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## **Regionalism vs. Nationalism: Prospect of Indonesia's Involvement in AFTA**

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# **Regionalism vs. Nationalism: Prospect of Indonesia's Involvement in AFTA**

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## **Abstract**

Indonesia has switched, in its foreign economic policies, to neo-liberal posture especially after the turmoil of Asian financial crisis, and continues to adhere to the course of liberalization, especially during the current regime of President Susilo Bambang Yudhoyono. The benefits from joining the ASEAN Free Trade Agreement (AFTA) have been believed to be a stepping stone for ASEAN countries to compete in the world markets. It is also believed to be better than other multilateral organizations such as WTO. However, many others, especially those of the minimalist camp, claim that pursuit of open regionalism has limited Indonesia's ability to resist the negative forces of globalization while ASEAN's contributions to Indonesian international autonomy and bargaining power have been minimal. This paper aims to examine Indonesia's reluctance for participating actively in AFTA from the political economy perspective. Given Indonesia's commitment to free trade and its accelerated dismantling of trade barriers, sometimes unilaterally, the reservations about AFTA seem paradoxical. Nevertheless, we want to argue that the crucial factor in deciding Indonesia's adherence to AFTA is employment. Despite its huge population, Indonesia's competitiveness is still under threat from other labor abundant ASEAN countries, not to mention China. Therefore, the adoption of a strategy of enhancing employment for Indonesia is critical for raising people's support for further regional integration and the successfulness of its participation in AFTA.

**Keywords:** AFTA, trade and employment, nationalism, openness

## **Nationalism and Foreign Economic Policy**

One of the most prominent features of the Indonesian Economy during the post-independence period is the emergence of economic nationalism. Shortly after independence, for example, the Indonesian government introduced the so-called *Benteng* system in 1950, which was intended to promote native Indonesian businessmen (Mackie, 1971: 47). Subsequently, following the introduction of Guided Democracy in 1957, the expropriation of foreign capital began to take place. During this period, many “Dutch trading and estate enterprises, the core of Dutch colonial capital, were expropriated together with Dutch shipping, banking and industrial enterprises” (Robinson, 1986: 79). The New Order government in 1966 made changes in the way economic nationalism was implemented. The New Order government’s main priority in its economic stabilization program was to curb the rate of inflation that it had inherited from the previous government (Thomas and Ponglaykim, 1973: 145). As a result, Indonesia implemented an open-door economic policy, which “aimed at producing maximum economic growth and relying heavily upon investment by international corporate capital” (Robinson, 1986: 131). However, these economic policies lasted only until 1975, when there was a resurgence of economic nationalism (Robinson, 1986: 131). The New Order government began to take a more active role in foreign policy, particularly within the regional context, following the end of the Cold War in the late 1980s and the resurgence of regionalism in both Western Europe and North America. In any case, the New Order government pursued a rather pragmatic approach in its overall conduct of foreign economic policy.

The economic crisis in 1997 marked the fall of the New Order government. Habibie was appointed the third Indonesian President following Suharto’s resignation on May 21, 1998. Habibie faced an immense challenge when he took the presidency, particularly with regard to alleviating the economic crisis and trying to establish the foundation of democracy in Indonesia. The deepening economic crisis and the independence crisis in East Timor triggered nationalist sentiment in the country. Searching for possible scapegoats to take the blame for the economic crisis, the Indonesian authorities and media alike pointed their fingers at currency speculators (Henderson, 1998: 155). The appointment of Adi Sasono, a former Islamic NGO activist, as the Minister of Co-operatives, Small, and Medium Enterprises also raised fears over the possible re-emergence of economic nationalism in Indonesia. In the past, he had developed the concept of the *Ekonomi Kerakyatan* (People’s Economy), which can be defined as a participatory economy, which allows fair and equal access to all members of society in the processes of production, distribution and national consumption without sacrificing human resources and environment to support the people (Sasono, 1999). In principle, the concept of the People’s Economy involved activities conduct-

