

IMPACT OF ASEAN CHINA FREE TRADE AGREEMENT (ACFTA) ON COMPETITIVENESS AND PERFORMANCE OF MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES OF CERAMIC

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ABSTRACT

ASEAN-China Free Trade Agreement (ACFTA) has positive and negative impacts on the economy, however there is limited scientific information at micro economic level. This article fill the gap with the purposes to analyze (1) the impact of ACFTA on micro, small, and medium-sized enterprises (MSMEs) of ceramic and (2) the role of market structure and competitiveness as intervening variables between ACFTA and performance of MSMEs of ceramic in Malang. Data were collected from 30 artisans at Dinoyo as the ceramic production center in Malang. Generalized Structured Component Analysis model was applied to analyze data with ACFTA as the exogenous variable, market structure and competitiveness as intervening variables, and performance of MSMEs of ceramic as the endogenous variable. The result of the study showed that ACFTA has insignificant impact on performance of MSMEs of ceramic in Malang. Market structure and competitiveness have not enough evidence as intervening variables between ACFTA and performance of ceramic enterprises. Competitiveness was the only variable that significantly has positive impact on performance of MSMEs of ceramic in Malang. One of the main reasons is that Malang is not market destination of the imported ceramic from China that have lower prices.

Keywords: ACFTA, market structure, competitiveness, performance, ceramic

INTRODUCTION

Economic integration between ASEAN member countries and China through ASEAN-China Free Trade Agreement (ACFTA) on January 1st 2010 formed a *Common Effective Preferential Tariff* (CEPT) scheme by decreasing import tariff up to 0-5% in 2011 among ASEAN member countries and China. The implementation of ACFTA has positive and negative impacts on the economy. Proff dan Proff (1996:321) emphasized that ACFTA has positive impact due to ASEAN countries and China have a homogenous character in forming regional economic integration, although it is heavily rely on the depth and speed of the integration. Therefore, Hufbauer dan Schott (1994:3-13) stated that economic integration needs the following steps:

free trade in goods and services; free transfer of capital; labour mobility; supraregional institutions; monetary coordinations; and fiscal integration.

The important impacts of ACFTA, among others, are *trade creation* and *trade diversion*, which could be positive and negative impact for welfare of a country (Viner, 1950; Balassa, 1967). Nevertheless, the development process of economic integration between ASEAN and China is in the early stage, i.e. free trade area/free trade zone. In this stage of integration, each ASEAN and China countries can have trade transaction intra ASEAN-China countries without tariff barrier, meanwhile trading with non ASEAN-China countries is still determined according to the regulation of each country.

Micro, Small, and Medium-sized Enterprises (MSMEs) is one of the priority sector under ASEAN economic integration. This sector plays an important role in the economy indicated by increasing contribution to Gross Domestic Product (GDP) both in ASEAN countries and China. According to Dipta (2010) and Sriningsih (2011), the implementation of ACFTA could decrease product competitiveness of MSMEs in Indonesia. There are 15% of MSMEs that have high competitiveness in the region, whereas the remaining have low competitiveness; and only 7% of MSMEs will be able to compete if China is incorporated in the ASEAN regional economy.

The MSMEs' contribution is also plays an important role in the economic structure of Malang region. Ceramic is one of the important business of MSMEs in Malang. Ceramic products can be found in Dinoyo area which is well-known as the ceramic production center in Malang. Various kinds of ceramic products are not sold only locally but also at the national and international market. Nevertheless, the implementation of ACFTA bring about impact on competitiveness and performance of ceramic industry in Malang.

As of 2015, publication concerning the impact of ACFTA on MSMEs performance and competitiveness especially ceramic product in Indonesia is hardly found. The publication so far are at the macro level such as study carried out by Madani (2001), Kwanjai *et al.* (2002), Pambudi and Chandra (2006), Park (2007), and Geib and Pfaff (2012). Research of MSMEs done by Rahutami and Kekalih (2011) was aimed to know MSMEs condition in Central Java, whether it will strengthen internal economy or could be an opportunity for export due to Central Java has deficit transaction with China. Research about MSMEs is also conducted by Tambunan (2011) and the study found that trade liberalization has positive impact on the development of MSMEs in Indonesia, however this is a general study about MSMEs not a specific study for ceramic product. Therefore, this article is an effort to fill the gap.

