# Indonesia

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## Introduction

With an estimated population of 250 million and per capita gross domestic product (GDP) of around US$900 billion, Indonesia is the fourth most populous country in the world and the 16th largest economy. It is the largest economy in Southeast Asia and ranks sixth among other Asian countries. The current state of Indonesia is the result of a long transformation that has been taking place for 50 years. While it obtained formal independence in 1949, the first 25 years of the history of the nation was marked with an independence war, military conflicts, and regional uprisings that led to economic disaster. It was not until the late 1960s that the process of economic development started.

A stable political situation was finally achieved when President Suharto took over the country's administration from President Soekarno in 1967, following political turmoil that lasted for almost 2 years[1]. Political and economic stability were crucial elements for the Government of Indonesia to pay more attention to economic development. The government of the New Order under President Suharto (1967–1998) immediately implemented macroeconomic stabilisation policies, such as reducing inflation from almost 600% to less than 10% within 5 years, that remarkably created a favourable situation for economic development (Hill, 2000).

[1] It started with a failed coup attempt by the Indonesian Communist Party (Partai Komunis Indonesia, PKI) in September 1965, which later shifted against Soekarno's leadership for not taking necessary action towards PKI. General Suharto, who emerged as a leader in stopping the coup, was authorised by President Soekarno in 1966 to stabilise the situation, but ended up taking actions that stripped Soekarno of his power with the help of Parliament. He was sworn in as President in March 1968, after having been appointed Acting President the year before (Vatikiotis, 1998).

Development was also marked with the transformation of policies and institutions, and the country's policy and attitude towards openness significantly shaped its economic performance. The New Order relied heavily on capital and investment from abroad to finance government projects and to promote business activities. While trade made only a small contribution to the economy, it was an important source of efficiency improvement (Soesastro and Basri, 2005). However, Indonesia's attitude towards trade and openness has changed frequently over the last 50 years. The country has tended to embrace openness and promote outward-looking policies to support economic reforms during difficult times but become more protective and inward-looking during economic boom periods.

Along with the development process came regional integration, particularly with other countries of Southeast Asia and East Asia. After receiving power to lead the country in 1966, Suharto decided to stop the Indonesia–Malaysia Confrontation – a series of military actions under the command of the previous president, Soekarno, against the creation of Malaysia – which lasted for 4 years. Realising that the stability of the region was an important factor in supporting development, Indonesia, together with Malaysia, Singapore, the Philippines, and Thailand, established the Association of Southeast Asian Nations (ASEAN) on 8 August 1967. Intended as a regional organisation to ensure peace and security during the Cold War, ASEAN has grown to also cover various aspects of integration during its later years, including in economic areas.

The two simultaneous processes of economic development in Indonesia and integration in the region have certainly affected each other. Indonesia pursued an agenda to promote its interests in as early as the 1970s when ASEAN came up with the idea of having several joint industrial projects. The country became the location for some industries – e.g. fertiliser production, pulp, and paper – deemed to be important for Indonesia at that time. In the 1990s and 2000s, Indonesia's liberalisation process could not be separated from the trade liberalisation and integration process in ASEAN. As the largest country in the region, Indonesia's role and attitudes towards regional integration had shaped economic integration in Southeast Asia and East Asia and would determine the future direction of this process.

This paper looks at the various elements of the interaction between Indonesia and ASEAN, particularly the economic policy formulation and the economic development processes. The next section examines Indonesia's perspective and approach towards openness and integration, and proceeds to discuss how ASEAN integration has affected Indonesia's economic situation, policy formulation, and economic performance. Finally, this paper discusses Indonesia's current and future role in ASEAN integration.

# Indonesia's Trade Policy and Integration Efforts

## Unilateral initiatives towards openness

Indonesia's development process can be characterised by several distinct periods. One of the most important early policies to support economic development was the introduction of the open-door policy on foreign investment in 1967 to finance economic activities. The policy towards economic openness was in line with the New Order's strategy for economic development, considering that the country had no financial resources to support the development. The government also began to simplify trade regulations quite quickly, introducing a series of major liberalising reforms over 1966 to 1969, while introducing capital account liberalisation and unifying the exchange rate of the rupiah (Hill, 2000).

