



# Indonesia's Motivations for Signing of the Indonesia-Chile Comprehensive Economic Partnership Agreement (IC-CEPA)

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## ABSTRACT

Free Trade Agreements (FTAs) have recently become a recognized global trend which continues to increase in number as they offer ease of access to markets and reduction of trade barriers. Almost all countries involved in FTAs pursue their national interests, particularly economic ones, and Indonesia and Chile are no exception. This topic is interesting to scrutinize because the geographical factors of the two countries are quite far distant, and there were larger economic partners for Indonesia in South America (Brazil and Argentina) than Chile in regards to the establishment of a Free Trade Agreement. This article uses the approach of Solis and Katada, international relations' experts, which looks at it with a broader view. The approach emphasizes the establishment of international economic cooperation not only based on economic interests or caused solely on geographical proximity. Yet still, even economic motives are considered, other motives like political motive cannot be denied. The results of this study indicate that Indonesia's involvement in IC-CEPA is not only based on economic motives, there are other motives such as politics (raise international status) which cannot be ignored.

## KEYWORDS

Free Trade Agreement; Chile; IC-CEPA; Indonesia;  
Trade cooperation

## INTRODUCTION

In recent years, free trade agreements (FTAs) have become a global trend many countries have pursued. This trend began with the establishment of the General Agreement on Tariffs and Trade (GAAT) in 1948 and the World Trade Organization (WTO) in 1995, in which several western countries formed trade cooperation at the regional level subsequently. NAFTA and the EU were the first triggers. However, East Asian countries have also established trade blocs and as a result, trade cooperation in the region escalated. According to the Asian Development Bank (ADB), the number of trade agreements increased from 39 in 2000 to 165 in 2020. The growth of FTAs in Asia was due to two factors ([Kawai, 2011](#)). Firstly, Asian countries are concerned that the two trading blocs (GATT and WTO) would control the global trading system rules so that Asian countries would be isolated. Secondly, the 1997-1998 crisis has motivated Asian countries to establish economic cooperation in order to maintain regional economic stability and growth.

As an Asian country, Indonesia is determined not to be left behind in the pursuit of free trade – a trend embraced by other Asian countries. For this reason, Indonesia continues to encourage regional and inter-regional trade cooperation outside the region, like Chile, which is located in the South American region. In 2019, Indonesia has ratified a trade agreement with Chile or called the Indonesia-Chile Comprehensive Economic Partnership Agreement (IC-CEPA). IC-CEPA is the tenth free trade cooperation that has been implemented and also the first step for Indonesia to engage in bilateral trade cooperation with cross-regional partners in Latin America. Discussions on the IC-CEPA have been started since 2006. Through six stages of negotiations, the two countries finally ratified the IC-CEPA in 2019. The main focus in this trade agreement is trade in non-tariff aspects of goods, which will further be developed in cooperation in the field of trade and investment.

When compared with previous research, it can be found that there are many motives behind a country being involved in economic cooperation agreements. Indonesia in establishing FTAs with other countries is motivated by economics ([Hafiz, 2014](#); [Polii, 2015](#)). Not only Indonesia, but several other countries are also driven by economic motives ([Hoadley, 2007](#); [Hoadley & Yang 2008](#)) because the FTA motive itself is closely related to the benefits derived from trading activities. However, there are also non-economic motives such as political or strategic motives becoming a driving motive by countries to establish trade agreements with others (see [Lee, 2013](#); [Mochizuki, 2009](#); [Zeng, 2010](#); [Cabestan, 2012](#); and [Casley, 2019](#)) and motives to secure access to resources ([Wilson, 2012](#)).

