Expanding Horizons: Indonesia's Regional Engagement in the Indo-Pacific Era



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Foreword

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In the coming decades, the biggest challenge for Australia will be maintaining our prosperity as an advanced economy. Our relationship with our near neighbour and fellow democratic nation Indonesia will be critical to achieve this. One of Australia's great foreign policy tasks will be cultivating a partnership with Indonesia which encourages it to "look south".

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Underlying a successful policy towards Indonesia is a strong understanding not only of Indonesia's domestic workings, but how it engages with other actors in the Indo-Pacific. To this end, the Perth USAsia Centre commissioned Expanding Horizons: Indonesia's Regional Engagement in the Indo-Pacific Era to examine this.

The common thread throughout this volume is that Indonesia is starting to engage in the Indo-Pacific in a number of new ways. Indonesian businesses are starting to internationalise. The country is starting to build strategic partnerships with emerging powers like India. Its economic diplomacy is expanding and it is placing multilateral agreements like RCEP on the top of its agenda.

It is no secret that Indonesia's economy will continue high-speed growth, boosted by its favourable demographics and an emerging middle class. Wealth and economic growth is the foundation of hard power. As Indonesia fast approaches the position of world's fourth-largest economy by 2050, it will find itself with the power to influence the Indo-Pacific region, shape its economic and political architecture, and be a global influence. We are already seeing Indonesia step up into this role.

One of the chapters of this volume notes that Indonesia is negotiating more trade deals with its neighbours and economic partners than ever. It prioritises regional agreements like the RCEP, but is simultaneously pursuing bilateral initiatives like the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA). Australia and Indonesia will hopefully conclude the agreement in the very near future. It is a step towards bringing Indonesia into our top ten trade partners, and creating an economic relationship befitting two G20 powers.

Trade is important. Investment even more so. Investment is the next step up from simple transactional trade in an economic partnership. It signals a high level of trust in one another's business culture and institutions. After IA-CEPA, the next step is facilitating mutual investment.

The TPP is now back on the agenda, this time in modified form as the 'CPTPP', minus the United States. The agreement withstood the shock of an American exit, a



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testament to the intrinsic need for progressive and high-quality trade agreements. Its ambitious reform agenda could prompt a significant transformation in how trade and investment is conducted among its members.

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Indonesia has expressed interest in joining the CPTPP, and Australia should pursue this. There is an opportunity here for Australia to work closely with its neighbour on accession. And the additional benefit is Indonesia's entry into a trade area with a set of advanced rules favourable to mutual investment.

Finally at home, Australian businesses, policymakers and the public need to understand Indonesia is no longer a developing economy. Its growing middle class will start consuming the kinds of high-quality, value-added goods and services that Australia can offer, with the comparative advantage of world-class quality and proximity.

Australia's agenda with Indonesia should focus on enhancing relations in a regional context. Focussing on the Indo-Pacific, there's no better way to build trust with one another than to build things together. Australia and Indonesia should not miss this opportunity to build on trustworthy institutions, norms, and rules in the Indo-Pacific.

The analyses in this Perth USAsia Centre publication constitute a contribution to the policy dialogue on how Australia and Indonesia can work together on the challenges and opportunities the emergence of the Indo-Pacific has to offer.



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The Hon. Professor Stephen Smith Former Minister for Defence, Former Minister for Foreign Affairs, Distinguished Fellow at the Perth USAsia Centre



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Introduction

Author: Jeffrey Wilson

Indonesia has long been a country of systemic importance in Asia. Its large territory and population, high-speed economic growth, and strategic location along Asia's key maritime axis have ensured it is a central player in all economic and security developments in the region. Yet for much of its history, Indonesia has kept a lower profile in regionalism initiatives than its status and position would imply. Since the *reformasi* period began in 1998, the top policy priorities of the Indonesian government have been domestic: consolidating democratic transition in the political system, managing complex internal security challenges, and fostering economic transformation through industrialisation and urbanisation. While an active player in the diverse range of ASEAN processes in Southeast Asia, Indonesia has yet to assert itself as a leader in the broader Asian region.

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This trajectory is already beginning to change. As democratic institutions consolidate, the country has increasingly acquired the capacity to more actively engage in regionalism initiatives. Consistent and high-speed growth promises to make Indonesia the engine driving economic growth in Asia. At the same time, the very notion of whom and what constitutes Asia is changing, with the older 'Asia-Pacific' model giving way to a geographically-expanded 'Indo-Pacific' concept. Given its strategic position at the fulcrum of the Pacific and Indian Oceans, this 'Indo-Pacific shift' means Indonesia is poised become a significant regional power in its own right. How Indonesia exercises this role will have lasting impacts on the economic, security and diplomatic architectures of the region.

This Perth USAsia Centre Special Report examines Indonesia's role in the evolving Indo-Pacific regional order. Bringing together a mix of leading Australian and Indonesian authors, offers a state-of-the-art analysis of the opportunities and challenges facing Indonesia's economic, security and diplomatic role in the Indo-Pacific.



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Key questions:

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- What dynamics including economic, security, and diplomatic transformations – are driving Indonesia's increasing importance in the Indo-Pacific region?
- 2. How does Indonesia see its place in the Indo-Pacific? What are its core regional interests, and its position vis-a-vis existing and emerging institutional architectures?
- 3. How can Indonesia manage its complex relationships with the major powers in the region, including China, Japan and the US?
- 4. What can Australia do to improve and better-institutionalise its economic, security and people-to-people relations with Indonesia?