However, this open policy was short-lived. By the early 1970s, it became apparent that Indonesia preferred import substitution and a more inward-looking development strategy, supported by the increase in international oil prices, which quadrupled in the mid-1970s. The oil boom that had taken place since 1973 made the country rich enough to afford many government-led economic projects. With huge state revenues from state oil company Pertamina, the government set up factories and increased production capacity in both oil-related and non-related sectors, such as oil refineries, fertiliser plants, cement, and iron and steel/aluminium.

The development of heavy industries was the highlight of this period for supporting the import substitution policy. Exports were dominated by the primary sectors, most prominently by oil products. The export base of manufactured goods was tiny, comprising only a little more than 1% of total exports in 1970–1975. Furthermore, despite rapid GDP growth, Indonesia's pattern of structural transformation seems to have been unsatisfactory as the share of industry in GDP slightly declined from 12% to 11%.

Initial efforts for openness and integration with the global and regional economy were unilateral responses to external developments, namely the decline in oil prices in the early 1980s. They began with limited economic policy deregulation complemented with tariff reductions and the removal of some non-tariff barriers (NTBs) in the manufacturing sector, especially in labour-intensive industries. By 1992, the average tariff had been reduced to 20% from 26% in 1986, while the incidence of NTBs fell to 5% from 32% (Pangestu and Feridhanusetyawan, 2003). The progress slowed in the early 1990s as most of the 'low-hanging' trade barriers had been eliminated. It became increasingly difficult to reduce protection since most of the barriers were in politically sensitive sectors, such as agriculture, heavy industries, and motor vehicles.

Further trade reforms took place in 1997–1998, the period of the Asian financial crisis, to comply with the structural adjustment programme attached to the International Monetary Fund's lending package. The package included a gradual reduction of import tariffs, including those on sensitive products of heavy industries; the removal of NTBs and licensing for imports of many agriculture products; and the liberalisation in several services sectors. These unilateral efforts, however, were put on hold and even reversed as forms of protectionism when economic recovery took place. Imports of agricultural products were prohibited except under certain conditions. Various policies were introduced in a revival of the import substitution strategy. Despite the need for investment in the services sector, various limitations were imposed on foreign providers, including those in finance, marine transport, and telecommunications.

## Indonesia's trade policy in a multilateral and regional context

Reversal of the unilateral open policy, which happened several times during Indonesia's development period, signifies the importance of international commitments in economic and trade areas. Indonesia had been involved in the multilateral General Agreement on Tariffs and Trade (GATT) since 1950 and was one of the founding members of the World Trade Organization. Indonesia's involvement in this forum helped shape the formulation of its trade policy.

World Trade Organization agreements set maximum tariff rates for most of Indonesia's imported products and placed binding requirements on existing market access–related regulations in various services sectors. The commitments also reduced the incidence of NTBs and eliminated quantitative restrictions on trade while at the same time removing local content requirements, which were common for supporting import substitution (Pangestu and Stephenson, 1996). While many of these commitments had little impact on actual trade liberalisation, they placed limitations on policy reversal.

Another important regional initiative is the Asia-Pacific Economic Cooperation (APEC) forum. While this remains informal and commitments are not formally binding or made through a process of negotiations, APEC has also influenced Indonesia's trade and investment policy, particularly on commitments to provide facilitation to economic activities. One example is the APEC investment principles, which call for equal treatment between domestic and foreign investors. Indonesia has accepted these principles and adopted them in its investment policy. While APEC's voluntary approach to trade liberalisation seems to be less demanding than preferential trade agreements, it provides more confidence for the unilateral approach. Commitments in APEC have often provided starting points for more formal and detailed commitments in various trade agreements.