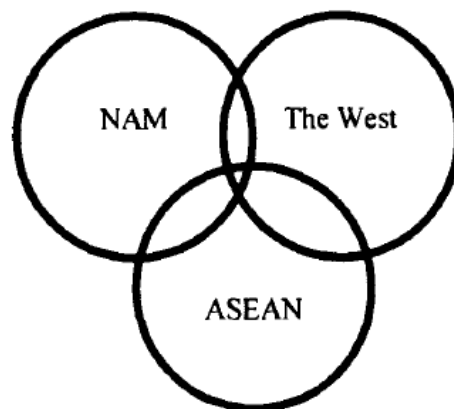
ed from the people, by the people, and for the prosperity of the people. However, economic nationalization of foreign and ethnic Chinese capital was not the main aim of Sasono as some suspected. True reform within the framework of the People's Economy, according to Sasono, would include the empowerment of the small and weak in order to create a strong middle class.

Harbibie's foreign economic policy was quite successful overall. Apart from his full commitment to the IMF's prescriptions, the success of Habibie was also due to his ability to promote political democracy in Indonesia, which allowed the country to regain the necessary support from the international community to alleviate the economic crisis. Another major move to secure economic support from foreign donors and international financial institutions was Habibie's intention to hold a fair and open election. Furthermore, at the regional level, during his short tenure, Habibie managed to make close contact with Mahathir Mohammad, the Malaysian Prime Minister. As a result, the future of ASEAN regionalism, and the progress of AFTA in particular, was no longer in jeopardy despite the strained relationship between Indonesia and Singapore (Chandra, 2008: 105).

Abdurrahman Wahid took over the presidency following the 1999 election. Shortly after his appointment as the head of state, President Wahid set out the main themes of his foreign economic policy, which included the promotion of foreign investment and free market reforms (Symonds, 1999). This was President Wahid's nationalist appeal to build a stronger Indonesia in the face of the economic crisis. In addition, Wahid also called for closer ties with Japan, China and the member countries of ASEAN. Another major foreign economic policy in the Wahid administration was a commitment to fully support the IMF rescue loan package, which was linked to the IMF Letter of Intent (LoI). The disbursement from the IMF was important because it could be "taken as a measure of market confidence in the progress of economic reform. Therefore, . . . the credibility of Indonesian economic reform [was] reflected in the successful and consistent implementation of the IMF program" (Ferdhanusetyawan, 2003: 238). Although the President was able to gain enormous support from the international community for Indonesia's efforts at national integration, Indonesian foreign policy during the Wahid administration remained quite conventional and its main ideas were similar to the foreign policy conducted by the New Order government (Smith, 2000: 523).

It was decided through a vote in the Parliament that the Wahid should step down and Megawati was sworn in to become the fifth Indonesian president on July 2001. As with her predecessors, the Megawati administration inherited the challenges of maintaining the country's integration, alleviating the economic crisis, and ensuring long-term political stability in the country. As with her father, Sukarno,

President Megawati has also been known as a staunch nationalist who was reluctant to jeopardize the current geographical existence of the country by allowing any separatist movements within the country. In terms of improving economic conditions, Megawati appears to have put the appropriate foreign economic policy in place. One key feature of the Megawati administration's overall foreign policy has been a return to the traditional concentric circle formula (see figure 1). This formula has identified ASEAN as the highest priority of Indonesian foreign policy. Indonesia's return to the concentric circle foreign policy formula dismissed speculation that Indonesia would abandon AFTA and other ASEAN regional economic integration initiatives. ASEAN and Western countries remain within the first and the third circles of Indonesian foreign policy overall. Major adjustments, however, have been made to the second circle (Non-Aligned Movement, NAM), which indicates that Indonesia will concentrate its foreign policy on the member countries of the Pacific Island Forums (PIFs), the Southwest Pacific Dialogue, and the Tripartite Consultation between Indonesia, Australia, and Timor Leste, and the three close economic partners of Indonesia, Japan, China and South Korea (Chandra, 2008: 111). The adjustments made to the concentric formula indicate Megawati's realization of the growing need to strengthen regional economic cooperation with the countries of the Southwest Pacific and North-east Asia. In this way, Indonesian foreign economic policy is decided according to the overall foreign policy of the country.