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CHAPTER I. Regional value chains and the internationalisation of Indonesian business

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Faris Al-Fadhat

Regional value chains and the internationalisation of Indonesian business

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Author: Faris Al-Fadhat

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Introduction

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For the past two decades, the Indonesian economy has experienced significant growth and development, including major changes in its corporate structure. Many Indonesian big businesses have transformed their integration with the global economy are moving from a focus on the domestic market, to become large business groups seeking international linkages through trade and investment beyond the Indonesian market. International economic activity is not something new for Indonesian businesses, which have been exporting and receiving foreign direct investment (FDI) for many decades. However, a recent qualitative change has occurred as these businesses have become integrated into complex regional value chains and have emerged as leaders (rather than just followers) of regional economic integration. The transformation carried out by Indonesian businesses is part of an internationalisation strategy that has benefited from their business networks across Southeast Asia.

Internationalisation should not be viewed solely as the result of corporate strategies, however. The international activities of Indonesian business groups have in large part been driven by the development of regional economic governance mechanisms, something which became a major phenomenon for economic architecture in the Asia-Pacific region during the post-war era. Regional economic cooperation has played an important role in smoothing the process, and establishing favourable regulatory conditions, for the international operations of Indonesian businesses. In particular, two recent examples of regional economic cooperation have directly linked to the international expansion of Indonesian business groups: the ASEAN Economic Community (AEC) initiative, and the Regional Comprehensive Economic Partnership (RCEP) trade agreement.

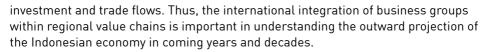
Importantly, the internationalisation of Indonesian businesses illustrates more than just changes to corporate outlook. It also provides a new foundation for the future growth and direction of the Indonesian economy as a whole. The international expansion of businesses strengthens Indonesia's integration into global production, commodity and investment chains; and is a foundation for the country's ambition to become the economic hub of Southeast Asia. In addition, internationalisation has also reconfigured the Indonesian government's preferences regarding economic policy, particularly in terms of recent regional initiatives to liberalise and augment



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The international expansion of Indonesian firms

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Although Indonesian government policy has largely been in the direction of trade and investment liberalisation since the 1980s, many big businesses have continued to rely predominantly on the domestic market¹. Their political relationships, especially with the ruling New Order regime (until its collapse in 1998), secured high levels of protection and subsidies which enabled easy profits at home². The legacy of this period was a domestic orientation in these businesses' operations, and a relatively limited degree of involvement with regional value chains. In particular:

- 1. They heavily depended on FDI to support their local companies' growth into new sectors, as well as their production for export markets;
- The establishment of offshore companies in countries such as Hong Kong and Singapore was designed to expand their businesses in the region but ended up as a strategy that mostly supported their domestic operations;
- 3. Their relationships with multinational companies in regional production networks were largely as subcontracting manufacturers, rather than equal partners. For example, in the electronic and automotive sectors, Indonesian businesses were usually either low-technology parts manufacturers or local distributors.

In the last two decades, and especially after recovering from the Asian financial crisis in 1998, there has been an important shift in Indonesian business groups' strategies. Many are now no longer dependent on the domestic market, and have started seeking 'adventures' beyond the national economy. By developing relationships with foreign corporations to bolster their business operations, they have transformed into big businesses with strong international orientations. This has been achieved through substantial investments in foreign markets; takeovers of foreign-based companies through mergers, acquisitions and joint ventures; and by playing a more significant role in regional value chains. While many large Indonesian companies continue to enjoy protection in the national market, particularly in the agricultural sector, they have also begun to advocate for further liberalisation at the regional level³. These changes indicate a new direction for Indonesian big businesses, that emphasises internationalisation and expansion into the Asia-Pacific region.



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The increasing volume of Indonesia's outward FDI, an interesting development in an economy which is a net capital importer, reveals this process. Outward FDI allows business groups to expand their activities outside the country to take control of existing businesses through mergers and acquisitions, as well as by establishing new projects of their own. As shown in Figure 1, outward FDI stock has increased significantly just twelve years after the end of the Asian financial crisis (2004-2016) going from a negative accumulation of flows to about US\$58,890 million. The growth of stock accumulation began in 2006 with a US\$1042 million investment. Although there were some periods of steady and slow development between 2008 to 2011 as a result of the global economic crisis, investment continued to increase significantly from 2012 with US\$124 million worth of investments reaching a peak in 2016 of more than US\$580 million.

This investment activity is part of a broader pattern of cross-border business expansion and industry consolidation in Southeast Asia in which Indonesian corporations are now significant players⁴. In 2016, the total value of corporate mergers and acquisitions through ASEAN member countries accounted for US\$59.2 billion.⁵ This figure reached an all-time high of US\$68.4 billion in 2014⁶. Indeed, this figure under states the true volume, as some strategic acquisitions and joint ventures carried out by Southeast Asian businesses are executed through offshore holding companies (such as those in Hong Kong).

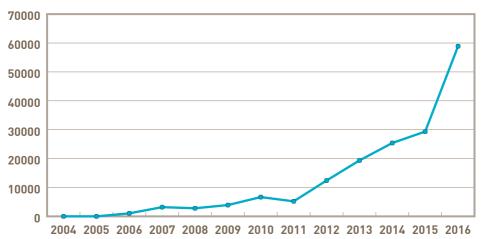


Figure 1: Indonesia's Outward FDI Stocks (in million US\$)

Source: UNCTAD Stat Database



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The internationalisation of Indonesian business groups via foreign-based investment vehicles has also contributed substantially to their integration with the regional value chains. This has occurred in number of sectors - including plantations (paper and oil palm), automobiles and mining – in which Indonesian companies have long been active players. However, these traditional activities have been augmented by three new sectors that have experienced significant progress in recent years: food and agribusiness, services (telecommunication, banking, and real estate) and infrastructure.