The purpose of the article are to (1) analyze impact of the ACFTA implementation of performance of ceramic artisan in Malang and (2) analyze the role of market structure and competitiveness as intervening variables between ACFTA and performance of MSMEs ceramic in Malang.

LITERATURE REVIEW

Economic integration is a part of the ways of a country to improve public welfare (Jovanovic, 1998) by means of liberate trade from any form of protection and restriction through form a free trade area. El-Algra (1998) defined economic integration as follows: "...economic integration as the discriminatory removal of all trade impediments between at least two participating countries and the establishment of certain element of co-ordination and co-operation between them..."

Thus, it can be concluded that economic integration imply eliminating any trade restriction with other countries and replaced by mutual benefits of economic coordination and collaboration

Economic integration indicate a group of nations which are geographically close to each others to establish a trade union aiming to gain economic benefits among member countries and limits penetration of other countries to the free trade zone (Chu and Park, 2007: 3) and to achieve economic growth through market extension, internalization of increasing return to scale

in the production and consumption, increase life standard of society as well as lessen income disparity among member countries (Daniel and Radenbaugh, 1986). Benefit of establishing economic integration would be bigger when member countries have similar comparative advantage, small market size, and low tariff imposition to non-member countries (Gibb and Michalak, 1994).

Economic integration, theoretically, has various types or criteria. Balassa (1961) classify economic integration into five degree: (1) free trade area; (ii) custom union; (iii) common market; (iv) economic union; and (v) total economic integration. Free trade area is characterized by existence of free trade without tariff barriers among member countries, however each country is allowed to levy tariff to non-member countries. Custom union apply decreasing import tariff to member countries and give trade barriers to non-member countries through Common External Tariff (CET). Common market is an extension of custom union by adding free flow of production factors (goods, services, capital, and labour) among member countries. Economic union is an economic cooperation agreement which include harmonization of national economic and fiscal policy. Political union is a form of integration involve comprehensive political harmonization among member countries such as form one political jurisdiction in the economic integration region. According to Lawrence (1991) stage (i) up to (iii) appear a form of shallow integration and stage (iv) up to (v) are forms of deep integration.

The impact of economic integration process is, among others, the existence of trade creation and trade diversion. According to Viner (Nicholls, 1998:324) trade creation and trade diversion are forms of welfare appears as an impact of economic integration. Trade creation can be interpreted as shifting goods which are produced by domestic producers with higher cost of resources to other member countries having lower cost of resources. Trade diversion, on the other side, is defined as shifting of goods produced by non-member countries own lower costs of resources to member countries having higher costs of resources. The existence of trade creation and trade diversion indicate that each country would have different economic benefits in an economic region (Lawrence (1991). The difference in the degree of economic integration has impacts on different integration pattern and mechanism of economic integration among countries, so that each country gains different benefits. According to Asante (1997), there are three factors determine degree of economic integration: market aspect, production factors, and economic policy. Carroll (1994: 24) emphasize that trade creation will give bigger benefits for countries involved in having high competition degree at the domestic market. More specifically, Balasa (in Silva, 2000:10) said that more benefits of trade creation only occur if goods are produced in the competitive market.

Competitiveness has macro and micro unit of analyzes. AT the macro level, competitiveness as stated by Schwab (2012) that 'competitiveness as the set of institutions, policies, and factors that determine the level of productivity of a country'. At the micro level, according to Black and Porter (2000:213) stated that "Competitive advantage is the ability of a firm to win consistently over the long term in a competitive situation". Based on operational management point of view, Krajewski and Ritzman (2005:62-65), stated that there are four competitive capabilities for a firm to win in a market segment: (1) cost, (2) quality, (3) time, and (4) flexibility. These capabilities seems can be applied in MSMEs of ceramic, for example low cost of production will end with low price of ceramic that enable producer to compete in free trade area.

