FACULTY OF ECONOMICS
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Thesis

"Does AFTA Create or Divert Trade for Indonesia?"

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"DOES AFTA CREATE OR DIVERT TRADE FOR INDONESIA?"

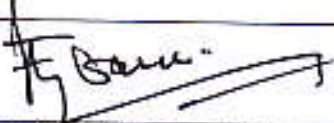**Thesis by: Trie Andini   Thesis Advisor: Prof. Dr. Nurzaman Bachtiar SE**

ABSTRACT

This research study analyzed the impact of ASEAN Free Trade Area (AFTA) on Indonesia in terms of export generation within member countries, specifically is it creates or diverts trade for Indonesia? This case is analyzed by using Gravity Model with panel data, in range 1989-2007. In this model I estimate two dummies that representative the value of trade creation and trade diversion. The estimations have shown important result that AFTA only produced trade creation for Indonesia.

Keywords: AFTA, Indonesia, Gravity Model, Trade Creation and Diversion

This thesis has been presented before the examiners in the Thesis Examination and successfully passed the Thesis Examination on August 30th 2010.
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CHAPTER I

INTRODUCTION

1.1 Background

In recent years international economic issues have taken center stage in the news. One of the issues is many countries implemented economic integration in trade development. Integration trade development is the increasing of relationship agreement on trade between countries, for example Regional Free Trade Agreements (RTAs), where RTAs has become the main form of trade liberalization since the early 1990s.

The example of RTA in Asia is ASEAN Free Trade Agreement (AFTA) which was established in 1992. AFTA was formed in 1993 by original countries: Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand, since the mid-1990s, and four more new member's countries joined ASEAN: Vietnam in 1995, Myanmar and Lao PDR in 1998 and Cambodia in 1999.

The main instrument of tariff scheme under AFTA is the Common Effective Preferential Tariff (CEPT). The Common Effective Preferential Tariff Scheme is a cooperative arrangement among ASEAN Member States that would reduce intra-regional tariffs and remove non-tariff barriers over a 15-year period commencing 1 January 1993. The goal of the Scheme is to reduce tariffs on all manufactured goods to 0-5% by the year 2008. The CEPT Scheme is the main instrument for making ASEAN a free trade area in 15 years. This means that ASEAN Member States shall

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have common effective tariffs among themselves in AFTA, but the level of tariffs with non-ASEAN countries shall continue to be determined individually.

A major reason for the process of economic integration in RTA is that it stimulated considerable interest in their welfare implications, both for members and the world as a whole. Trade patterns might be altered in several ways, one of the way results in trade creation and trade diversion. Based on Pardo and Freund (2009) trade diversion is the shift from productive trading partners (non-members) to unproductive trading partners (members). In contrast, trade creation is the shift of production from inefficient domestic providers to efficient RTA members; it could make members trade more with others members.

So, in one side trade creation is associated with the standard gains from trade and in the other side trade diversion can make a trade agreement harmful for both members and nonmembers. Based on that description the successful of AFTA will depends in large measure on whether they are "trade creating" or "trade diverting".

We can see there is trade creation for Indonesia after belong to AFTA by statistic data, it can be proven by the percentage of Indonesian exports to ASEAN members increase from exports increased from 11.12% in 1989 to 15.43% in 1996, surprisingly in crisis era in 1998 total Indonesian export to AFTA members about 19.06%, this percentage increase from 16.99% in 1997. It is not really surprising then, that Indonesia has turned to its neighbors to revitalize its trading performance.

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CHAPTER VI

CONCLUSION AND SUGGESTIONS

6.1 Conclusion

This thesis have purpose to see the export flow of Indonesia after Indonesia join on ASEAN Free Trade Agreement (AFTA). The model that I use shows the effect of potential supply in Indonesia and potential demand from Indonesian trading partner to the total export of Indonesia. For the effect of AFTA itself will be explained by two dummy variable which will show if this free trade agreement create trade or divert trade for Indonesia. I will use data of Indonesian export from 1989-2007 to estimate the model.

From the analysis of data by gravity model, I got conclusions that:

- Indonesia GDP has positive effect and significant to total export of Indonesia. So every increasing of Indonesian GDP proportionally increases the total Indonesian export. The previous researcher said that if the exporter GDP increase the production capacity in that country also increase. So export production in Indonesia will increase due to increasing of total Indonesian GDP.

- Importer GDP have positive and significant effect to demand for Indonesian product. So every increasing of importer countries GDP the demand for Indonesian product also increases.

- Indonesian population/ population of exporter country have positive and significant effect to total export of Indonesia. This is because of large

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