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In the food and agribusiness sector, big businesses such as Royal Golden Eagle, Sinar Mas Group and Salim Group have marked out a strong presence in the Asia-Pacific region⁷. They have acquired companies in Singapore, Malaysia, Vietnam, China and Australia – building upon their long standing position in the Indonesian domestic market. Such regional expansion allows Indonesian businesses to move from the previous strategy where goods were produced domestically for either domestic consumption or sometimes export; to a vertically-integrated strategy that controls all stages of food production in value-chains spread across the Asian region.

For the Salim Group, the food industry has become one of its largest business lines. The Group has an ambition to become a leading player of mass food production and distribution at both the regional (Southeast Asian) and international scales⁸. In addition to its Indonesian-based company Indofood, which has already become one of the largest food companies in Asia, Salim has strengthened its operation throughout the region. For example, through its Hong Kong-based holding company, First Pacific, the Group runs the largest sugar business in the Philippines via Roxas Holdings⁹. In Singapore, its business is operated by the Interflour Group, one of the biggest flour millers in Asia with a total milling capacity of approximately 1.5 million tons per year. Interflour also runs flour mills in other Southeast Asian countries including Malaysia, Vietnam and Indonesia¹⁰. In China and Australia, the Group's food business is operated by China Minzhong Food Corp. Ltd and Goodman Fielder respectively¹¹.

The internationalisation of Indonesian businesses in service sectors - particularly banking, telecommunications and real estate - is another new development. This activity has been made possible by Southeast Asia's strong economic performance; as well as population growth that means the region has a large market potential¹². A key example is Indonesia's Lippo Group, which has benefited enormously from these developments. Lippo first emerged as a domestically-oriented business group



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focused on the banking and real estate sector. After being forced to sell some of its assets following the Asian Financial Crisis, Lippo transformed its operations by merging with Malaysia's CIMB Group, to establish CIMB Niaga Bank. The bank is currently ranked the fifth largest in Indonesia by assets¹³. To enhance its banking business Lippo also acquired the Jakarta-based lender, Nationalnobu Bank¹⁴.

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In real estate, the Lippo Group consolidated its business under Lippo Karawaci, the largest property company in Indonesia. The company collaborated with the state-owned China Resources Group and partnered with Japanese company Mitsubishi Corp to back the Group's expansion in the region. Through mergers and acquisitions, Lippo's investment in real estate has grown to reach several Southeast Asian countries such as Singapore, Malaysia and Vietnam; as well as extending to Hong Kong, China and South Korea¹⁵. In telecommunication technologies, Lippo has collaborated with Mitsui & Co. in internet businesses. They jointly launched Indonesia's first fourth-generation high-speed mobile network and built a large data centre in 2015¹⁶. The joint-venture project was part of Lippo's larger ambition to be a telecommunications leader in Southeast Asia. This was marked by the Group's investment in Venturra Capital, a new \$150 million venture capital fund to invest in the region's technology companies¹⁷.

The internationalisation of Indonesian businesses has also been seen through their investment in transport infrastructure projects. Many of these projects have been launched by Asian governments in recent years, particularly in Southeast Asia, as they are expected to provide a solution to the notorious traffic problems which have unfortunately become synonymous with the region's capital cities. Manila was the world's 10th-most congested city in 2016. The Philippines' capital, along with Jakarta and Bangkok, topped the ranking as cities with the most chronic traffic problem in Southeast Asia¹⁸. Indonesian business groups have played a role in the expansion of regional investment in the infrastructure sector. For example, a number of infrastructure projects in metro Manila, including power generation, water supply, and toll roads, were undertaken by the Salim Group through its First Pacific's subsidiary Metro Pacific Investments Corporation (MPIC)¹⁹.

This expansion in the infrastructure sector occurred in conjunction with the deepening of regional production networks. With recent regional economic integration, especially through the ASEAN Economic Community (AEC) project, Southeast Asian governments have seen the importance of infrastructure in supporting the region's connectivity and movement of goods. In this context, the Salim Group was involved in port operations in Vietnam through its Interflour Vietnam Limited subsidiary, which developed the Cai-Mep Agri-Port²⁰. The Port is



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currently the largest special-purpose grain port in ASEAN, and plays a key role in supporting Salim's flour mills and grain distribution networks across the region. The internationalisation of Indonesian businesses in the development of infrastructure was also benefited by a large amount of capital investment from China, particularly through the China-led Asian Infrastructure Investment Bank (AIIB)²¹.

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Implication and significance for the Indonesian economy

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As the internationalisation of businesses has become salient in the post-Asian Financial crisis period, it has carried implications for Indonesia's economic outlook. This impact has been felt in two interconnected aspects: Indonesia's international economic engagement, and the direction of governmental economic policy reforms.

First, internationalisation has not only seen businesses expand beyond the national context, but also contributed to Indonesia's deepening integration with the global economy. In particular, it has greatly strengthened the participation of Indonesia in regional value chains in the Asia-Pacific region. In Indonesia, the long-standing political relationship between large businesses and the state has meant that business interests play a major role in shaping national economic policy directions²². Therefore, with the new international ambition of many big businesses since the late 1990s, Indonesia's economic orientation has also been reconfigured to facilitate such global expansion through liberalisation. As global and regional value chains have become the dominant feature of world trade – where goods and services are no longer produced, traded and consumed in one country but fragmented across many – Indonesia has engaged in liberalizing reforms to augment its participation in such processes.