Competitive advantage concept has been used by many researchers with various indicators. Flynn *et al.* (1995) explained that advantage of firm is ways in which firm create value to its customers. It can be achieved through creating competitive advantage by various dimensions such as low cost and differentiation (Porter, 1999) and Black and Porter (2000).

RESEARCH METHODS

Variables

Variables in this study consists of exogenous, intervening, and endogenous variables. Exogenous variable is ACFTA (X_1), intervening variables are market structure (Y_1) and competitiveness (Y_2), and endogenous variables is performance of MSME ceramic (Y_3).

ACFTA (X_1) is defined as economic integration framework between ASEAN countries and China. Implementation of the cooperation was commenced effectively since January 1st 2010. ACFTA indicators are (a) tariff (X_{11}), which is number of tariff imposition in trade implementation, (b) numbers of ceramic products imported from China (X_{12}), and (c) government intervention in limit to restrict numbers of imported ceramic from China.

Market structure (Y_1) is defined as composition of the producers in producing and selling ceramic products the regional market of ASEAN-China. The indicators are: (a) numbers of ceramic producers (Y_{11}), (b) numbers of ceramic producers in Indonesia and other ASEAN countries (Y_{12}), numbers of ceramic products sold in ASEAN market (Y_{13}), numbers of ceramic products sold in Indonesia and other ASEAN countries (Y_{14}), and ease of raw material procurement (Y_{15}).

Competitiveness (Y_2) is defined as the degree of competition in the market. Indicators of competitiveness are (a) cost of production (Y_{21}), (b) quality of ceramic product (Y_{22}), and (c) utilization of technology in the production process (Y_{23}).

Performance MSMEs ceramic (Y_3) is defined as degree of achievement to fulfill family needs. Indicators used are: (a) earnings from ceramic make them afford to pay for their children education fee (Y_{31}); (b) earnings from ceramic make them afford to pay for family health care (Y_{32}); and (c) earnings from ceramic them afford to fulfill family needs beyond education and health care (Y_{33}).

Data

Data were gained from 30 MSMEs ceramic artisan at Dinoyo and Merjosari area of Malang. This study was a census one due to that are the population of ceramic artisan in the area as the ceramic production center in Malang. Data were collected using questionnaire contained statement of indicators of the variables with five Likert scale: starting from strongly disagree; disagree, do not know, agree, and strongly agree.

Model

Generalized Structured Component Analysis (GSCA) was used to analyze data. This model was used because it is nonrecursive as well as differentiate reflective and formative measurement (Solimun, 2013) and it has small sample (Tenenhaus *in* Solimun, 2013).

Figure 1 depict the relationship between variables as conceptual framework in accordance with the purpose of the article.