### ASEAN as the driver of regional integration

As mentioned earlier, ASEAN was not intended to be a driver of economic integration in the region. However, several factors pushed the Member States to turn ASEAN into an economic integration vehicle. One important motivation was the de facto economic and business integration that has been taking place in the region for quite a while, mostly driven by foreign investors and multinational companies. As regional business arrangements have become more complex, they have required facilitation from authorities to ensure cross-border economic activities in the region. Another reason was to provide fresh motives and purposes for the ASEAN Member States in the post-Cold War period.

The ASEAN Free Trade Area (AFTA) in 1992 was not the first ASEAN initiative on economic integration, but it was the first formal and binding commitment to reduce trade barriers in a detailed and comprehensive way. AFTA set the deadline of the Common Effective Preferential Tariff (CEPT) to be 5% or less in 2003 and to cover more than 90% of imported items. This was then extended to cover most traded items by 2010. The ASEAN Member States also agreed to liberalise services and investment and to facilitate economic and business activities. The commitment to form an ASEAN Economic Community (AEC) promoted the integration initiative to a higher level. As a member of ASEAN, all these initiatives affected Indonesia's perception on economic integration and openness not only towards other Member States but also to the rest of the world.

## ASEAN's Influence on Indonesian Policy

How do ASEAN economic initiatives affect Indonesia's economy? To answer this question, this section discusses the extent to which ASEAN integration initiatives have influenced Indonesia's policies by looking at some of the commitments and their implementation.

## AFTA and Indonesian trade policy

One major initiative of ASEAN is to promote free trade in the region, which has been described broadly since the inception of AFTA, particularly under the CEPT. In this area, Indonesia's commitment is quite significant. Indonesia is committed to reducing preferential tariff rates to zero within the agreed timeline. By 2010, less than 1.3% of Indonesia's imports from other ASEAN Member States remained subject to tariffs while the rest enjoyed duty-free tariffs. The implementation of the ASEAN Trade in Goods Agreement has reduced the tariff rates even further.

One interesting aspect to examine is how the CEPT rates have affected Indonesia's trade policy, particularly in the formation of the most-favoured-nation (MFN) rate. Table 1 shows the influence of the ASEAN preferential rate on Indonesia's MFN tariff rate. As expected, ASEAN's CEPT rate decreased significantly during the period 1995–2010 from 14.2% to 2.1%. However, Indonesia's MFN tariff rate also followed a similar pattern. The average MFN tariff decreased substantially from 16.5% to 7.1%.

**Table 1. Average Indonesia's Tariff Rates and the Number of Tariff Lines**

| | 1995 | 2003 | 2010 |
|---|---|---|---|
| Average CEPT rate (%) | 14.2 | 2.8 | 2.1 |
| Average MFN rate (%) | 16.5 | 7.2 | 7.1 |
| Number of duty-free MFN tariff lines | 10.8 | 21.7 | 22.8 |
| Number of CEPT tariff lines | 61.4 | 75.3 | 98.7 |
| Number of tariffs with MoP less than 5% | 28.8 | 30.5 | 57.3 |

Note: CEPT = common effective preferential tariff, MFN = most-favoured nation, MoP = margin of preference (the difference between the MFN and the preferential rate).

Source: Calculated by the author from Indonesia's tariff schedule and CEPT.

The number of MFN lines with zero tariff also followed the same pattern as the CEPT. In 2010, 98% of tariff lines for imports from other ASEAN Member States was set to zero, a significant increase from only 68% during the first 3 years of CEPT implementation. But Indonesia also increased the number of its duty-free tariff lines for imports from other countries. For many tariff lines, the MFN rates were eliminated to zero just several years after their CEPT rates. Moreover, the reduction of MFN rates was also in line with the CEPT. While in 1995 only less than 30% of tariff lines had 5% differences between their MFN and CEPT rates, in 2010 this increased to 57% of tariff lines. That indicates that more MFN tariff rates are not significantly higher than the

CEPT rates. While more rigorous examination is needed, this indicates that the ASEAN CEPT rate might have had a positive effect on Indonesia's MFN tariff.