However, Indonesia has its own pattern of trade agreements for two reasons. Firstly, Indonesia is always involved in trade agreements with its main trade partners. For example, Japan is the first country and the main partner in Indonesia's trade agreements. Based on data released by the Indonesian Ministry of Trade in 2018, the total value of trade between Japan and Indonesia reached USD 37 billion. Other examples, regional trade cooperation within the ASEAN framework also involves partner countries involved in RCEP (ASEAN+1), most of

which are 10 of Indonesia's main trading partners. Those countries are China with a total of USD 72 billion for Indonesia, South Korea for USD 18 billion, India for USD 18 billion and Australia for USD 8 billion in 2018 ([Ministry of Trade of Indonesia, 2021](#)). Secondly, almost all of Indonesia's trade cooperation agreements involve countries within the Asian region ([Ministry of Trade of Indonesia, 2021](#)).

The IC-CEPA is a cooperation agreement that has its own uniqueness and is quite different from the cooperation pattern Indonesia has been pursuing so far. Indeed, not only is Chile geographically distant and located outside the Asian region, but the value of trade between Indonesia and Chile is not significant as well. Compared to Indonesia's trade with other countries in South America such as Brazil and Argentina, Indonesia-Chile volume trading is very small. In 2017, for example, Indonesia's total trade volume with Brazil reached USD 3.1 billion and Argentina amounted to USD 1.4 billion, while with Chile it was only USD 278 million in the same year ([Ministry of Trade of Indonesia, 2021](#)). From this trade volume data, a significant question arises: why does Indonesia choose Chile as its trade partner compared to other countries in Latin America which have larger trade volumes? To answer this question, the following discussion will focus on the economic and non-economic motives that prompted Indonesia to sign the IC-CEPA.

This article aims to investigate Indonesia's driving motives of the signing of the Indonesia-Chile Comprehensive Economic Partnership Agreement (IC-CEPA). It begins by outlining the relevant theoretical framework, followed by methods, results and discussion, before reaching a conclusion.

## **THEORETICAL FRAMEWORK**

### **Cross Regional Trade Agreement (CRTA): Motives of Cross-Regional Partner Choices**

Free trade has been a concern of economists since the 18th century. Two figures such as Adam Smith with his theory of absolute advantage and David Ricardo with his theory of comparative advantage contributed to the emergence of the theory of international trade. Both have the same concern for free trade with a minimal role of the state in international trade. On the other hand, Frederich List emphasizes the importance of human resources and the role of the state in economic development. According to List, the *laissez-faire* concept espoused by Smith and Ricardo tends to ignore human resources and the role of government in economic development ([Levi-Faur, 1997](#)). Yet, the role of the state in trade is considered a protector of the national productive forces. The state, in this case, does not have to think only about material capital in order to gain profits, but consideration of mental capital (human Resources) is also vitally significant ([Levi-Faur, 1997](#)). It is because the extent and amount of human capital determine the success or failure of economic development. Even though they have different views, the three economists see international trade as a way for a country to improve its economy.

On the other hand, geographical factors also support international trade cooperation ([Siddique, 2007](#)), especially in creating trade agreements in certain areas. In the East Asia

region, the geographical proximity of countries in the Asian region has contributed to the great advantages of trade in the form of goods and services except ASEAN actually shows the opposite result ([Cai, 2010](#)). ASEAN countries face the main obstacle among themselves because of the similarity of superior products traded between these countries ([Akraanee, 1983](#); [Yeung, 1999](#)). Thus, geographical proximity simultaneously has its own advantages and challenges, especially for trade in the region.

This article adopts the analytical framework of [Solis and Katada \(2008\)](#), which looks at it with a broader view. Solis and Katada emphasized the establishment of international economic cooperation not only based on economic interests or caused solely on geographical proximity. Yet still, even economic motives are considered, other motives like diplomacy motive (Raise international status) cannot be denied. From economic perspectives, FTAs have become a tool to expand the market through a preferential trade and investment liberalization, or it also means to prevent exceptions and to level the playing field by countering trade and investment diversion effects of existing FTAs. From the political side, FTAs have become a tool to level up the countries' status and image in order to get an image of "benign leadership" because the country could establish economic collaboration. In this sense, benign leadership means a country who has positive image because its economic openness to all countries.