Some of the key policy reforms required for active participation in global value chains is openness to foreign investment and foreign ownership of major businesses; the removal of trade restriction and business licensing; and an upgrading of domestic corporate capabilities through partners with multinational firms²³. For many years, Indonesia's protectionist trade policies have been a major obstacle to its participation into global and regional value chains, something which also concerned many of Indonesia's trading partners. Such barriers took the form of export restrictions (especially in raw materials); many licensing requirements; and limitations on the scope of operations for foreign owned businesses²⁴. Many business sectors have been included in the so called 'Negative Investment List', which excluded foreign players in many key sectors including banking, mining, services, and transportation. Some of these sectors have only been liberalised very recently, after the Jokowi government announced liberalisation packages in 2016²⁵.



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The international expansion of Indonesian business groups is likely to further accelerate following these reforms, as business groups take advantage of new policies to more deeply insert themselves in regional value chains.

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Participation within the regional value chains means much more to the Indonesian economy than just "exports out, foreign investment in". It also helps the national economy achieve a number of important developmental goals, including growing productivity, improving efficiency, and augmenting international competitiveness. For example, the liberalisation of foreign ownership rules in sectors such as infrastructure and transportation is important not only in facilitating investment in Indonesia's infrastructure, but also encouraging an increase in the technical capacity of Indonesia's infrastructure and construction companies. Openness to services not only ensures market access for foreign investment in this sector, but also improves the knowledge base and technological wherewithal of Indonesia's economic acceleration and its future growth. With its status as the largest economy in Southeast Asia and a member of the G20, Indonesia is well-placed to achieve its ambition to become the hub for the region's economic connectivity.

Second, the international expansion of big businesses also builds political momentum behind the country's liberalisation efforts. While market-oriented policy reforms are not entirely new for Indonesia, policy settings have nonetheless been characterized by a strong role of the state in protecting large (yet often inefficient) businesses in the domestic market. Although the economy is broadly open to FDI, the majority of investment has flowed into a handful of protected business groups and sectors, largely for the expansion of their domestic operations. Indeed, exportoriented industrialization strategies employed since the 1980s often involved a large number of protectionist policies²⁷. The transformation of businesses with international expansion has conditioned the government's new policy direction towards liberalisation. Responding to the new needs of business, various liberalising economic reform packages, especially in trade, tax and investment, have been adopted in recent years. Hence, the internationalisation of business has smoothed Indonesia's integration into the global economy through associated policies designed to free trade, improve the ease of doing business, and attract capital inflows.



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For example, in 2011 the Indonesian government set a priority of becoming more integrated with global and regional economic systems through a 'Masterplan for the Acceleration and Expansion of Economic Development of Indonesia 2011-2025' (known as 'MP3EI'). The policy is premised on the notion that Indonesia can gain benefits from its "regional and global geo-strategic position" by developing itself as an economic hub in Southeast Asia²⁸. Among its priorities is an emphasis on Indonesia's connectivity with global and regional supply chains. For example, the national government has improved the operation of 'National Single Window' systems at international hubs, ports and airports, through the implementation of an integrated management logistics system. This links national supply chains with the ASEAN regional supply chains at international ports. Connectivity is supported by policy reform in the shipping system, which is designed to reduce the costly waiting time for containers, which frequently occurs at ports. Indonesia's stevedoring process takes a considerably longer time than in most other ASEAN countries.

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The MP3EI policy also seeks to promote the inflow of foreign capital by liberalising several investment rules. This is in line with broader investment policy reforms negotiated at the regional level though the ASEAN Comprehensive Investment Agreement (ACIA). ACIA is a free, open, transparent, and integrated investment agreement designed to promote Southeast Asia as a single investment destination. In order to grow the volume of inward FDI, the Indonesian government has announced reform packages providing both national and international investors with business incentives in relation to production costs; tax and tariffs; export procedures: licensing and permits: land procurements: and investment protections²⁹. The government also boosted investment through a so-called 'Big Bang' liberalisation package in 2016, which removed foreign ownership restrictions for thirty five industries. This package has been labelled the most progressive Indonesian economic policy reform of the last 10 years and is viewed as a decisive step in bringing more international investment into the country³⁰. The impact of liberalisation is seen in the improvement in Indonesia's investment climate. According to a report by the Economist Corporate Network, Indonesia was Southeast Asia's top investment destination for multinational enterprises in 2017³¹.



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Regional economic architecture and Indonesia's role

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One noteworthy aspect of the international expansion of Indonesian business is that it has not only been supported by market-oriented economic policies at home, but also developments in the regional economic architecture more broadly. Regional economic cooperation has promoted liberalisation through free trade agreements (FTAs) and policy coordination efforts which have provided conditions that support the internationalisation of corporate activity. In other words, the internationalisation strategies of Indonesian businesses are inextricable from the wider context of regional economic governance.

Amongst the economic institutions of the Asia-Pacific region, two major agreements have the potential to further promote the international expansion of Indonesian businesses. The first is the ASEAN Economic Community (AEC), which is an economic integration initiative between the ten ASEAN members states. The second is the Regional Comprehensive Economic Partnership (RCEP) agreement, a megaregional trade bloc currently under negotiation between ASEAN and six countries with which it has already established FTAs (Australia, China, India, Japan, South Korea and New Zealand).