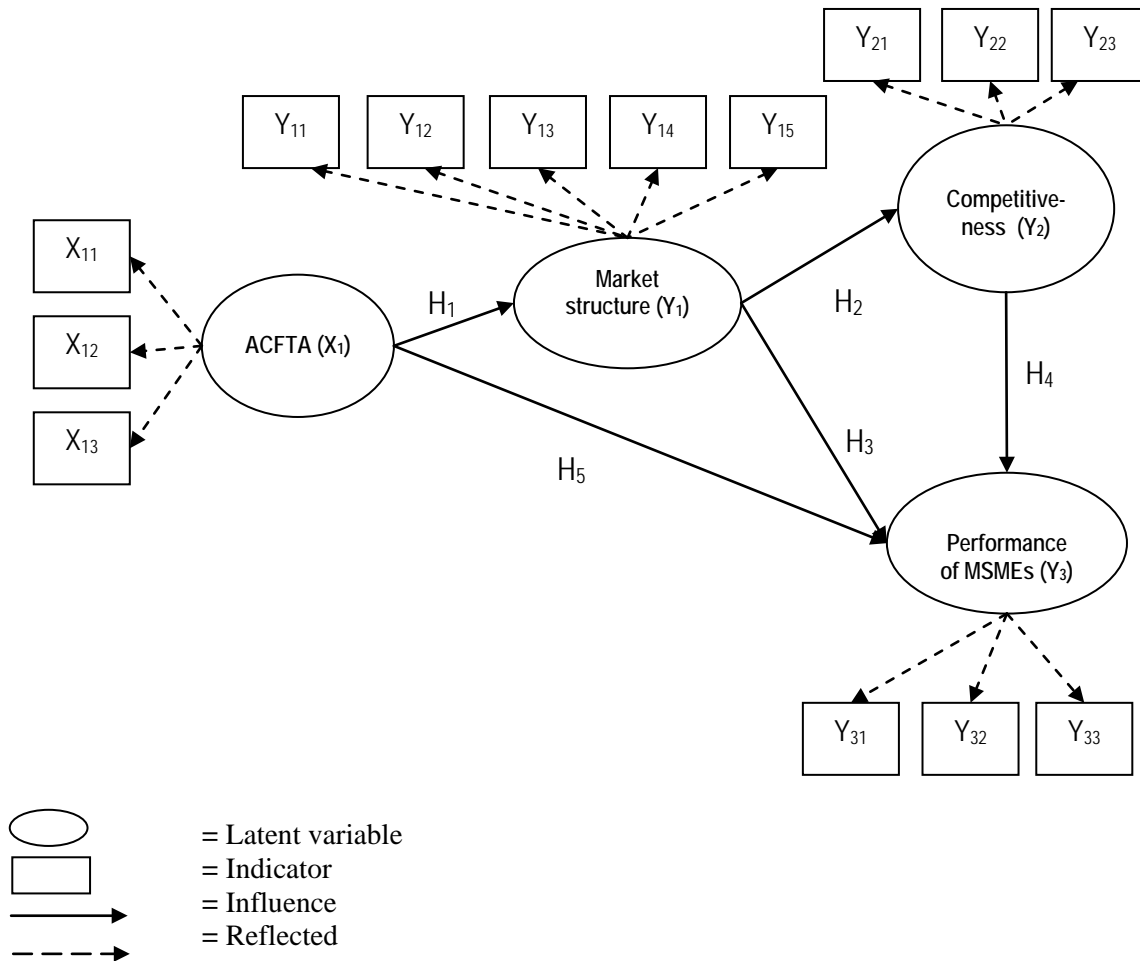


Figure 1. Research Model

RESULTS AND DISCUSSION

Statistical Result

Statistical analysis shows that all indicators are valid, except numbers of ceramic producers in Malang as the market structure indicator is marginal (loading close to cut off). Convergent validity loading is also marginal. ACFTA and market structure are not reliable, whereas competitiveness and performance of MSMEs ceramic are reliable. Overall, it can be concluded that model in good enough or marinal due to internal consistency is close to the cut off (0.60).

Model of fit structure is good enough since FIT is 0.472 that the model explaine 47.2% of the phenomena and AFIT is 0.42.7 that is relatively stable after taking into account number of sample and variables. Model of fit overall is good because Goodness of Fit Index (GFI = 0.984) ≥ cut-off (0.90) and Standardized Root Mean Square Residual (SRMR = 0.095) ≤ cut-off (0.08).

The statistical result of analysis using GSCA software is summarized in Figure 1.