As mentioned above, it is common for a country to establish an FTA in order to get economic advantages. A few countries also use FTA as a tool to gain political objectives. [Hoadley and Yang \(2008\)](#) and [Solis and Katada \(2008\)](#) offer an example of this. After China acquired WTO membership in 2001, it changed its early FTA policy to open up cross-regional trade agreements with Chile, New Zealand, and Australia. The rationale behind China's embarking on preferential trade talks is to intensify China's comprehensive national power and further the "peaceful rise" campaign (encourage the notion of China's peaceful rise through cooperative economic endeavors). Likewise, Thailand moved quickly towards FTAs due to its concern to acquire negotiation skills and increase its international status as a country possessing an FTA network across regions ([Hoadley&Yang, 2008](#)).

The concept of Cross Regional Trade Agreement/ CRTA has its own excess because it does not emphasize on geographical proximity of the involved countries in economic cooperations. According to [Solis and Katada \(2008\)](#), CRTA has its own advantage because the negotiation process is carried-out in a low-risk political environment in which the involved countries are unbound by intractable historical links, geographic or leadership disputes.

Based on this analytical framework, this study finds that Indonesia's involvement in a free trade agreement with Chile (IC-CEPA) driven by two motives: 1) economics (the need to export manufactured products and avoid trade discrimination), and 2) politics (increasing the status of countries in the ASEAN region). Even though Chile is located outside the region of Asia and a big third of Indonesia's trading partner in South America, both countries, as [Solis and Katada \(2008\)](#) mentioned, have no political dispute and are unbound by intractable historical links. This fettle supports both countries in establishing IC-CEPA.

## METHODS

This study involves secondary analysis using mix methods (qualitative and quantitative) (Creswell, 2014), wherein data is collected from official statistics and other resources, and then analyzed and interpreted. One of the approaches used in this article is the case study approach. A case will be limited by time and activities, and researchers collect detailed data using various data collection procedures (Creswell, 2014; cited in Stake, 1995; Yin, 2012).

The data collection technique uses the literature study method which originates from books, magazines, newspapers, the internet, documents, or journals related to the research topic analysis. After the data is collected, data interpretation is then carried out, where the researcher gives meaning to the data, translates it, or makes the data understandable (Neuman, 2000).

## RESULTS AND DISCUSSION

### The Journey of the FTA in Indonesia

The Free Trade Agreement (FTA) is an economic-trade agreement that binds two or more countries in the field of trade in goods, trade in services and investment. Through FTAs, trade in goods gets the elimination of tariffs and eases other non-tariff barriers, whereas in trade in services, FTAs can maintain market access. In terms of investment, FTAs aim to provide legal protection and attract foreign investment.

