The Impact of Indonesian-European Union Comprehensive Economic Partnership Agreement (IEU-CEPA) on Indonesia's Textile and Textile Products Export.

Gilar Tri Panji Saputra[1]

[1] STIS Polytechnic of Statistics

Abstract:

Now days the world is facing a global economic crisis that is a decline in world economic growth. The global economic crisis also has an impact on the economics of Indonesia. The decline in global economic growth has made international trade sluggish, and Indonesia's trade balance deficit. With the existence of international cooperation, it is expected to be one way to improve the trade balance by encouraging exports. Before carrying out international cooperation it is very important to choose the right partner. Currently Indonesia in an international collaboration with the European Union called the Indonesian-European Union Comprehensive Economic Partnership Agreement (IEU-CEPA). The European Union has a large economic market, an open economy, and commodities that have high complementarity so that it will not cause competition that can give negative impact to Indonesian market. The IEU-CEPA regulates overall economic cooperation that is summarized in three blocks, there are trade which includes exports and imports, prices that include commodity prices and tariffs, and performance that includes demand and supply. One of the goals of the IEU-CEPA is to eliminate tariff barriers. The tariff system applied to Indonesia is still high, especially for some of Indonesia's main commodities such as textiles and textile products (TPT), this can result in stunted export growth. Therefore, this IEU-CEPA collaboration is expected to be able to increase Indonesia's export growth and overcome the trade balance deficit.

The purpose of this study is to examine the impact of the three blocks in the IEU-CEPA on exports of textiles and textile products before the IEU-CEPA is implemented. Then predict the conditions of the three blocks after the elimination of tariffs in the IEU-CEPA. The study results show that the three blocks are interconnected (simultaneous) in the export of textiles and textile products. Then this study also shows that removing TPT export tariffs to the European Union can increase the value of Indonesia's TPT exports. Therefore, it is expected that other collaborations will be made to encourage Indonesian exports.

Keywords: Textiles Exports; IEU-CEPA; Tariffs; Simultaneous Equation.

a. Introduction:

As the impact of the global economic crisis, Indonesia's economy is in a trade balance deficit over the past two years. Global economic growth is slowing and Indonesian commodity prices are declining, and on the other hand imports must continue to meet domestic needs. Economic diplomacy is one way to handle the trade balance deficit resulting from weakening global economic growth. With economic cooperation related to international trade, it can expand markets and reduce barriers to international trade. However, the Indonesian government has not been optimal in carrying out economic diplomacy, so it has not been able to deal with uncertain global economic dynamics.

As one way to improve economic diplomacy, the Indonesian government is on cooperation with the European Union on economic issues, which is called the Indonesian - European Union Comprehensive Economic Partnership Agreement (IEU-CEPA). The purpose of IEU-CEPA is to improve market access through reducing tariffs and non-tariff barriers, attracting investment, increasing capacity building cooperation, opening internships and employment opportunities, and increasing competitiveness. The European Union is one of the profitable economic partners for Indonesia. Because the Indonesian and European Union economies are at different levels so competition will not occur. According to UN Comtrade data, Indonesia's export commodities have high complementarity with EU import commodities. Some of Indonesia's main export commodities to the European Union are vegetable products, textiles, machinery, plastics, and rubber.

According to data from the Indonesian Ministry of Trade, textiles and textile products (TPT) are commodities with the second biggest contribution to exports to the European Union at 12.47% and TPT is also the commodity with the highest growth in Indonesia's exports to the European Union at

18.98% at the beginning of the year 2019. Currently, textile export tariffs to the European Union reach 5-20%, this value is quite high when compared to some competing countries such as Vietnam and Bangladesh which have reached zero percent. Currently, Indonesia is determined to use the Generalized Scheme of Preference (GSP) tariff system, which applies lower tariffs compared to World Trade Organization (WTO) regulations. However, when an Indonesian product has graduated, the GSP tariff system is no longer enforced and replaced with a tariff system set by the WTO with a higher tariff. this can have a negative impact on Indonesian exports, and could worsen Indonesia's competitive position in the world textile market.