The AEC initiative, which was launched at the ASEAN Summit of 2003, has emerged as an important process in facilitating business expansion across regional borders. The launch of the AEC Blueprint in 2007 marked a turning point in ASEAN's economic cooperation efforts; shifting from the previous focus on trade liberalisation associated with the ASEAN Free Trade Area (AFTA), and moving towards a more comprehensive view of economic openness that considered a wider range of (non-trade) policy reforms. The AEC embraced open, outward-looking, and market-driven principles by covering the interlocking of commodity trade, production and investment as well as establishing the region as a single market and production base. This was adopted in order to transform ASEAN into a more competitive and globally-integrated economic bloc. The four 'pillars' of the AEC agenda, and their core reform elements, are summarised in Table 1 below.



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Table 1: AEC Pillars and Core Elements

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Pillars	Core Elements
Single Market and Production Base	Free flow of goods; Free flow of services; Free flow of investment; Freer flow of capital; Free flow of skilled labour; Priority integration sectors; Food, agriculture, and forestry
Competitive Economic Region	Competition policy; Consumer protection; Intellectual property rights; Infrastructure development; E-commerce
Equitable Economic Development	SME development; Initiative for ASEAN Integration
Integration into Global Economy	Coherent approach toward external economic relations; Enhanced participation in global supply networks

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Source: ASEAN (2008), ASEAN Economic Community Blueprint. Jakarta: ASEAN Secretariat.

For Indonesian businesses, the four pillars of the AEC are imperative for their internationalisation process, specifically through the facilitation of interlocking commodity, investment and production processes. To position Southeast Asia as a "single market and production base", the AEC scheme set priorities to "facilitate the development of production networks in the region and enhance ASEAN's capacity to serve as a global production centre or as a part of the global supply chain"³². For many large corporations, this will not only result in more productivity within Southeast Asia itself, but will also increase the competitiveness of their products in markets outside the region. In addition, it also facilitates the close partnership between Indonesian companies and Southeast Asia-based multinational enterprises through mergers, acquisitions and joint ventures.

Similar to AEC, RCEP has significant potential to extend the international moves of Indonesian businesses to an Asia-Pacific rather than just a Southeast Asian scale. Launched in 2013, a decade after the AEC was initiated, RCEP is an 'ASEAN-Plus' type trade deal which recognizes ASEAN centrality, but brings partners beyond Southeast Asia into regional trading arrangements. It seeks to combine the existing ASEAN+1 FTAs into a larger multilateral deal that involves ASEAN's most important trading partners³³. Indeed, RCEP complements the AEC by proposing numerous provisions that are in line with AEC's objectives. RCEP is concerned with market access in the region through trade liberalisation on goods and services, as well as promoting cross-border capital investment. The agreement also stresses the means to narrow developmental disparities between its members by proposing economic and technical cooperation (Table 2).



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Table 2: RCEP Key Provisions

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Issue	Intended provisions
Trade in goods	Progressively eliminate tariff and non-tariff barriers to all trade
Trade in services	A comprehensive, high-quality agreement which substantially eliminates restrictions and discriminatory measures
Investment	Promote, protect, facilitate and liberalise cross-border investment
Economic and technical cooperation	Extend existing initiatives in ASEAN+1 FTAs, with the aim of narrowing development gaps in the region
Special and differential treatment	Special and differential treatment in agreed commitments, consistent with differing developmental levels of members
Other provisions	Inclusion of intellectual property, competition, e-commerce and dispute settlement provisions

Source: Jeffrey Wilson (2017), "The Regional Economic Community Partnership (RCEP): India's Economic Bridge to Asia" in Gordon Flake et al., *Realising the Indo-Pacific: tasks for India's regional integration*, Perth USAsia Centre at The University of Western Australia. June.

At the time of writing, RCEP remains under negotiation. But Indonesian businesses will surely benefit from its completion. RCEP has been criticised for its lower liberalisation ambitions in comparison to the other mega-regional trade agreements in Asia, the (initially US-led) Trans-Pacific Partnership (TPP), for example. However, its proposed reforms will considerably increase in impact due to the US withdrawal from the TPP in 2017³⁴. More importantly, as Indonesian business groups have begun to acquire several companies beyond Southeast Asia, notably in countries such as Australia, China, Hong Kong, and Korea, the RCEP will provide an institutional mechanism for their internationalisation beyond Southeast Asia into the Asia-Pacific region more broadly.

While the regional economic architecture has and will continue to offer a beneficial regulatory environment for the internationalisation of Indonesian businesses, it nonetheless poses a number of challenges. The Indonesian business community needs to be aware of challenges that might arise due to regional trade agreements such as RCEP and the TPP, as they will influence the internationalisation processes. This challenge is related to competition between different countries' business groups. The different interests and distinct level of operations of big businesses in certain sectors have the potential to complicate the negotiation and implementation of regional trade agreements. Given the close relationship between business and



the state in many Southeast Asian countries, the competition between business groups will influence each government's policies. Another issue lies in the dynamic of domestic politics, especially with the rise of nationalism and populism which has been evident in countries such as Indonesia, the Philippines and Thailand³⁵. The rise of this 'right' political spectrum has been followed by a return to some economic nationalist policies, which might interrupt the implementation of regional economic agreements.

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These challenges must be addressed, not only by businesses but also by stakeholders in government agencies. As the regional economic architecture is very much determined by the approach of its member governments, they play an important role in contributing to regional frameworks which facilitate the international operations of business. Within the context of the AEC and RCEP, Indonesia's participation is indispensable given its position as the largest economy and major power in Southeast Asia. Hence, Indonesia's domestic moves towards a market-driven economy will contribute to the realisation of regional trade agreements. Importantly, it will also reinforce the internationalisation and integration of Indonesian business groups within the regional market, something which in turn will buttress Indonesia's future role as a regional economic power in its own right.