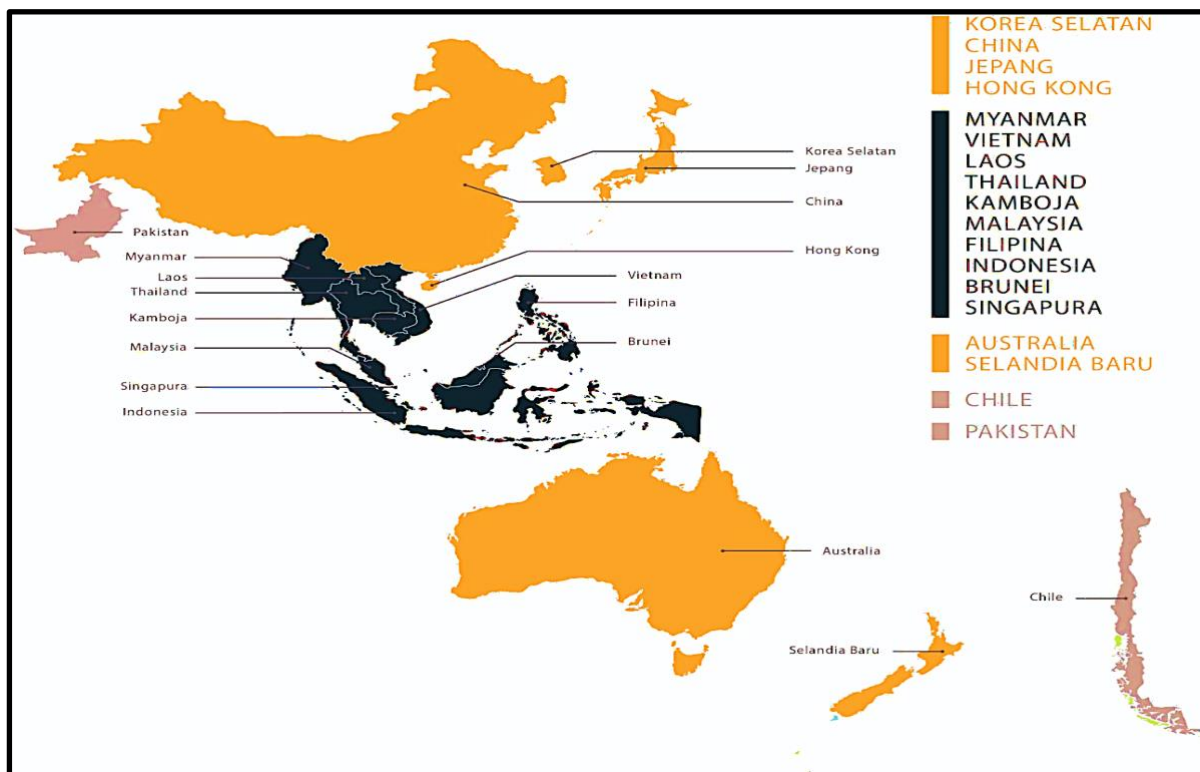


Figure 1. Indonesia and Other Asian Countries on FTA. Source: [FTA Center, Ministry of Trade of The Republic of Indonesia \(2021\)](#)

The figure above explains Indonesia's involvement in FTA with all countries in the Asia region. The orange marker is Indonesia's important trading partner, and the black marker is referred to ASEAN countries. Not only in Asia, Indonesia is also actively involved with Chile, which is located in South America. Chile was the first country outside Asia that Indonesia engaged with through FTAs. Further in 2022, Indonesia also ratified an FTA with Mozambique under Indonesia-Mozambique Preferential Trade Agreement (IMPTA). The table below lists countries that already have FTAs with Indonesia and agreements that have been in force:

Table 1. The Involvement of Indonesia on Free Trade Agreement From Year to Year

No	Indonesia's Trading Partner under FTAs	Year
1	AFAS	1995
2	AJCEP	2002
3	IJEPA	2008
4	ACIA	2009
5	AIFTA	2010
6	ATIGA	2010
7	Development Eight (D8)	2011
8	AK-FTA	2018
9	Indonesia-Chile Trade In Goods	2019
10	ACFTA	2019
11	AANZFTA	2019
12	IPPTA	2019
13	AHKFTA	2020
14	IACEPA	2020
15	IE-CEPA	2021
16	IMPTA	2022
17	IK-CEPA	2023
18	RCEP	2023

Source: [FTA Center, Ministry of Trade of The Republic of Indonesia \(2021\)](#)

From the table above, it can be seen that earlier Indonesia FTA policy was dominated by neighboring countries in Asia and Australia region. Recently, Indonesia expanded its FTA policies towards countries outside the region like Chile (2019) and Mozambique (2022). From this pattern, Indonesia seems to pursue its interest in both economic and political advantages through FTA and CRTA involvement. First, goods get cheaper because FTAs serve reducing the export cost component, namely import levies in export destination countries which are FTA partner countries. Second, in services trade, FTA seeks to protect market access and

ensure conducive conditions for service product providers to develop. In this case, Indonesian Business Actors get special service trade commitment treatment from Indonesia's FTA partners and act as a 'policy guarantor' to prevent trading partners from changing their laws to become more stringent, even when the government regime changes. Third, on the side of political benefit, The World Bank directly attach for countries engaged in many FTA negotiations in order to be noticed as a 'trade hub nation' ([Ibarra-Yunez, 2003](#)). This status is very useful to improve a country's international status. The next section will discuss the economic motives and political motives behind Indonesia's driving factors to join CEPA with Chile.