IEU-CEPA in addition to providing tariff removal policies, the IEU-CEPA can also prevent Indonesia from the increase in the tariff system. Tariffs affect Indonesian textile exports, if the elimination of tariffs is carried out in all sectors then the highest increase in exports will have an impact on textiles (Soedjito Audrey, 2015). There are several things that need to be considered related to trade issues, prior to the enactment of this IEU-CEPA, so that this collaboration can be in line with expectations to be able to have a positive impact related to Indonesia's international trade, such as improving product quality and increasing market share, development of supporting industrial infrastructure, development and increasing Human Resources (HR), and maintaining and increasing economic growth through trade and investment (Ibid P. 40). In general, these things are contained in three blocks, namely the trading block, the price block and the performance block. From previous studies matters related to these 3 blocks have an influence on the value of exports (Adrian Lubis, 2010; Okta R, 2018; Ida Bagus D, 2018). Therefore, this paper aims to predict the three blocks when the abolition of tariffs in the IEU-CEPA is enforced and when the IEU-CEPA is not realized.

b. Methodology:
Analysis Method

The analysis used in this research is analysis of the econometric model. The econometrics model analysis is used to carry out simulations and predictions of three blocks. In the econometrics model, several variables are interrelated, hence the simultaneous equation econometrics model is used. In this econometrics model consists of 10 equations, seven structural equations, and three identity equations. Consists of 7 endogenous variables, and 20 predetermined variables. The simultaneous equation model is as follows:

TRADE BLOCK

$$EEUt = \beta_{10} + \beta_{11}\, LNGDPEUt + \beta_{12}\, TIEUt + \beta_{13}\, PTDt + \beta_{14}\, PEt + \beta_{15}\, IHPt + \beta_{16}\, EEUt_{-1} + u_{1t} \quad (1)$$

$$EROWt = \beta_{20} + \beta_{21}\, LNGDPROWt + \beta_{22}\, TIROWt + \beta_{23}\, PTDt + \beta_{24}\, PEt + \beta_{25}\, IHPt + \beta_{26}\, ERRt + \beta_{27}\, EROWt_{-1} + u_{2t} \quad (2)$$

$$IEUt = \beta_{30} + \beta_{31}\, LNGDPIDNt + \beta_{32}\, TIIDNt + \beta_{33}\, ERRt + \beta_{34}\, IEUt_{-1} + u_{3t} \quad (3)$$

$$IROWt = \beta_{40} + \beta_{41}\, LNGDPIDNt + \beta_{42}\, TIIDNt + \beta_{43}\, ERRt + \beta_{44}\, IROWt_{-1} + u_{4t} \quad (4)$$

$$EIDNt = EEUt + EROWt \quad (5)$$

$$IIDNt = IEUt + IROWt \quad (6)$$

PRICES BLOCK

$$PEt = \beta_{50} + \beta_{51}\, STDt + \beta_{52}\, (PIt_{-1}/PCW_{t-1}) + \beta_{53}\, PEt_{-1} + u_{5t} \quad (7)$$

$$PIt = \beta_{60} + \beta_{61}\, EIDNt + \beta_{62}\, IIDNt + \beta_{53}\, PIt_{-1} + u_{6t} \quad (8)$$

PERFORMANCE BLOCK

$$PTDt = \beta_{70} + \beta_{71}\, PEt + \beta_{72}\, PCWt + \beta_{73}\, (IRRt\text{-}IRRt_{-1}) + \beta_{74}\, UTKTt_{-1} + \beta_{75}\, BBMt_{-1} + \beta_{77}\, PTDt_{-1} + u_{7t} \quad (9)$$

$$STDt = PTDt + IIDNt - EIDNt \quad (10)$$

Variables:

EEUt	:Export volume to Europe	LNGDPIIDNt	:Indonesian GDP real ($USD)
LNGDPEEUt	:Europe real GDP ($USD)	TIIDNt	:Import tariff Indonesia
TIEUt	:Export tariff to Europe	IROWt	:Import volume from ROW
PTDt	:Textile production (kg)	EIDNt	:Total export volume (kg)
PEt	:Export price ($USD/kg)	IIDNt	:Total import volume (kg)
IHPt	:Producer price index	STDt	:Textile supply (kg)
EROWt	:Export volume to ROW (kg)	PIt	:Import price ($USD/kg)
LNGDPEROWt	:ROW real GDP ($USD)	PCWt	:Cotton price ($USD/kg)
TIROWt	:Export tariff to ROW	IRRt	:Real interest rate
ERRt	:Exchange Rate (Rp/$USD)	UTKTt	:Average textile workers
IEUt	:Import volume from Europe	BBMt	:Fuel price (Rp)