In summary, Indonesian business groups have been significantly transformed in the post-Asian Financial Crisis period. Their move from a domestic market focus to adopting internationalisation strategies has led to their emergence as major players in regional value chains in Southeast Asia. This shift has broader implications not only for the corporate structure of Indonesian business, but also for the national economic outlook. It is an important change which is pushing Indonesia to be more integrated with the global economy, and adopt a new phase of liberalising reforms. As Indonesia is at a key geopolitical and strategic position, and currently enjoys high-speed economic growth, the internationalisation of business is strengthening the country's regional and global profile. The regional economic architecture, especially through recent multilateral cooperation initiatives, has and will continue to provide an institutional framework that will help businesses' international operations. The regional trade block is indeed not something to take for granted as some challenges will remain. But it will enhance the linkages of commodity, investment and production processes as well as facilitate the close corporate networks across the region.



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CHAPTER II. The political economy of Indonesia's natural resource wealth

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Matthew Busch

The political economy of Indonesia's natural resource wealth

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Author: Matthew Busch

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Indonesia is bestowed with an array of valuable natural resources. This includes energy reserves such as crude oil, natural gas, and thermal coal as well as industrial minerals such as bauxite, copper, nickel, iron ore, tin and zinc. As is common in many resource-rich countries, a large share of resource production is sold onto world markets. Indonesia is the world's largest exporter of thermal coal; formerly the largest exporter of LNG (now Australia); the largest exporter of palm oil; and (prior to the 2014 ban on the export of certain unrefined ores), one of the largest suppliers of nickel and bauxite.

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These world-class endowments, however, have yet to be supported by strong institutions for the exploration, contracting, and management of resources. Neither has Indonesia developed an effective and coherent mechanism to capture the economic rents they generate. Rather, in recent years there has been a series of governmental interventions into the mining sector, notionally intended to enhance the state's control over and benefit from natural resources. A prominent example is the 2009 Mining Law, which imposed export bans and domestic processing requirements for several minerals. Another is the difficulty for oil and gas investors to obtain contract extensions for their projects, which instead have been awarded to Pertamina, the state-owned national energy company.

These developments are commonly known as 'resource nationalism' – attempts by resource-rich states to exercise national control over the mineral and energy endowments within their borders. Some common themes to Indonesia's contemporary resource nationalism are evident³⁶:

- Efforts to renegotiate or otherwise dispense with legacy resource contracts;
- Demands for higher levels of domestic ownership of resource firms;
- Requirements that resource firms increase local content in the goods and services they use to operate; and
- Mandatory 'added value' to any product that is exported.

These developments are the consequence of Indonesia's political economy. Rentseeking is a prominent contributor to the forms of resource nationalist interventions in Indonesia. Domestic interest groups are attracted by the rich economic rents on offer, and use their political access to elicit policies that, though discursively justified with arguments about domestic ownership and national empowerment, are far



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more driven by sectional interests. This reflects the importance of the relationship between natural resources dynamics of political and economic power in Indonesia. Indeed, the marshalling of resources has historically been essential to Indonesia's logic of power, traditions of patronage, and the role of the state with respect to both society and private capital. However, while forms of resource nationalism are influenced by corruption and rent-seeking, it is also a phenomenon driven by more longstanding and ingrained assumptions about power and governance.

This chapter explores recent developments in policy for the exploitation and ownership of natural resources in Indonesia. It examines how resources have long been proximate to power and the state in Indonesia, before discussing recent trends in Indonesia's natural resource sectors. Next, it discusses resource nationalism in the Indonesian context, arguing that this is not only a reflection of nationalism and a bias against foreign investment, but also results from limits to Indonesian state capacity. As a consequence, resource investors are often pressured to support state-led developmental objectives. The chapter closes with a discussion of the implications for Australia, both its investors as well as for the context of its bilateral relations with Indonesia.

Resource wealth and national identity in Indonesia

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Indonesia's national identity is imbued with a sense of resistance to foreign intervention and exploitation. Citizens often recount received narratives about how its natural wealth has incited the colonial instincts of governments and corporations alike. Resources have played a key role to important historical moments. When the Japanese invaded the Netherlands East Indies in 1941, one of their earliest objectives was securing major oilfields and refineries in Sumatra and Kalimantan. Sukarno made the nationalisation of Dutch and internationally-owned plantations, utilities, mines, and other businesses but, in a nod to both geopolitical as well as economic realities, not the three US-owned major oil producers, a cornerstone of his confrontations with the West.

Later, following an aborted 1965 coup, Sukarno was sidelined in favour of a militaryled government that immediately sought to attract international capital to the country. Freeport Sulfur (today Freeport McMoran), seeking to exploit a major copper deposit in Papua, was among the first new investors to the country. Indeed, its lawyers essentially drafted the first Investment Law of 1967³⁷. Mining continues more than five decades later on an adjacent, and far richer, deposit. The Freeport-Indonesia relationship, although of clear mutual benefit (Freeport, for example, is



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still the country's largest single taxpayer), has become publicly fraught in recent years as Indonesian officials demand both greater ownership of the company as well as control over its operations.