However, ASEAN initiatives on trade barriers have marginal effects on certain sectors, notably agriculture. Indonesia maintains a list of sensitive products in its CEPT schedule that includes rice, sugar, soybeans, and wheat flour. This allows Indonesia to exclude these products from the trade commitments with other ASEAN Member States. Until recently, imports of various agricultural products were still prohibited except for certain situations where the government considered them to be necessary. However, the country agreed to phase out import duties on several unprocessed agricultural products to 0%–5% under the ASEAN Trade in Goods Agreement.

## Trade facilitation

Another important element of commitments in ASEAN is the promotion of trade facilitation and customs modernisation. Indonesia began its customs modernisation when import inspection authority was given back to Indonesia's Customs Office in 1997. Previously, since 1985, the government had asked a survey company, Société Générale de Surveillance, to conduct pre-shipment inspections and be in charge of trade procedures. This was then followed by a series of customs reforms and improvements to infrastructure, institutions, and procedures.

ASEAN introduced programmes to facilitate trade in 1997 in view of AFTA, by calling for greater harmonisation of trade procedures under the ASEAN Customs Policy Implementation and Work Programme, including the harmonisation of tariff classifications. Indonesia agreed to carry out these efforts as part of its modernisation of customs and trade procedures (Damuri, 2006). The next main agenda of trade facilitation in ASEAN was the creation of an ASEAN Single Window, which required the establishment of the Indonesia National Single Window.

Indonesia has been quite successful in implementing trade facilitation measures, particularly with regard to the Indonesia National Single Window. Seventeen major ports, accounting for more than 98% of the value of Indonesia's foreign trade, have been connected to the system (Damuri et al., 2015). Although the system still has a lot of room for improvement, it has facilitated Indonesia's private sector in dealing with trade procedures.

## Services reform

Recognising the importance of services trade, ASEAN Member States have initiated negotiations concerning the services sector since 1995, when the countries first decided to negotiate the ASEAN Framework Agreement on Services (AFAS). This services agreement among ASEAN Member States focuses on liberalisation efforts, particularly in Mode 1 and Mode 3.

While the agreement has been in place for more than 2 decades, Indonesia seems to have encountered difficulties in carrying out its commitments under the AFAS. The country committed to liberalising 104 subsectors in the latest AFAS Package 9 with a foreign equity limitation of more than 70% by the end of 2015. Indonesia only managed to follow the commitment for 81 subsectors and seems to be lagging behind in following the commitments in health-related services, communications, and logistics, despite these being priority sectors. Under the current regulatory environment, many subsectors still limit foreign participation to less than 70%. Indonesia also faces issues related to national treatment principles in AFAS, especially regarding taxation policy, land use, and professional qualification requirements, which dictate different treatment for foreign and domestic firms (Damuri, 2015).

Despite being framed to protect national interests, protectionist policies have cost Indonesian society dearly. For example, the lack of openness in the healthcare sector has led to deficient healthcare facilities in several regions and low-quality service delivery. In another instance, the protectionist regulatory regime in the maritime sector has imposed high transport and logistics costs on the users of these services, as support for infrastructure and efficient cargo-handling processes remains highly insufficient. The lack of competitiveness in the telecommunications sector has also led to the Internet fixed broadband penetration rate in Indonesia being among the lowest in the region. ASEAN initiatives for services have, unfortunately, yet to lead to a better and more open regulatory environment for Indonesia's services sector.

## Investment liberalisation and facilitation

Investment liberalisation and facilitation have always been vital to deepening economic integration in ASEAN and East Asia. In 2009, the Member States introduced the ASEAN Comprehensive Investment Agreement (ACIA) to enhance and integrate previous agreements on investment. As a country in which growth relies on foreign direct investment (FDI), Indonesia is anticipated to support these commitments. Results show that there have been some progress and successful implementation of investment liberalisation and facilitation in Indonesia.