Estimation Method

From the results of model identification, it was found that all models were overidentified. So the estimation method to be used is Two Stage Least Square (TSLS). In the simultaneous equation model, one cannot see the effect of a variable on other variables that are in other structural equation. So the simulation is needed to be able to see the effect. Simulations are carried out to see the elimination or reduction of Indonesian textile export and import tariffs to the European Union. The simulation is carried out in four scenarios, the elimination of EU textile import tariffs, the reduction of EU textile import tariffs to 1%, and the elimination of Indonesian textile import tariffs. This scenario is carried out if the IEU-CEPA is implemented and results in a policy of eliminating or reducing tariffs. Then the final scenario is the determination of tariffs on European Union textile imports from Indonesia by 15%, this scenario is carried out when the IEU-CEPA is not implemented or does not result the policies to eliminate or reduce tariffs and Indonesian textile products have graduated, resulting in an increase in export tariffs.

Data

The data used in this study are quarterly time series data from 2004-2018 for Indonesia, the European Union (28 countries), and rest of the world obtained from the Central Statistics Agency, Ministry of Trade, World Trade Organization, UN Comtrade, World Bank, and Bank Indonesia.

c. Result:

Simulation of Indonesian and European Union Textile Export-Import Tariffs

The simulation of Indonesian textile export-import tariffs to the European Union is carried out in four scenarios, namely through the elimination or reduction of tariffs resulting from the IEU-CEPA collaboration and if the IEU-CEPA is not realized. The impact of the elimination or reduction of IEU-CEPA export-import tariffs can be analyzed according to several indicators contained in three blocks, namely the trade block, price block, and performance block.

Table 1. The result of the simulation of Indonesia-EU textile export-import tariffs

Variable	Name of variable	Actual value	Changes (%)			
			TIEU 0%	TIEU 1%	TIEU 15%	TIIDN 0%
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Trade Block						
EEU	Export textile volume to Europe	67287832	43.37	34.70	-86.72	-0.02
EROW	Export textile volume to rest of the world	4.34E+08	8.26	8.27	8.41	8.41
IEU	Import textile volume from Europe	10075874	0.30	0.30	0.30	-5.77
IROW	Import textile volume from rest of world	4.05E+08	-5.77	-5.77	-5.77	7.58
EIDN	Total export textile volume Indonesia	5.01E+08	12.97	11.82	-4.37	7.27
IIDN	Total import textile volume Indonesia	4.15E+08	-5.62	-5.62	-5.62	7.26
Prices Block						

PE	Export textile price	9.0984	-1.96	-1.83	-0.03	-0.14
PI	Import textile price	3.96E+00	-4.37	-4.12	-0.70	0.55
Performance Block						
PTD	Domestic textile production	7.68E+08	0.72	0.67	0.01	0.05
STD	Domestic textile supply	6.82E+08	-12.13	-11.34	-0.20	-0.86

a. Trade Block

From the simulation results of the export and import tariffs of Indonesian textiles to the European Union on the volume of Indonesian textile exports to the European Union, the elimination of tariffs provided a significant increase, where when applying tariffs of 0% the volume of textile exports to the European Union increased by 43.37 %. When the elimination tariffs was not produced and only a tariff reduction adjusted to tariffs in other countries by 1% also provided a substantial increase of 34.70% even though this increase was not as large as the rate of tariff elimination. Whereas if the IEU-CEPA is not implemented and there is an increase in the export tariffs in accordance with the MFN tariff system by 15%, there will be a large decrease in the volume of textile exports up to 86.72%. When the IEU-CEPA is enacted, it is possible to eliminate tariffs on European Union textile exports to Indonesia, when this happens there is no significant change in the volume of Indonesian textile exports to the European Union, which is only decrease 0.02%.