**Figure 1 Three Concentric Circles of Indonesian Foreign Policy**

Source: Smith (2000), p. 18.

Meanwhile, Indonesia experienced major problems with foreign investments. The main obstacles to investment in Indonesia were international as much as domestic. At the international level, aggressive U.S. foreign policy toward Afghanistan and Iraq has had a damaging effect on the Indonesian economy. These two events stimu-

lated threats and demonstrations against the United States and its allies in Indonesia (Anwar, 2003: 75). At the domestic level, issues such as regional security, law enforcement, labor market problems, the overlapping responsibilities of central and provincial government, regulatory burdens, and distributions in the tax system remain major problems to be confronted by potential investors in Indonesia (Bappenas, 2003).

Dr. Susilo Bambang Yudhoyono (Also referred as SBY) is the first Indonesian president that has been directly elected by the voters throughout Indonesian history. He secured the majority of votes in presidential elections in July 2004. Yudhoyono's conviction toward neo-liberalism has been consistent since he was elected as the representative of the Democratic Party to take part in the presidential election. During his election campaign, for example, Yudhoyono ensured his supporters that the promotion of foreign investment would make a positive contribution toward job creation in the country. One important element to support his neo-liberal policy was the strengthening Indonesia's relationship with the United States, a move which was welcomed by the Indonesian armed forces. Another important element of Yudhoyono's neo-liberal agenda was the active and aggressive participation of Indonesia in bilateralism, regionalism, and multilateralism. Indeed, the Yudhoyono administration was generally supportive toward any forms of regionalism in a complementary to the ideological approach that was subscribed by the Indonesian leader.

In sum, the collapse of the Indonesian economy in 1997 brought significant changes in the way that nationalism and foreign economic policy were integrated by the state. The conventional approach of implementing economic nationalism was no longer applicable. Faced with an ever-increasing dependency on various international financial institutions and other foreign donors, all the post-economic crisis Indonesian governments were forced to follow stringent measures to secure loans from these international institutions. The agreements made between these Indonesian governments and the IMF through the signing of Lol, in particular, have been particularly demanding. However, there have also been debates among the Indonesian political elite as to whether Indonesia should continue its relationship with the IMF, which officially expired at the end of 2003 (Economist Intelligence Unit, 2003: 22). On the one hand, the Indonesian political elite is concerned that the Indonesian government will continue to lose its sovereignty by following IMF measures. On the other hand, the presence of the IMF has, indeed, improved the macroeconomic condition of Indonesia. Although the final outcomes have yet to be seen, the Indonesian public has shown growing dissatisfaction toward the IMF's stringent conditions. As regards Indonesian foreign economic policy in ASEAN, the shift of leadership from Wahid to Megawati allowed Indonesia to return to its more traditional focus on its

immediate neighbors. As a result, Indonesia remains committed to the progress of ASEAN economic regionalism, particularly AFTA. After all, it has always been in the interests of Indonesia to put ASEAN at the cornerstone of its overall foreign policy.