### ***Economic Motive: Trade Diversion to Increase Welfare***

It is undeniable that trade agreements pursued by countries are motivated by economic interest in order to increase welfare. So does Indonesia, which established CEPA with Chile to gain the economic benefits. From an economic point of view, Chile is Indonesia's good match because consumer goods (clothing, food beauty and health products) became Indonesia's first biggest export and on the other side, consumer goods became Chile's first biggest import. From here, Indonesian export products are acceptable in Chile's market.

Table 2. Ten Most of Indonesia Product Exports 2017

Product Group	Export (US\$ Thousand)	Export Product Share (%)
Consumer goods	66.376.524	39,32
Intermediate goods	44.355.729,64	26,27
Raw materials	42.270.657	25,04
Fuels	36.883.034,21	21,85
Vegetable	29.572.997,64	17,52
Capital goods	15.022.368,72	8,9
Mach and Elec	14.361.640,06	8,51
Textiles and Clothing	12.526.457,58	7,42
Wood	10.418.556,7	6,17
Plastic or Rubber	10.139.464,53	6,01

Source: [Ministry of Trade of The Republic of Indonesia, \(2021\)](#)

Table 3. Ten Most of Chile Product Imports by 2017

Product Group	Import (US\$ Thousand)	Import Product Share (%)
Consumer goods	28.270.149,95	43,32
Capital goods	19.207.310,41	29,43
Mach and Elec	15.015.526,23	23,01
Intermediate goods	10.109.023,6	15,49
Fuels	9.839.545,44	15,08
Transportation	9.356.559,95	14,34
Raw materials	7.530.659,84	11,54

Chemicals	5.801.599,99	8,89
Textiles and Clothing	4.202.829,25	6,44

Source: [Ministry of Trade of The Republic of Indonesia \(2021\)](#)

Based on the two tables above, if seen from Indonesia's side in terms of export-import, the largest export product is consumer goods with a percentage of 39.32%, which is consistent with Chile's most import product, consumer goods with a percentage of 43.32%. From this point of view, Indonesia can benefit from importing consumer goods to Chile. On the other hand, Chile, which exports a lot of raw materials with a percentage of 46.17%, can be channeled to Indonesia, which also imports 13.46% of raw materials ([The World Integrated Trade Solution, 2022](#)).

Accordingly, economic interest motives driving Indonesia to pursue IC-CEPA is clear. This motive is also in accordance with Chile's tariffs on imported products which are quite low, and this is applied for Most Favored Nations. For example, every single Indonesian export product that goes to Chile will be charged a tariff of six percent, but the export tariff can be reduced to zero percent if Indonesia entered into a trade agreement with Chile. With a zero percent tariff, Indonesia can maximize its exports to Chile without high tariff barriers, and this is expected to boost Indonesia's export market.

Before IC-CEPA, three of Indonesia's neighboring countries, Malaysia, Thailand and Vietnam, have been getting more economic gain because of establishing FTA in the past with Chile. The export growth of these three countries increased because of receiving low export tariffs through the FTA. For instance, those three countries and also Indonesia dominated on consumer goods product exports to Chile in 2016. However, Indonesia cannot enjoy the economic benefit like its neighbors which gain more advantages from consumer goods export through the previous economic trade agreement towards Chile because of tariff barriers that charged six percents.