In the export volume to the rest of the world, almost in all simulations showing the same change, that is an increase of 8%. Regarding tariffs on textile exports to the European Union, it does not really affect the volume of textile exports to the entire world.

The Indonesian textile import volume from the European Union in the three simulations on Indonesia's textile export tariffs to the European Union only gave an effect of an increase of 0.30%. This means that textile export tariffs to the European Union do not have a significant effect on the volume of Indonesian textile imports from the European Union. Whereas when there was a removal of textile import tariffs from the European Union, there was a decline in the volume of textile imports from the European Union by 5.77%.

Meanwhile, in the volume of textile imports from the rest of the world, in the three simulation of textile export tariffs to the European Union there was a decrease in the volume of textile imports from the rest of the world by 5.77%. This means that changes in textile export tariffs to the European Union do not have a significant effect on the volume of textile imports from the rest of the world. Whereas the simulation of textile import tariffs from the European Union increased the volume of textile imports from the rest of the world by 7.58%. With the elimination of tariffs on textile imports from the European Union, it would increase the volume of textile imports from the rest of the world.

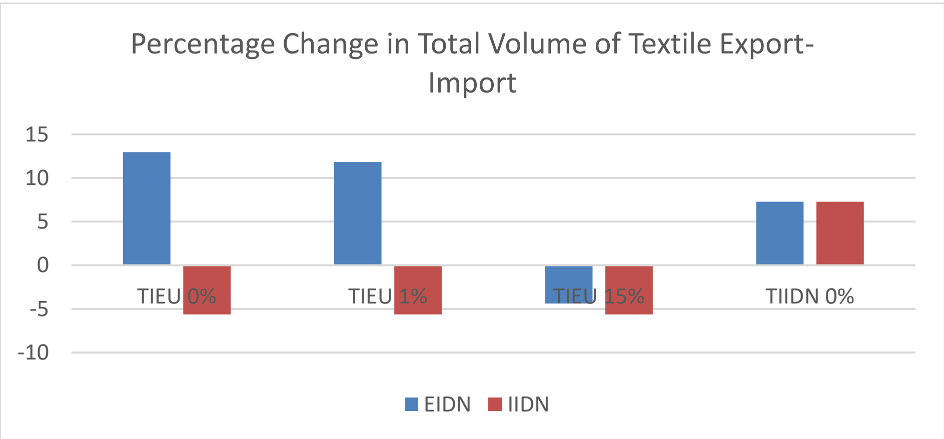

Image 1. The result of tariffs simulation on total volume of textile export-import

From the description, the textile export tariff simulation of 0% is the best simulation in improving the performance of textile exports in Indonesia, in addition to increasing the total export volume which is quite large by 12.97%, it also reduces the total volume of textile imports by 5.62%. With this policy, it will certainly have a positive impact in overcoming the trade balance deficit in the textile sector.

a. Price Block

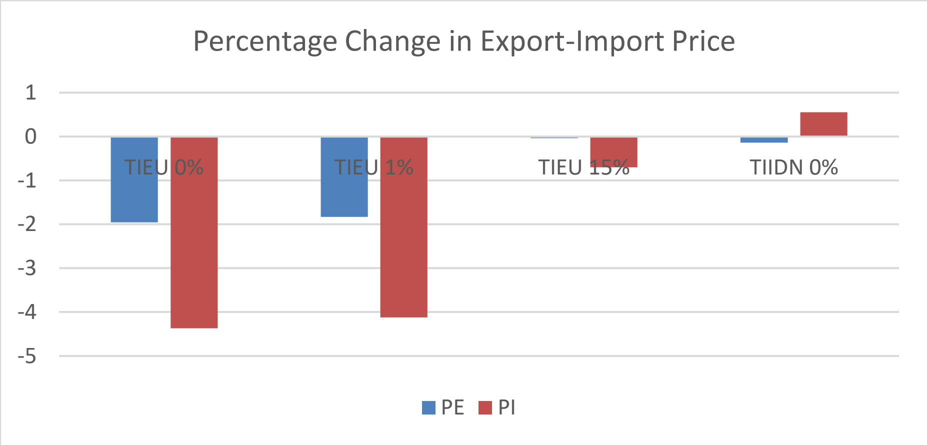

Image 2. The result of tariffs simulation on export-import price

All tariff simulations produce negative changes to textile export prices, but only export tariff simulations 0% and simulation tariffs 1% show a significant change of around 2%. Meanwhile, import prices has the largest percentage change in the simulation of the textile export tariff of 0% by -4.37%, and only the simulation of the import tariff of 0% produced a positive change in the price of textile imports, although the change was relatively small.