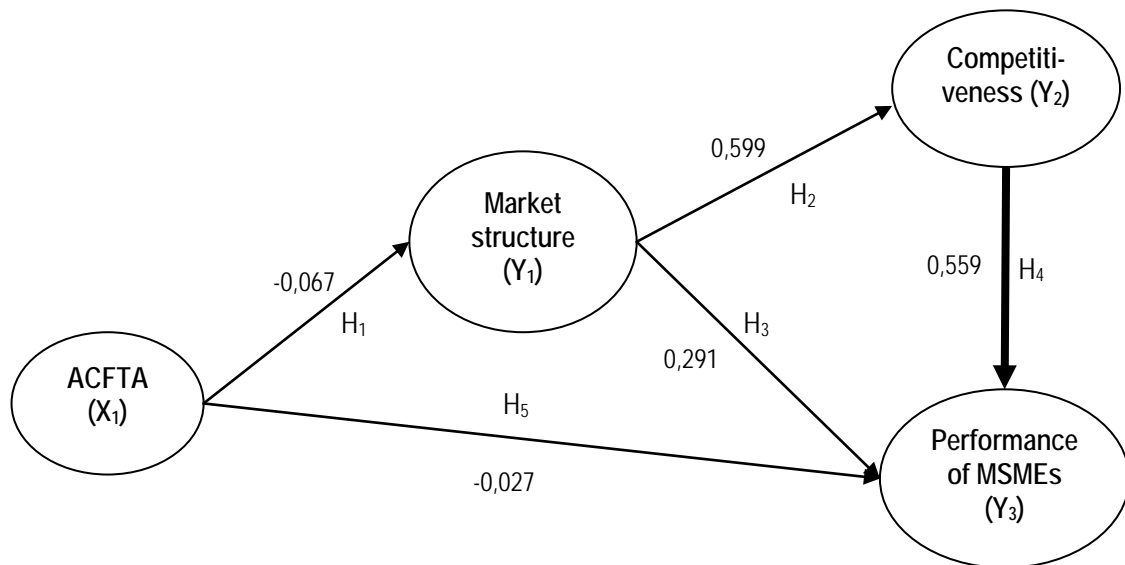


Figure 2. Statistical Analysis of Structural Model

➔ : Significant at $\alpha = 5\%$

Statistical analysis (Table 1) showed that almost all of the hypotheses were rejected, except the influence of competitiveness on performance of MSMEs ceramic (hypothesis 4 was accepted). The path coefficient of competitiveness is positive, means that the stronger competitiveness the higher performance of MSMEs ceramic will be, holding other variables constant.

Table 1. The result of structural analysis and hypotheses testing

No.	The variables relationship	Path coefficient	CR	Decicion to hypothesis
1	ACFTA (X1) → market structure (Y1)	-0,067	0,15	Reject H1
2	Market structure (Y1) → competitiveness (Y2)	0,599	1,24	Reject H2
3	Market structure (Y1) → performance of MSME ceramic (Y3)	0,291	0,76	Reject H3
4	Competitiveness (Y2) → performance of MSME Ceramic (Y3)	0,559	2,48	Accept H4
5	ACFTA (X1) → performance of MSME ceramic (Y3)	-0,027	0,11	Reject H5

Source: summarized from statistical analysis

Discussion

ASEAN economic integration through ACFTA is has no significant effect on market structure of MSMEs ceramic on Malang. The main reason is that ceramic product imported from China did not enter into ceramic market in Malang. It is an indication that Malang is not market destination of Chinese ceramic products may be because of ceramics produce in Malang have spesicic characteristics as a basis of competitiveness (Malang Post, 2015). This finding is in line with study of Tambunan (2011) that global trade liberalization has no strong negative

influence on MSMEs performance in Indonesia. The decreasing numbers of ceramic producer in Malang during 2014-2015 was insignificant; there was only 10 ceramic producers shift to become gypsum producers, meanwhile 30 artisans still producing ceramic. The study of Pambudi dan Chandra (2006) found that costs of production in domestic market increase as the impact of ACFTA implementation. The increasing costs of production of ceramic in Malang was affected by increasing price of liquid propane gas (*elpiji*) of 12 kg from IDR 119.000 to IDR 136.000 per tube by the end of 2014 instead of ACFTA impact. As the results, average cost of production per month increase from IDR 5.712.000 to IDR 6.528.000.

The increasing cost of ceramic production in Indonesia can result in trade creation in ACFTA framework and it will benefit for other ASEAN countries, especially China that able to produce low cost of ceramic (Nicholls, 1998). If Indonesia does not be able to produce ceramic at a lower cost and therefore competitive price, China and other ACFTA countries will take bigger benefits from the regional economic integration. Trade creation is bigger when countries involved in the economic integration have high degree of competition to win at the domestic market (Carroll, 1994).

Products imported from China was actually overwhelm domestic market. According to the Head of Indonesian Ceramic Industry Association, ceramic products that were 6.6 million cubic meter (m^3) of ceramic imported from China in 2011 and it were increase twice (12 million m^3) by 2012 (Kementrian Perindustrian, 2015). Data also showed that imported ceramic products from China during the periode of 2007 – 2010 was US\$ 174.6 million on average, but it increased dramatically in 2012 become US\$ 278 million.