In 2007, the government promulgated a new investment law, Law No. 25 on Capital Investment. The law provides, among others, national treatment to foreign investors and investments, standard protection for investors, and a list of obligations and responsibilities of investors. It also specifies that in principle, all lines of business are open to foreign investment, except for those sectors specifically mentioned in the so-called 'negative list' (*Daftar Negatif Investasi*, DNI) and in other laws and regulations. The negative list is also subject to change every 2–3 years to accommodate new developments. All these features were adopted following various principles laid down in investment agreements in ASEAN and other regional initiatives, such as APEC.

The DNI has been reviewed and revised three times since 2007, with the latest being launched in 2016. The new DNI tends to be more open than the previous one. It also pays more attention to the commitments Indonesia specified in the ACIA. This is an improvement from the last DNI, which placed higher restrictions on several subsectors than in their ACIA descriptions.

Indonesia has made some progress in investment facilitation. It has introduced a one-stop service centre for investment to serve in a more rapid, simple, transparent, and integrated fashion. The service also integrates all licensing and non-licensing services related to investments, which used to be scattered across 22 ministries and government agencies. This progress is in line with the AEC blueprint (ASEAN Secretariat, 2015), which calls for more transparent, consistent, and predictable investment rules, regulations, policies, and procedures (Atje and Sasmito, 2015).

## ASEAN in the Indonesian Economy

The other ASEAN Member States were traditionally not important partners for Indonesia, except for Singapore, which serves as a hub of economic activities in the region. However, through economic integration, the economic links between Indonesia and ASEAN have become more important.

### Benefits of ASEAN integration for the economy

A large proportion of studies on the impact of ASEAN integration on the regional economy is conducted using the computable general equilibrium (CGE) model.

The CGE model is an ex ante simulation model that uses a general equilibrium setting to analyse the potential costs and benefits of a trade agreement before implementation.

An early study by Pangestu and Feridhanusetyawan (2005) looks at the impact of Indonesia's liberalisation efforts, including those conducted under AFTA. It concludes that the welfare gain from AFTA alone was negligible in comparison to liberalisation under the GATT/Uruguay Round. It added a welfare gain of only 4% to the impact of the GATT. One reason for this small benefit comes from the fact that agriculture has remained quite restrictive in the early arrangement of AFTA. The study also concludes that incorporating agricultural liberalisation into AFTA would have increased its benefits.

A more recent study by Plummer, Petri, and Zhai (2012) found that full implementation of the AEC would have raised ASEAN real incomes by US$69.4 billion, or 5.3% over the 2004 baseline income by 2015. Based on the study, Indonesia would be one of the countries to benefit most from the integration, with a 6.2% increase in real income. Additionally, simulations by Plummer, Petri, and Zhai show that raw materials output will mostly shrink relative to the baseline, while manufacturing and services output is likely to rise relative from the baseline. The increase in the services sector reflects the sector's linkages with and importance to the manufacturing sector as a result of more integrated regional production.

Using a dynamic CGE model, a study by Plummer and Lee (2011) suggests that reducing administrative and technical barriers (e.g. streamlining customs procedures and the mutual recognition of product standards) and lowering the trade and transport margins (e.g. through increased competition and improvements in infrastructure) are significant for enlarging the benefits of the AEC. The study finds that reductions in frictional trade costs, as well as the trade and transport margins, have significant effects on economic welfare, as deviations in equivalent variations, while allowing for endogenously determined productivity levels, have a small impact. The estimated welfare gains for 2015 were 1.1% for Indonesia, much lower than for Thailand at 9.4%.

