Indonesian exporter did not find benefit in using IJEPA scheme.

On the Import utilization, IJEPA is the most utilized followed by ACFTA and AKFTA. Explanation for these phenomena is laid on the trade structures between Indonesia and Japan. Indonesia import auto parts (especially car engine and machinery from Japan) as an input material for Japanese auto maker in Indonesia. In auto and auto parts sector, MFN tariff rate is still high in Indonesia, so that Indonesian importer will find huge benefit to utilize IJEPA.

Utilization of FTA also has a significant impact to increase trade performance. Correlation test between export utilization of FTA and average export growth to the respective country during 2008-2011 shown a positive and significant result (correlation coefficient = 0.93).

5.2 Policy Recommendation

Theoretically, Rules of Origin could be another way to impose trade barrier and hence reduce utilization of FTA. This study also showed negative relation between restrictiveness of ROO and the utilization of FTA in Indonesia.

Therefore, it is important to keep ROO not too restrictive in the future FTA talks in order to make those FTA work.

Simplicity in compliance to FTA will make business sector easier to use FTA scheme, especially for Small Medium Enterprises (SMEs). A wide-regime ROO, such as employed in ACFTA will be preferable than long-listed of Product Specific Rules (PSRs). A standardize preferential ROO for all ASEAN FTAs will be preferable than many different ROO each FTAs (*spaghetti bowl* problem).

Certification of Origin for AKFTA, ACFTA and IJEPA are issued by public institution (in Indonesia case, COO is issued by ministry of trade). This type of certification could incur high cost because of double assessment (by applier and verification by authority). Therefore it is preferable that in next FTA negotiation, certification could be issued by producer itself (self-certification) which is common used by American type FTAs.

It is important to always evaluate implementation of FTAs and its effect to the Industry. Surveys at the company level regarding their utilization of FTA, or their perceived benefit or negative impact on current FTA will be beneficial to understand company behavior toward FTAs, their problems, and to search solution to increase utilization of FTA and increase welfare.

5.3 Limitation of Study and Recommendation for Further Study

Unfortunately writer could not get access to the utilization data for IJEPA more detailed. It will be very interesting and important to breakdown and analyze utilization on sector level. Restrictiveness level of ROO is different across sector and so thus utilization of FTA. Therefore a regression analysis on the sector level will prove relation between ROO and utilization of FTA more accurate. The findings also become more solid if we add more FTA with different characteristic.

There are so many factors that could affect utilization of FTAs. ROO is only one of the factors that deal with compliance to grant permission on using FTA (Administrative dimension of FTA). There is also political and diplomacy dimension (such as motive to initiate FTA, negotiation process, etc) and also economic dimension (Intra-industry trade, Foreign Direct Investment, Margin of Preference, etc). Multivariate analysis using all of these dimensions will also be interesting.

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국문초록

원산지제한규정이 인도네시아의 FTA 활용에 미치는 영향:
중국,일본,한국과의 FTA 를 중심으로

MAULANA Doddy Eka

행정대학원 행정학 전공

서울대학교

21 세기 들어 동아시아에서는 자유무역협정(FTA)이 새로운 무역정책으로 강조되어 왔으며 오늘날 세계 FTA 무대의 선두에 있다. 아시아는 북미와 남미 국가들에 비해서도 국가당 FTA 체결 건수가 앞서는데, 아시아 국가들은 평균 3.8 개의 FTA 를 체결하여, 2.9 개를 체결한 미주대륙 국가들에 비해 더 많다. 인도네시아는 동남아시아에서 가장 큰 국가로서 주변국에 뒤쳐지지 않도록 FTA 를 급속도로 확산하고 있다. 현재까지 7 개의 FTA 를 체결하였으며 9 개의 FTA 를 협상 중이다.

이렇듯 FTA 가 빠르게 증가하고 있음에도 불구하고, 실제로 산업현장에서 FTA 가 어떻게 활용되고 있으며 어떤 요인에 의해 FTA 활용이 결정되는지 여부는 불확실하다. 본 연구는 인도네시아에서 FTA 활용에 무역제한도(trade restrictiveness)가 미치는 영향에 대해 평가하였다. 이를 위해 아세안-중국 FTA, 아세안-한국 FTA, 인도네시아-일본 FTA 세 개의 FTA 를 대상으로 하여 연구하였다. 분석을 통해 원산지 규정에 대한 제한이 많을수록 FTA 활용도가 낮다는 것을 발견하였다.

주요어: 인도네시아, FTA 활용, ACFTA, AKFTA, IJEPA, 원산지규정

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