Table 4. The Benefits of FTA on Chilean Tariff Cuts for Imported Consumer Goods Products (USD Million)

Country	2015	2016	2017	2018	Tariff Cuts (%) After Forming FTA With Chile	
					2015	2018
Malaysia	98	95	110	122	0,16	0,03
Vietnam	221	255	339	341	1.09	0,25
Thailand	225	200	286	316	6	0,02
Indonesia	101	105	155	133	6	6

Source: [World Integrated Trade Solutions \(World Bank\) \(2022\)](#)

From the table above, three Indonesian neighboring countries that have FTA with Chile experienced tariff cuts gradually and this also impacted on increasing the export values. Malaysia got tariff cuts for *consumer goods* export products of 0,16% in 2015 and then lowered to 0.03% in 2018, and it was also implicated in increasing Malaysia export value from USD 98



million in 2015 to USD 122 million in 2018. Vietnam and Thailand faced tariff cuts from 1.09% and 6% in 2015 to 0.25% and 0.02% in 2018 and enjoyed increasing export values. Nevertheless, Indonesia itself is still subject to an average tariff of 6% in the 2015-2018 period<sup>1</sup> and its export values of *consumer goods* tend to fluctuate which reached USD 101 million then became USD 155 million in 2017 and then lowered to USD 133 million in 2018. From this evidence, it can be concluded that zero percent of export tariff through FTA will encourage the export growth of the involved countries.

FTAs also provide a negative impact like discriminatory regulations for uninvolved countries. The data of table 4 showed that before the implementation of IC-CEPA, Indonesia got discrimination of tariff barrier of its exporting products to Chilean market. However, other three countries got some cut of tariff barriers because they build FTA with Chile in the first place than Indonesia. The loss of trade barriers in a broader context is also unavoidable, such as stricter investment rules and so on ([Solis&Katada, 2008](#)). It is possible that through trade agreements, the countries involved can open up broader and deeper collaborations such as sharing knowledge, information, technology transfer or maybe making the business climate more dynamic. Here, an FTA not only increases material benefit but also non-material advantages. Before the signing of IC-CEPA, material and non-material losses that have made Indonesia lagging behind and unable to enjoy the benefits of trade liberalization with Chile as did by Malaysia, Thailand and Vietnam. This reason also encouraged Indonesia to get involved in the IC-CEPA.

Even though Chile is not Indonesia's main trading partner in the South American region, it is still important for Indonesia to establish trade cooperation with Chile to avoid discrimination in trade regulations. Thus, in the end, involving in IC-CEPA will offer Indonesia cutting export tariffs and can also encourage increased exports to the Chilean market as has been experienced by its three neighboring countries.

### ***Political Motive: Increase International Status as a "Trade Hub Country"***

The approach on non economic side emphasized that a country is involved in an FTA due to political motives, whether security or diplomacy, to increase the status of the country ([Solis & Katada, 2008](#)). Also, Solis and Katada stated the state uses diplomacy to strengthen ties with security guarantors (extra-regional).

In this case, however, it is impossible for Indonesia to look for security motives from its involvement in the FTA towards Chile because Indonesia is larger in terms of economic or even security power than Chile. Although in some cases both countries had done security cooperation, of course Chile can not be Indonesia's security guarantor due to its smaller power particularly in military and also other terms than Indonesia.

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<sup>1</sup> WITS uses the concept of effectively applied tariff which is defined as the lowest rate available. If there is a preferential tariff (there is an FTA), then it will be used as the effectively applied tariff. If a country does not enter into an FTA, then the rate applied is the MFN rate. From the data released by WITS, only Thailand (2015) and Indonesia (2015 and 2018) have not entered into an FTA with Chile, therefore the tariff used is the MFN rate (with an average of 6%).

Indonesia has other political motives (increasing its status on the international stage) as a trade hub in ASEAN. Trade hub is a term commonly used to represent a country or an area as a financial and trade center. Trade hub labeled countries should have a wide open economic network in which there must be easy and globally economic trading activities with small till majoring countries. Here, establishing economic cooperation and becoming open economic with other countries is one of the terms of trade hub country.