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During the oil boom of the 1970s, Indonesia's petrodollars underwrote a massive heavy industries drive, the excesses of which helped build a politico-business oligarchy that remains powerful today³⁸. The Bontang LNG plant in East Kalimantan, completed in 1977 and for many years the world's largest, still operates today. Pertamina has recently succeeded, after years of agitation, in wresting 100% control from the French and Japanese owners of the massive Mahakam block, which provides the bulk of the plant's feedstock. In another example during the 1990s, the Bre-X fraud³⁹, when Canadian investors claimed a massive gold discovery in the jungles of Kalimantan, prompted resource nationalism like that of an earlier era, as political elites, including members of the president's own family, scrambled for a share of the spoils. President Suharto ultimately intervened to dictate not only the terms of the investment, but also the developer's partner.

Above all, controlling and distributing natural resource rents has long been fundamental to the exercise of power in Indonesia. Suharto's New Order regime worked to attract the foreign capital needed to exploit its resources, but investments were always structured in partnership with the regime's main vehicles of patronage, including elite-owned conglomerates or charitable foundations controlled by the First Family, military, or important political groups. Indonesia was politically centralized, and natural resource rents systematically flowed to the Jakarta-centric elite, with a considerably smaller share trickling back to the regions. Since the end of the New Order in 1998, Indonesia has transitioned from authoritarianism to electoral democracy, while also implementing political decentralisation. This has had important consequences for the operations of natural resource investors and the sharing of resource revenues.



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Understanding resource nationalism

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Resource nationalism is a common phenomenon found in many resource-rich countries. At their most basic, negotiations over the terms for the exploitation of natural resources focus on how 'economic rent' – the unearned value that accrues from a factor of production – is divided between the state, mining companies, and local communities. During boom phases when resource prices are high, the economic rents generated by mining can become very large, as sale price greatly exceeds cost of production. Resource nationalism is a state strategy to use economic policies to increase its control over the economic rent from the exploitation of its resources within its territory⁴⁰. Several types of intervention are commonplace: ownership of resources; operation of resource companies; and the function of markets for resources⁴¹.

For many developing economies, successful resource exploitation necessitates some degree of economic openness. This is required to access export markets, as well as to attract investors (usually foreign) to obtain necessary capital and technology. For host countries, this creates inherent policy tension between openness to foreign trade and investment on one hand, while still ensuring an adequate share of the resulting economic rents are captured by the state. To do so, states deploy policies that exercise forms of direct or indirect control over who can exploit natural resources, and on what terms.

The legal and regulatory frameworks for resource exploitation come to reflect this struggle between state and capital, which seek to maintain a working relationship while also maximizing their respective shares of economic rent. Investors and governments therefore engage in complex, multi-stage negotiations wherein companies agree to contribute risk capital, technology, and know-how in return for some form of economic right to the resources. As resource projects often require massive upfront capital expenditures, these relationships must span several decades, with investors seeking stability to recoup their initial outlays and eventually earn profits. Taxes, royalties, and production shares are state tools for securing its share; whereas cost recovery, tax holidays, and investor-state dispute settlement (ISDS) mechanisms are investor tools for managing risk.



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Structural change in Indonesia's resource sector

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Like many developing countries, Indonesia has sought greater control over its natural resources in recent years, and branding Indonesia as a site of 'rising' resource nationalism is commonplace⁴². According to advocates, these efforts are necessary to achieve Indonesia's developmental objectives, such as a 'multiplier effect' or driving investment to value-added sectors⁴³. Proponents cite avoiding the so-called 'middle income trap', by moving away from the export of raw or lightly processed commodities to commodity-based products with higher domestic value-added content⁴⁴.

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Resource exploitation remains important in contemporary Indonesia, and resources comprise a large share of trade and foreign exchange earnings. If including palm oil, an estate crop of which Indonesia is the largest producer, nearly one-third of Indonesia's total goods exports are natural resources⁴⁵. In 2013, at the peak of the commodities boom, nearly 45% of total exports were these commodities. This has had consequences for the rest of the economy, as knock-on effects such as the appreciation of the real exchange rate damaged the competitiveness of other economic sectors⁴⁶.

During boom times, these trends also gave rise to massive wealth creation, both for foreign-owned and domestic corporations. By around 2010, almost all of Indonesia's major business groups had expanded into thermal coal and palm oil. Particularly fortunate groups had both. Timing sometimes proved decisive, including in the early-2000s when several international miners' lack of confidence in the commercial outlook for coal, and Indonesia's political stability, led to the sale of large legacy coal assets to domestic conglomerates. Amid soaring Chinese industrial demand, these assets were worth billions of dollars just a few years later.

Many beneficiaries of Indonesia's marketisation during the 2000s, not to mention the flow of natural resource assets to domestic interests, came from the ranks of the existing New Order oligarchy⁴⁷. But equally significant was the sudden creation of many new small-scale mining interests. Soaring demand and high prices empowered the rise of relatively small-scale, inexperienced mining firms to exploit more marginal and less capital-intensive deposits of coal, iron ore, bauxite, and nickel. For local governments in resource-rich districts, the economic impact was marked, as they received large central transfers under new decentralisation rules. They also controlled many of the permits and approvals necessary for natural resource investors to operate, and, as a consequence, many local officials set out to ensure they obtained a share of economic rent commensurate with their influence over the use of these resources.



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Importantly, resource nationalism has continued despite the waning of the commodities super-cycle. The 2014 export bans for nickel and bauxite targeted two sub-sectors where most minerals extraction was done using domestic capital, often in league with local government officials. In 2017, concerns about the financial health of the state-owned miner Antam were part of the justification for a relaxation of the bans. Domestic groups (often proximate to or, in the case of State Owned Enterprises (SOEs), owned by the state) have exploited opportunities to acquire the projects of departing international miners at low cost⁴⁸. At the same time, increasing regulatory and legal pressure has continued for the remaining foreign-owned incumbents, including continued confrontations over legacy mining contracts. In 2017, the Energy Ministry announced it would no longer 'service' projects that have not renegotiated their contracts and accepted considerably less secure mining licenses⁴⁹.

