

# The impact of RTAs on trade in Indonesia

Gohar Samvel Sedrakyan<sup>1</sup>

Department of Economics, Finance and Quantitative Analysis and  
Bagwell Center for the Study of Markets and Economic Opportunity

Michael J. Coles College of Business  
Kennesaw State University

## SUMMARY OF FINDINGS

The motivation for this paper is to answer the question whether all regional trade agreements (RTAs), which operate as one of the driving forces in this process of trade creation, are equally beneficial to both partners. This paper studies the impact of RTAs on the change in dynamics of trade, disaggregated by imports and exports, between Indonesia and its intra-ASEAN and non-ASEAN partners. The focal point is the analysis of the change in trade dynamics between Indonesia and forty-two other countries when specific types of RTAs are implemented. The forty countries are chosen based on their contribution to Indonesia's international trade and produce about 95 percent of it. Two other countries, Lao People's Democratic Republic (Lao PDR) and Brunei Darussalam, are members of the ASEAN free trade area (AFTA), which was essential in constructing our RTA variables.

We construct two gravity models, exports and imports, of trade to conduct the current analysis. Four different measures of RTAs are included to reflect the agreements that Indonesia

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<sup>1</sup> Corresponding contact information: address: 560 Parliament Garden Way, Kennesaw, GA 30144, USA, email: [gsedrak1@kennesaw.edu](mailto:gsedrak1@kennesaw.edu).

had used in conducting its international trade from 1989 to 2019. Those four RTAs cover agreements on intra-ASEAN integration (RTA 1), ASEAN Plus (RTA 2) collaboration, trade based on Partial Scope Agreements (RTA 3) and none of the listed agreements (RTA 4). We also consider the change in trade between Indonesia and World Trade Organization (WTO) member countries. After assessing the results related to the aggregate levels of exports and imports, we disaggregate the data by nine product groups exported from and imported to Indonesia: fuel, minerals, animals, plastic or rubber, textiles and clothing, wood, metals, machines and electronics, and vegetables. This step allows us to test whether the product level analysis supports our results derived from the aggregate level study.

The results suggest that the trade of Indonesia did not fully benefit from the potential of it being a member of the ASEAN free trade zone (AFTA). Thus, our analysis did not find a significant effect impacting the exports from Indonesia to these countries and this negative insignificant coefficient implied that this effect is not systematic and can be reversed. The other side of trade, the countries of AFTA, utilized the potential of the Indonesian market much better and that impacted the rise in their imports. In light of these findings Indonesia will be better off if it reevaluates its comparative advantages over the AFTA partners and fully utilizes the potential that this free trade area offers to its members, specifically applied to expanding its exports to these partner countries. Further, the analysis assessed that trade with the ASEAN Plus partners had the largest area for improvement. Here, the exports to these countries were significantly and negatively affected by the terms of ASEAN Plus type agreements. The decline of exports was accompanied by a sharp increase in imports. These simultaneously occurring events may profoundly affect the balance of trade if no new trade policy changes are made and steps are undertaken to improve the outlined disbalances.

Indonesia successfully utilized the potential of PSAs and being a member of the WTO. Here, we assessed that the exports to these countries were positively impacted by these two types of agreements and grew significantly. In contrast, although the coefficients associated with imports from the countries which have PSAs and operate as WTO members with Indonesia had positive signs, the same listed RTA agreements did not seem to have a significant impact on generating imports from these partners. This suggests that Indonesia did not fully benefit from the diversified products and services that these countries could potentially offer. Therefore, as another strategy, Indonesia may consider to better utilize the diverse potential of the imports from these countries and still retain its positive balance of trade related to the PSA and WTO partners. Lastly, the analysis suggests that not having regional trade agreements was not beneficial to Indonesia. The exports of Indonesia to these countries had a significant decline. The same negative, yet insignificant, effect was determined in terms of imports to Indonesia from these countries. Therefore, as another strategy to enhance the balance of trade is to recommend signing a higher number of partial scope agreements (PSA) directly with new potential partners. The analysis of Indonesia's trade selectively disaggregated by nine product groups provided observations in line with the discussion on the aggregate exports and imports outlined above.