In the South East Asia region, Singapore is labeled as a trade hub country due to its strategic location as a shipping lane that connects east and west. In terms of shipping tonnage, its port became the busiest port in the world with an annual average of 140,000 vessel calls with 200 shipping lines which connect 600 ports globally. Moreover, its important role in ASEAN and its open economic partnership with majoring countries until small countries put Singapore in this position. To this day in Asia, Singapore is the most engaged economic cooperation country within or outside the region numbered 27 FTA in total.

Looking to Singapore, Indonesia seems to catch the wave by becoming ASEAN trade hub. According to the Head of the Trade Research and Development Agency (BP3) of the Ministry of Trade, Kasan Muhri, this project was created since 2016. In order to achieve that project, infrastructure facilities such as 42 Bonded Logistics Centers, and several international shipping ports in Indonesia was build (Kuala Tanjung, Belawan, and Bitung). Another new regulation was also created. Based on Presidential Decree Number 26/2012 concerning the National Logistics System Development Policy Blueprint, Bitung and Kuala Tanjung become international sea nodes in Indonesia.

Having such international shipping lane is crucial for trade hub countries in order to attract international business traffic of the Pacific Ocean to come to Indonesia. From this shipping lane, Bitung now is a node for product export activities from Eastern Indonesia and also a port of call for implementing ASEAN subregional cooperation.

Besides infrastructure support, an open economic policy also determines whether a country could become a trade hub, like Singapore, which has been labeled as a trade hub in ASEAN due to its open economic policies. Singapore has 27 implemented free trade agreements. So, in order to become trade hub countries, Indonesia continues to expand the FTA network with countries that can be collaborate in the economic sector. One of the steps that Indonesia could start was establishing an FTA with Chile. As the largest country in the South East Asia region, it is important for Indonesia to become a trade hub in order to support its main role as a leader in ASEAN and strengthen its bargaining position in the region among its neighboring countries. Thus, opening a relationship through economic cooperation with a profitable country could be the one to gain not only its economic but also non-economic advantages. Indonesia then began to join FTAs with a small country outside the region for the first time which is Chile under IC-CEPA.

It does not stop there. According to the Asian Development Bank (ADB), Indonesia also proposed economic cooperation with outside regional countries like Canada, Columbia, Gulf Cooperation Council (Saudi Arabia, Kuwait, the United Arab Emirates, Qatar, Bahrain, and

Oman), and some African region countries. It is clear that by joining FTA with more countries, Indonesia could gain economic advantage and in the end also could support Indonesia bargaining position in the region.

## CONCLUSION

Free trade has offered trade without geographic boundaries and removed trade barriers. Many countries pursue the advantages offered by free trade, making this an activity inevitable for a country to pursue its national interests. The Asian Development Bank provides evidence that from year to year the number of countries involved in free trade has continued to increase from 2000 with 39 trade agreements and in 2020 it increased to 165.

As a big country in the region, Indonesia also wants to pursue the benefits of FTA by establishing cooperation with a country outside the region, Chile. Establishing FTA with Chile under the name IC-CEPA is the first step and unique pattern that Indonesia has taken because previously, Indonesia had only established FTAs with its major partners or with countries in the Asian region. What was Indonesia's purpose in this IC-CEPA while Chile is also not Indonesia's big partner there?

This research found that Indonesia has two motives, economic and political. In economic terms, Indonesia avoids discrimination in trade regulations because by joining IC-CEPA Indonesia could get cutting export tariffs and can also encourage increased exports. Whereas in political view, this economic agreement also became driving motives for Indonesia to seek a status as a trade hub in ASEAN. This status is so beneficial in order to support its main role as a leader in ASEAN and strengthen its bargaining position in the region among its neighboring countries.

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#### **HOW TO CITE THIS ARTICLE:**

- Musfiroh. (2024). Indonesia's motivations for signing of the Indonesia-Chile Comprehensive Economic Partnership Agreement (IC-CEPA). *Papua Journal of Diplomacy and International Relations*, 4(1), 16–28. DOI: 10.31957/pjdir.v4i1.3132