The increasing numbers of ceramic products in domestic market, that is about 40 million m^3 according to the Head of Indonesian Ceramic Industry Association, is was illegal (Tempo, 2011). That ceramic products were sold at a very low price (IDR 65 thousands per m^2), whereas domestic price for the same products was IDR 100 per m^2 . Imported ceramic should be levied and costs so that it would be sold at the price of at least IDR 85 thousands per m^2 .

Market structure was also has no significant impact on competitiveness of ceramic products in Malang. Market structure after ACFTA implementation should be perfect competition. In fact, market structure for ceramic products in Malang is imperfect competition for most of ceramic artisan (705) were strongly disagree that there are many numbers of ceramic producers in Malang, and most of the ceramic artisan (63%) were also did not know about numbers of ceramic producers in Indonesia and other ASEAN countries.

Market structure was also has no significant impact on performance of MSMEs ceramic in Malang. Overall analysis found that performance is significantly affected by competitiveness instead of market structure and economic integration through ACFTA. Market structure in Malang is imperfect competition due to ceramic producers have limited information concerning numbers of ceramic products sold at national and international market. This information will helpful in effective and efficient decision making process of production and marketing. Besides, market structure of imperfect competition was stringly indicated by heterogeneous ceramic products according to consumers. Ceramic producer have not been optimize imperfect market competition by acting as price maker.

Competitiveness was the only variable that significantly affect performance of MSMEs ceramic in Malang. Competitiveness was measured by three indicators: (1) cost of ceramic production in Malang that is cheaper than other production area; (2) quality of ceramic products in Malang that are better than products from other production area included from China; and (3) production process and marketing have utilized new technology. Based on the statistical analysis, quality of ceramic product and production process play an important role in determined ceramic competitiveness. Most of the ceramic artisan (56.7%) agreed even stringly agreed that quality of ceramic products in Malang are better than products from other production area included

China; and 80% agreed even stringly agreed that production process and marketing of ceramic in Malang are technological-based by means of machinery, computer, and internet.

Ceramic product in Malang and generally from Indonesia would have higher competitiveness if it is supported by various government programs and policies, such as National Standard (Standar Nasional Indonesia/SNI) for ceramic product. Indonesian government through Indonesia National Body (Badan Standarisasi Nasional) speed up implementation of SNI for 564 product included ceramic since the beginning of 2014 (BSN, 2014). Acceleration of the obligation of SNI is aimed at protecting local producers toward imported product under free trade agreement. So far, a lot of imported product had low quality and low price so that local producers were not protected.

Besides protection through SNI, MSMEs ceramic competitiveness can be increased by innovation, especially product innovation. Innovation is believed to improve ceramic products competitiveness in the global market. Motive or unique design would be attractive for consumers. Some enterprises have developed ceramic based on local culture, such as batik design (Kompas, 2015).

ASEAN ecomic integration through ACFTA has no significant on performace of MSMEs ceramic in Malang. As has been mentioned that Malang, so far, is not market destination of Chinese ceramic product. Spesific or uniqueness of ceramic produced in Malang tha has been acknowledge by European society (Jawa Pos, 2015) can be one of the reason of Chinese ceramic to not entering Malang ceramic market.

CONCLUSION

ASEAN economic integration through ACFTA has no significant impact on performance of MSMEs ceramic in Malang. Market structure and competitiveness are also have not significant as intervening variables between ACFTA and performance of MSMEs ceramic in Malang. Competitiveness, the only variable, which has significant effect on performance of MSMEs ceramic in Malang. ACFTA has no impact on performance of MSMEs ceramic due to Chinese ceramic products were not entering into Malang, maybe because of this area is not market destination of Chinese ceramic products. Product quality and technological-base production process determine competitiveness of MSMEs ceramic in Malang.

In order to maintain and improved competitiveness of MSMEs ceramic in Malang and Indonesia in general, government should speed up application of SNI for ceramic product to protect small producers through non-tariff barriers. Moreover, government should intensify diffusion of information to all parties involed in ceramic industry concerning the impact of ACFTA on enterprise performance.

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