### Indonesian Perceptions of AFTA

The perceptions of Indonesian state and non-state actors of AFTA in recent years have been changing. The emergence of regional economic crisis in 1997, in particular, has played a major role in changing their attitudes toward ASEAN regional integration schemes. This change of attitude was actually stimulated by the economic crisis in that there was a consensus among Indonesian policymakers that enhanced regional economic integration in the Southeast Asian region would provide a fundamental mechanism to alleviate the economic crisis. As a result, the Indonesian government welcomed ASEAN's initiatives to accelerate the AFTA schedule as envisioned in the Statement on Bold Measures (ASEAN 1998). This statement reflected the realization of ASEAN leaders that the economic crisis would have disastrous effects on the business dynamics and the economies of ASEAN member countries. It is for this reason that the member countries of ASEAN agreed to initiate some concrete measures to minimize the negative effects of the economic crisis. Although AFTA in itself was not able "to address the regional upheaval and was certainly not designed to deal with such events" (Narine, 2002: 186), ASEAN leaders were convinced that the acceleration of AFTA would stimulate economic growth and renewed business confidence, which, in turn, would speed up the process of economic recovery in the region. As it stood, Indonesia managed to place as many as 6,346 items (88.43%) on to AFTA's inclusion list in 2000, and 6,461 items (90.04%) in 2001 (Depperindag, 2000: 27; cited in Chandra, 2008: 150), which reflected Indonesia's genuine commitment toward AFTA.<sup>1</sup>

Table 1 AFTA Common Effective Preferential Tariff (CEPT) List for 2001

	Inclusion List	Temporary Exclusion List	General Ex- ception List	Sensitive List	Total
Brunei	6,284	0	202	6	6,492
Indonesia	7,190	21	68	4	7,283
Malaysia	9,654	218	53	83	10,008
Philippines	5,622	6	16	50	5,694
Singapore	5,821	0	38	0	5,859
Thailand	9,104	0	0	7	9,111
<b>ASEAN 6 Total</b>	<b>43,675</b>	<b>245</b>	<b>377</b>	<b>150</b>	<b>44,447</b>

<sup>1</sup> However, according to ASEAN Secretariat as adapted from Chowdhury (2007), the number of items in 2001 Indonesia's inclusion list is 7,190. See Table 1.

Source: ASEAN Secretariat; adapted from Chowdhury (2007), Table 2.

Apart from a need to alleviate the economic crisis, Indonesia was also inclined to strengthen ASEAN economic regionalism through AFTA for the overall benefits accrued from regional integration strategy. Chandra's field research also reveals that, because of its commitment to AFTA, Indonesian state and non-state actors were convinced that the country could move closer to achieving its objectives of sustained economic development and the maintenance of national unity (Chandra, 2008: 150). With its capacity to promote economic growth and competitiveness, AFTA will have positive knock-on effects on the overall economic development of Indonesia, leading to prosperity. This nationwide prosperity will help the Indonesian government to minimize the threat of national disintegration presently posed by several ethno-nations, i.e., Aceh, Papua, etc., which has become a serious post-crisis phenomenon in Indonesia. Moreover, the Indonesian government will also be able to increase its autonomy and bargaining power in the international arena through its full commitment in the ASEAN regional integration schemes. In the age of an increasing drive toward multilateralism, pressure groups, i.e., the business community, the academic community, NGOs and civil Society organizations (CSOs), in Indonesia are demanding that their government should play an active role in the international arena. Greater prosperity throughout the Southeast Asian region will also increase the prestige and power of other ASEAN member countries. Such conditions, in turn, will give ASEAN member countries greater autonomy and bargaining power in dealing with major powers, such as the United States and the EU, in many multilateral negotiations. In the long run, the regional integration strategy is also hoped to contribute to the promotion of Indonesian culture and identity at both regional and international levels. Therefore, the need to minimize the negative impacts of the economic crisis and other important incentives afore-mentioned has acted as stimulants to promote the speeding up of the AFTA schedule.

