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The IA-CEPA and Sector Adjustments: A Specific-Factors Model of Production

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Abstract
The Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), is expected to increase trade flows between the two largest economies in the region potentially benefiting 280 million consumers. With highest level of trade, changes in output and payment to factors of production can be anticipated. We use the Specific Factors model of production to estimate the magnitude of these changes and results show substantial adjustments. The attempt to better integrate both economies through the IA-CEPA, could have important implications for employment, especially for Australia.
Keywords: Indonesia; Australia; IA-CEPA; wages; output; Specific Factors model

1. Introduction

In September of 2012, Indonesia and Australia commenced negotiations to expand trade, investment, and economic cooperation. The program known as the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), aims at bringing closer together the two largest economies of the region, a key part of the Asian Century idea.

Despite their geographical proximity, the level of trade between the two countries, while important, is not that significant. Indonesia is Australia's 12th largest trading partner and the 11th export market. In 2013, Indonesia's exports to Australia amounted to $4.4 billion or 2.4% of its overall exports while Australia's exports to Indonesia amounted to $4.6 billion or 1.8% of its overall exports. What is important, however, is that despite the relatively low levels of trade between the two countries, the rate at which trade has been growing in the last few years is significant, averaging about 7.2% per year.

The Australia-Indonesia economic relationship is not just limited to trade. These two countries have established a relationship that goes beyond imports and exports, and include ties in the cultural and political arenas. Australia has long realized that the stability and economic

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