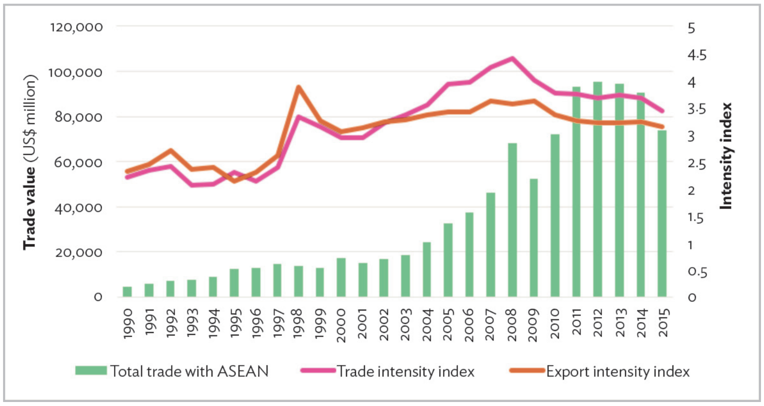
Several studies have also estimated the impact of the AEC on the growth and shifts of sector employment. A study from the International Labour Organization and the Asian Development Bank (2014) estimated a net increase of 14 million jobs in Cambodia, Indonesia, the Lao PDR, the Philippines, Thailand, and Viet Nam. The largest demand was estimated for low- and medium-skilled jobs. This is consistent with the findings in the study by Plummer, Petri, and Zhai (2014), in which the CGE model shows that the rise in sector employment tends to be dominated by increasing jobs in the informal sectors, with the exception of the Philippines.

Nevertheless, the study by the International Labour Organization and the Asian Development Bank also projects high-skilled occupations to grow in some economies. High-skilled employment growth between 2010–2025 in Indonesia, Cambodia, the Lao PDR, the Philippines, Thailand, and Viet Nam is estimated to be 41%, with half of the gain taking place in Indonesia.

## Indonesia's trade with ASEAN Member States

Figure 1 shows the general trend of Indonesia's trade relations with other ASEAN Member States. Indonesia's total trade with ASEAN increased throughout 1990–2015. The trade intensity index – an indicator of whether trade between two economies is greater or smaller than would be expected based on their importance in world trade – was bigger than 1 and was increasing, signifying the increasing importance of ASEAN to Indonesia.

**Figure 1. Total Trade with ASEAN, Trade Intensity Index and Export Intensity Index of Indonesia with ASEAN, 1990–2015**




Source: International Monetary Fund, Direction of Trade Statistics.

There are two turning points, namely in 1993 and 2003, during which Indonesia's total trade with ASEAN increased at a faster rate than in the previous period. Trade grew by more than 16% after the inception of AFTA in 1992 and got stronger when AFTA was almost fully implemented in 2003.

Few changes are observed in terms of trade with Indonesia's partners within ASEAN. More than 90% of Indonesia's trade with ASEAN was conducted with ASEAN-4 (Singapore, Thailand, Malaysia, and the Philippines). Singapore is Indonesia's largest trade partner. Until 2015, Singapore's share in Indonesia's trade with ASEAN was still larger than 40%. Nevertheless, this is much less than in 1993 when the share of trade with Singapore was 67.47%.

Along with the decline in trade with Singapore, trade with Malaysia and Thailand picked up to double from their respective amounts in 1993. Trade with Malaysia rose to 25.39% in 2013 from the 14.41% in 1993. A similar pattern occurred with Thailand, for which trade nearly doubled to 17.74% in 2013 from 9.18% in 1993. In the case of Thailand, the increase in trade share was driven by the increase in the share of imports from Thailand. As for Malaysia, it was driven by the increase in the share of exports to Malaysia.

It should be noted that the increasing trade came more importantly from imports, as indicated by the lower export intensity index. The value of imports overtook exports in 2005, not long after the implementation of AFTA. This has led to a general suspicion that AFTA was less beneficial to Indonesia, at least in trade. One explanation for this situation is the low utilisation of AFTA by Indonesian exporters. In order to receive the ASEAN preferential rate when exporting to other ASEAN Member States, exporters need to show that their products are eligible to be considered 'ASEAN products' according to the specified rules of origin. Only less than 7% of exports made use of the CEPT rate until 2007, although the figure increased to 50% in 2012 (CSIS, 2013). This caused exports from other ASEAN Member States to grow slower than imports.