From all the results of the simulation of export and import tariffs of textiles, the percentage changes in the prices of exports and imports are relatively small, this shows that the export and import tariffs of textiles don’t have much influence on export and import prices. Export and import prices are influenced by domestic and foreign textile demand and supply. Then the export price and import price determine the value of textile exports and imports. Because changes in the value of exports and imports of textiles are not only determined by the magnitude of changes in the volume of exports and imports, but also determined by the export price and import prices.

b. Blok Kinerja

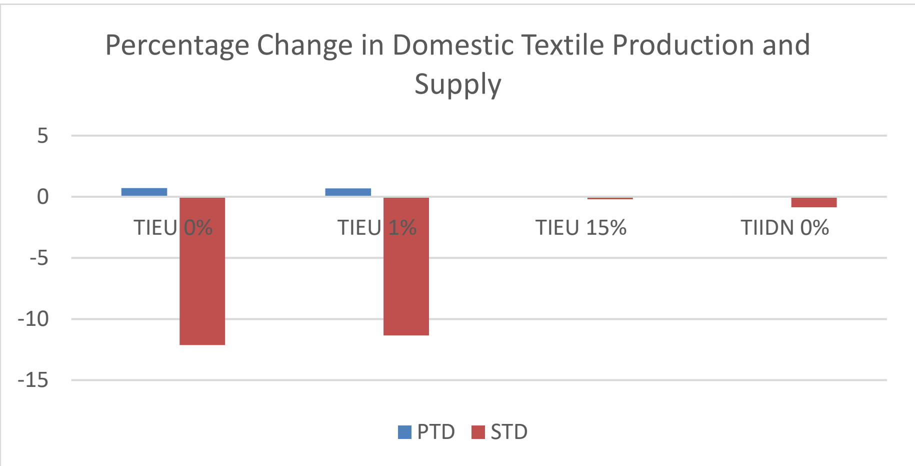

Image 3. The result of tariffs simulation on domestic textile production ad supply

All of the results of the simulation of textile export and import tariffs did not make a significant change to domestic textile production. Because the tariff does not directly affect domestic textile production. So that despite changes in export tariffs and import tariffs will not provide significant changes in domestic textile production. In the domestic textile supply, there was a decrease in the simulation of textile export tariffs of 0% and 1%. Because with the textile export tariff of 0% and 1% tariff there was a large increase in the total volume of textile exports and a decrease in the total volume of textile imports, so that domestic textile supply will decrease.

b. Discussion, Conclusion and Recommendations:

With the enactment of the IEU-CEPA by producing policies to eliminate textile export and import tariffs or by reducing export tariffs to 1%, this gave a significant increase in the total volume of textile exports by 12.97% and reduced the total volume of textile imports by 5.62%. This can overcome the deficit in the textile trade balance, and in other words the IEU-CEPA has a positive impact on Indonesian textile exports. Meanwhile, when the IEU-CEPA is not realized or in the IEU-CEPA it does not produce a tariff reduction policy, it is very possible for an increase in Indonesian textile export tariffs when Indonesian textile products have been 'graduated'. The increase in export tariffs will reduce the total volume of Indonesian textile exports by 4.37% and also reduce the total volume of textile imports by 5.62%. When there is an increase in textile export tariffs to the European Union, it will have a negative impact on Indonesian textile exports.

Therefore, this IEU-CEPA collaboration must be resolved immediately, and the issue of eliminating export tariffs can be set. Because with the abolition of tariffs can encourage Indonesian textile exports and can overcome the textile trade balance deficit. Then the government needs to increase economic diplomacy by holding economic cooperation with other countries in the world with regard to domestic preparedness and competitiveness. Economic cooperation will increase international trade by expanding markets and removing tariff and non-tariff barriers.

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