However, the Indonesian government's commitment toward the implementation and scheduled acceleration of AFTA drew some criticism from various sources in Indonesia. Indonesian domestic pressure groups such as business associations, NGOs, CSOs, for example, were very skeptical of Indonesia's entrance into the AFTA scheme. A year prior to the implementation of the AFTA scheme in January 2002, for example, the Indonesian Chamber of Commerce and Industry (*Kamar Dagang dan Industri Indonesia*, KADIN) expressed its concern about AFTA and made an official demand that the Indonesian government should delay Indonesia's entry into the scheme until 2005 (*Kompas*, 2001). Almost a year after its implementation, the Indonesian government was still receiving stiff criticism over its commitment to AFTA. In the face of possible increases in fuel, power, and telephone prices in early 2003, for example,



various Indonesian labor organizations and members of the Indonesian Entrepreneurs Association (*Asosiasi Pengusaha Indonesia*, APINDO) maintained that the Indonesian government's commitment to AFTA was a proof that the government was more concerned about the country's global position than the welfare of its people (Guerin, 2003). The anti-AFTA sentiment in Indonesia contended that the government should be more concerned about domestic problems rather than giving priority to regional trade liberation issues.

Another important factor in analyzing contemporary Indonesian attitude toward AFTA was the introduction of the Regional Autonomy Laws (*Otonomi Daerah*, OtDa), which challenged the AFTA scheme. In 1999, the Habibie administration issued Act No. 22/1999 (UUPD), which is a regional government law, and Act No. 25/1999 (UUPKPD), which concerned with fiscal balance between central and regional governments. Both regulations were officially implemented in January 2001. These two acts were aimed at decentralizing the heavily centralized system during the New Order period. Specifically, Act No. 22 was used to make a fundamental shift in government functions from the central to regional level, while Act No. 25 was implemented in conjunction with the former to focus on fiscal relations between the central and regional governments (Silver *et al.*, 2001: 346). They have generated great concern, particularly over the issue of ethno-nationalism. In KADIN's view, for example, the OtDa will complicate the investment laws that could hinder business transactions (Tempo, 2001). Following the implementation of these regulations, many provincial governments have issued numerous laws which have greatly bureaucratized the relationship between officials and the business sector. The Indonesian government, on the other hand, argues that such changes are a natural result of political transition in Indonesia, and should be considered reform euphoria.

At the time of the formation of AFTA, the ASEAN countries accounted for only 10% of Indonesia's total exports. Indonesia increased its export share to ASEAN to about 18% in 2006. Singapore is Indonesia's major ASEAN export market. However, the share of Indonesia's exports to Singapore has remained stable at around 10% since the early 1990s. On the other hand, the importance of Malaysia as an export destination has increased from around 1% in 1991 to close to 5% by 2004.

ASEAN is more important as a source of Indonesia's imports than as a destination of Indonesia's exports. Around 32% of Indonesia's imports came from the ASEAN countries. Overall, ASEAN still accounts for around 24% of Indonesia's total trade; countries outside ASEAN remain major trading partners. Although Indonesia's intra-ASEAN trade has increased in recent years, it only accounts for 11% of total intra-ASEAN trade, well behind more advanced members, Singapore and Malaysia, and 4 percentage points behind Thailand in 2005(see Table 2). Singapore alone accounts

for around 41% of total intra-ASEAN trade, followed by Malaysia with a share of around 22%. Thus, it seems that less developed members are not benefiting much from AFTA.

Table 2 Country Shares in Intra-ASEAN Trade (%), 2005

	Share (%)
Brunei	0.7
Cambodia	0.4
Indonesia	10.9
Laos	0.2
Malaysia	21.6
Myanmar	0.8
Philippines	5.3
Singapore	40.7
Thailand	14.9
Vietnam	4.6

Source: ASEAN Secretariat.

Given Indonesia's very small share in total intra-ASEAN trade, Indonesia is not expected to gain much from AFTA. One study undertaken by the Ministry of Industry and Trade suggests that Singapore and Malaysia benefit most from AFTA, followed by Thailand and Indonesia (reported in Saleh, 2005). This is in line with their respective intra-ASEAN trade shares. Based on CGE modeling, Feridhanusetyawan and Pangestu conclude, "The creation of AFTA . . . is estimated to contribute little additional welfare benefit . . . to Indonesia . . ." On the other hand, they find significant welfare gains from full implementation of trade liberalization under Uruguay Round and Asia Pacific Economic Cooperation. However, agricultural liberalization in AFTA is likely to benefit Indonesia as we can expect from Indonesia's potential capability to provide agricultural products for the region (Feridhanusetyawan and Pangestu, 2003: 72).