## Development of the production network

Another explanation comes from the emergence of the international production network (IPN) in the region. In this business model, domestic and foreign firms utilise comparative advantage by slicing up production into finer stages and sourcing inputs from different locations according to factor intensity and the abundance of factors of production. This means trade in intermediate inputs becomes more important in trade and economic activities.

**Table 2.** **Share of Foreign Value Added in Exports (%)**

| | 1995 | 2000 | 2005 | 2008 | 2011 |
|---|---|---|---|---|---|
| **Share of foreign value added in Indonesia's exports** | | | | | |
| Total | 12.5 | 17.3 | 16.5 | 14.6 | 16.5 |
| Manufacturing | 19.6 | 24.3 | 22.3 | 21.5 | 26.7 |
| **Share of foreign value added originating from ASEAN** | | | | | |
| Total | 8.3 | 13.0 | 18.0 | 19.2 | 38.6 |
| Manufacturing | 7.7 | 12.4 | 17.3 | 18.3 | 40.8 |

Source: Calculated by the author from the OECD-TIVA database.

Trade in value added statistics indicates the importance of this regional network, which might explain increasing imports from ASEAN. Table 2 shows the intensity of foreign value added in Indonesia's exports, an indicator of the importance of the international network in exports and production. We can deduce two points. First is the increasing share of foreign value added in Indonesia's exports, which indicates a greater involvement of Indonesian industries in the international network. This is even more obvious in the case of manufacturing industries. Second is the increasing proportion of foreign value added coming from other ASEAN Member States. These two factors indicate the development of a production network among ASEAN Member States and the importance of ASEAN not only as a market for Indonesia's exports but also as a source of production inputs.

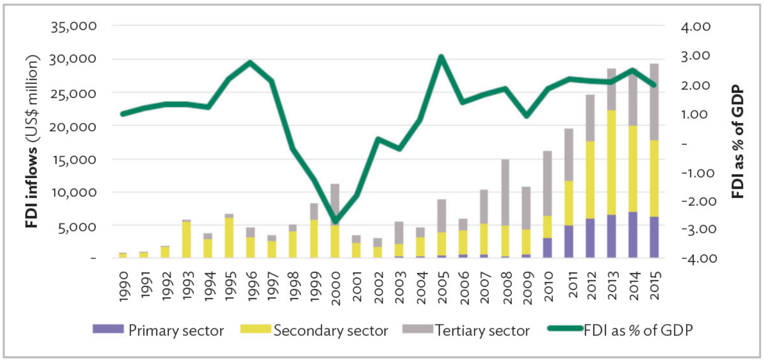
Greater participation in the IPN has enabled Indonesian industries to develop further. The IPN promotes higher specialisation, which allows firms and industries to improve their efficiency and productivity. Even during the earlier stages of the production network in the late 1980s and early 1990s, Indonesian industries gained from sourcing their intermediate inputs from foreign countries and specialising in the final stage of production (Amiti and Konings, 2007). Participation also increased the transfer of technology since foreign companies need to ensure that their domestic partners can produce to international standards. This creates an opportunity for the domestic industry to upgrade its performance and reach higher stages of production. In addition, greater participation in IPN also brings investment and provides job opportunities, which the economy needs.

## FDI in Indonesia

The emergence of the IPN and participation in it also suggest that ASEAN initiatives in investment are not merely interested in promoting intra-regional investment but also in making ASEAN as a whole more attractive to FDI. Indeed, there has been increasing FDI into ASEAN Member States in recent years, including Indonesia. Nevertheless, the FDI contribution to gross fixed capital formation in Indonesia has been relatively small compared to its ASEAN peers. In 2014, FDI accounted for only 8% of the gross fixed capital formation in Indonesia, compared to 12.5% in Malaysia, 10.5% in the Philippines, 13.5% in Thailand, and 21.8% in Viet Nam (UNCTAD and ASEAN Secretariat, 2016).