In a more recent study Hartono *et al.* (2007), also using CGE modeling, found similar results to Feridhanusetyawan and Pangestu (2003). Their simulation results show that real GDP of Indonesia increases by only 0.13% and the welfare gain by only 0.61% from AFTA trade liberalization. On the other hand, real GDP and overall welfare gains from global trade liberalization are 1.31% and 2.64% respectively. More interestingly, unskilled labor income increases by only 0.79% from AFTA liberalization as opposed to a staggering 6.46% from global trade liberalization.

Table 3 Indonesia's Gains from Trade Liberalization (percentage change compared to base-line simulation)

	AFTA Liberalization	Global Liberalization
Real GDP	0.13	1.31
Imports	1.92	8.86
Exports	0.68	3.89
Unskilled labor Income	0.79	6.46
Capital Income	0.64	4.87
Welfare*	0.61	2.64

\* Welfare index includes 17 variables, such as inflation, wages, government revenue, GDP, etc.

Source: Adapted from Hartono *et al.* (2007), Table 5.

The estimated gains from ASEAN *plus* and other bilateral trade liberalization (Indonesia-China, Indonesia-Japan, Indonesia-Korea, Indonesia-India) are also quite small compared to global trade liberalization. Only in the cases of East Asian FTA and APEC FTA, the estimated welfare gains are reasonable. A very similar sectoral output effect occurs in the case of ASEAN-China FTA. More damaging impact on labor-intensive sectors such as textiles and leather happens in the case of ASEAN+3 and East Asian FTA.

The expected loss from AFTA and ASEAN *plus* FTAs in the labor-intensive sector has significant political economy implications, especially when Indonesia's competitiveness is being eroded due mainly to other labor surplus countries such as Vietnam and China. Between 2000 and 2002 nearly one million workers lost jobs in the textile, garments and footwear (TGF) industries (Chowdhury, 2007: 10). And if we look at it from a longer run perspective, the TGF lost a total of 7.7 million workers from the period of 1985-95 to the period of 1995-2005 (Aswicahyono *et al.*, 2011: 18). Exports in TGF hardly grew and they declined in the wood-based industries (including furniture) from 1995 to 2005.<sup>2</sup> Nevertheless, employment growth was still significant in both these industries, suggesting that some labor-intensive segments were still able to compete in world markets. For example, even though TGF and wood industries contributed less than 5% of the increase in the value of manufacturing exports in 1995-2005, they provided 40% of all jobs associated with exports in this period.

The share of unskilled labor-intensive manufactured exports has been declining since the early 1990s, about the time when AFTA was initiated. This saw the rise in unemployment rate from 4.4% in 1994 to 4.9% in 1996. The rate rose to a peak at 11.24% at the end of 2005 and increasingly declined to less than 6% recently (Trading Economics, 2013). Therefore, it becomes politically difficult to pursue further regional integration when Indonesia is rapidly losing competitiveness in labor intensive

<sup>2</sup> The value of exports continued to increase slowly in the TGF industries in 2000-2005, while they fell in the wood-based industries. See Aswicahyono *et al.* (2011), Figure 8.

manufacturing exports mainly to its ASEAN partners, contributing to rising unemployment and poverty. The persistence of unemployment and poverty may slow down not only regional integration but also multilateral liberalization. There is already a view among academics, officials, business leaders and civil society organizations that liberalization has gone too far (see, *e.g.*, Chandra, 2008). They are demanding that protection should be increased in sensitive sectors such as textiles, chemicals, motor vehicles and steel (Vanzetti *et al.*, 2005).

## Concluding Remarks

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