As Figure 2 shows, there is an increasing trend of FDI coming to Indonesia. However, as a percentage of GDP, FDI remains relatively small. Before the Asian financial crisis, almost 70% of FDI went to the manufacturing sector, attracted by Indonesia's comparative advantage in labour-intensive industries. Investment shifted towards the services sector after the crisis and later to the primary sector, such as mining and agricultural plantation, when the commodity boom took place in the mid-2000s, although investment in the secondary sector has been gaining more importance lately. The largest proportion of FDI comes from Singapore, Japan, European countries, and the Republic of Korea.

**Figure 2. FDI Inflows to Indonesia by Sector, 1990–2015**




FDI = foreign direct investment, GDP = gross domestic product.
Source: BKPM Statistics.

FDI from ASEAN has always been important to Indonesia. Around 44% of Indonesia's foreign investment during the last 10 years came from its neighbouring countries. However, 94% of the investment actually came from Singapore. The importance of Singapore in Indonesia shows that the city state plays an important role as a financial and investment hub in the region, where part of the FDI inflow to Singapore does not add to the productive assets of the country but flows through to other countries.

## Conclusion: Indonesia's Future in ASEAN Economic Integration

This paper highlights the role of Indonesia in ASEAN integration, especially in the economic area. Indonesia's participation has shaped ASEAN integration into the current form. As the largest economy in Southeast Asia, Indonesia would also determine the future direction of economic integration in the region. It is then important to examine whether Indonesia would still play an active role in shaping the future of regional integration, especially among Southeast Asian countries.

While Indonesia has been enthusiastic to pursue greater market access for its exported products, and in return to open up its market, deeper and broader economic integration under more recent initiatives such as AEC 2015 has attracted strong resistance. Indonesian businesses, for example, are among those who fear the implementation of AEC[2]. This fear is coupled by lack of credible information on the integration process and how it would affect the economy and business[3]. Indonesia's current political-economic aspirations that focus mostly on domestic issues, such as infrastructure development and logistic costs reduction, have also shifted the country's attention to and involvement in regional integration. The general perception is that by solving these domestic issues, Indonesia would improve its economic competitiveness.

That does not mean the country neglects its economic integration initiatives with its major partners. However, it is more selective in pursuing integration. Currently Indonesia is negotiating bilateral trade agreements with two major partners, namely Australia and the European Union. President Joko Widodo also expressed interest in joining the Trans-Pacific Partnership, eyeing the market of the United States. It seems that the country is willing to sign an agreement with partners that can offer tangible benefits, either from market access or from economic cooperation and capacity building opportunities.

2 In one survey of companies' perceptions, Indonesian companies indicated greatest concerns regarding ASEAN integration. Around 42% of the respondents regard the integration as a threat, compared to only 10% in other ASEAN Member States (see the results of the survey at https://www.bcgperspectives.com/content/articles/growth_globalization_winning_asean_how_companies_are_preparing_economic_integration/?chapter=3#chapter3) . While the survey has many weaknesses, it gives an indication of how the business community in Indonesia sees the process.

3 One of the biggest concerns among Indonesians regarding the implementation of AEC 2015 was the invasion of foreign labour from other ASEAN Member States. That had never happened because the AEC did not aim for free movement of labour. However, false information has led to opposition against ASEAN economic integration.

On whether Indonesia plays an active role in ASEAN's future integration depends on whether the initiatives are perceived to benefit Indonesia or not. It is then important for ASEAN to come up with some tangible initiatives to increase its attractiveness among Member States, including Indonesia. But it is even more important for Indonesia to know its interests in regional integration and to know the benefits it would bring.

The availability of credible information is crucial in getting political support and to obtain domestic consensus on the country's interests in ASEAN integration. The Government of Indonesia should convey detailed and sincere information about the benefits and consequences of the integration. This can be done only with more research and evidence-based information on the impact of economic integration. Failure to facilitate such activities would lead to misunderstanding that eventually would evolve into opposition.

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