Resource nationalism in an Indonesian context

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In Indonesia, resource nationalism is not simply a regulatory response to booming world resource markets, but rather an expression of complex political and economic dynamics. One important dimension concerns the state's relationship to society. In Indonesia, resource nationalism also bears the hallmark of a 'weak' state. Such a state struggles to overcome political forces, ideologies, and the many challenges of exercising its authority and implementing its decisions. Often, not only does this involve battles with private capital, but also among and between actors within the state apparatus.

Natural resources play a talismanic role in Indonesia's historical traditions, as those with power crafted the legal and regulatory instruments needed to control the economic rent stemming from these sectors. As Indonesia's post-authoritarian governance has become more fractured and decentralised, the form and depth of the legal and regulatory instruments have followed course, and in some instances, this has pitted different actors against one another.

For example, for several years in the mid-2000s district governments, with new regulatory powers and access to rich revenue streams conferred under the decentralisation program, were allowed to issue mining permits. What followed was an explosion of well over 10,000 permits, many of which were overlapping, likely illegal, or unregistered beyond the local government. Ultimately, in the eyes of a central government, many of these permits were 'illegal'. The energy and mining ministry launched its 'clean and clear' list of 'legal' mining permits, prompting outrage among local governments and a scramble among investors to get their permits into the list.



Some influential district chiefs continued issuing permits in defiance of the central government, and one sued the central government in the Constitutional Court⁵⁰. The Court ruled that local governments, subject to existing regulations, could carry out the spatial planning and designation of mining permit areas. Central authorities would control the tenders by doling out future licenses. The 'clean and clear' list had also evolved into a potent tool for the central authorities to police local actors, as mining firms not on the list could not receive a host of other central-level permits and approvals necessary to operate. Ultimately, this case shows how the central government's efforts to exercise greater control over resource sectors is not solely targeted at companies, but can also pit central and local state actors against each other.

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Indeed, resource nationalism is not always, despite the implications of its name, directed solely at foreign actors. Many recent instances of resource nationalism burden domestic actors as well. One example is the Energy and Mining Ministry's recently announced price cap of \$70/ton for coal sold to domestic power plants⁵¹. PLN, the state electricity company, is saddled with a public service obligation to supply electricity to households at a state-mandated price below its average cost of generation. PLN's balance sheet has deteriorated further as it was given a key role in aggressive government targets for new generation capacity and networking improvements. PLN is losing money, and it falls to the central government to bail the company out with regular equity injections⁵².

With coal prices again increasing since a low in 2014, the cost of coal-fired electricity is also rising, causing a dilemma for energy policymakers. In this case, an apparent solution was to decree a maximum, and well below market, price cap for coal sold to domestic power plants. Coal mining firms, which already face a 'domestic market obligation' (compelling them to sell a proportion of their product to PLN), have agitated against the policy, which will effectively shift a portion of the government's bailouts to PLN onto the private sector. Critically, virtually all of Indonesia's coal mining firms are domestically owned, demonstrating how a politicised developmental objective, the preservation of cheap household power prices, can motivate resource nationalism, even in a way that causes burdens and costs for highly influential local players.

As this example shows, the state also struggles to deliver, through official channels, the provision of public services such as electricity to its citizens. Resource nationalism is therefore often justified as a necessary means to ensure that Indonesian citizens are able to share in the country's natural resource wealth through benefits such as subsidised energy⁵³. This is an understandable objective,



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but its application reveals that the state often lacks capacity when compared to private sector technical, administrative, and financial capacities. Resource companies, whether foreign or local, are a politically convenient target for these efforts. This is compounded by the fact that many are foreign multinationals with large profits, far away shareholders, and controversial histories of involvement with the New Order regime.

A key illustration is Freeport McMoran, which operates the giant Grasberg coppergold mine in Papua province. A wide spectrum of citizens and officials have criticised the company and argued its long history in Indonesia has not brought acceptable development or opportunities for Indonesia or local communities⁵⁴. These demands reflect a powerful assumption about the perceived role of foreign investors, and how they are regarded as accountable for an outcome (local development objectives) that in many societies would be widely seen as the responsibility of the government. Instead, Indonesia, even as it has changed many of its political institutions, still clings to older political-economic traditions, including the Suharto era expectation that investors contribute to national development as a side payment for the right to operate and access resource rents.

Despite much progress, Indonesia also remains a developing country, and often, especially in remote areas, resource firms are seen as the logical engine for development that the government is unable or unwilling to address. For this purpose, the government sometimes seeks to dictate the technical terms of resource projects, not simply for rent-seeking purposes but also for developmental objectives. However, these objectives are often vaguely defined, and implemented in regulations with little to no economic analysis to support the intervention. In the case of Inpex's Masela LNG project, the government overturned a third-party technical study to mandate a far more expensive onshore build in one of the most remote parts of the archipelago⁵⁵. The same fate awaited technical studies showing a multibillion-dollar copper smelter would almost never earn a profit⁵⁶. In each case, officials invested more in gauzy ideas about the bonuses or spillovers that would reputedly accrue to society than any economic or cost-benefit analyses.



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Implications for Australia

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Understanding Indonesia's resource politics is important for both Australian businesses and government. Australian companies have interests in Indonesian natural resources and Australia has directly contributed to the identification, proving, and development of Indonesian resources as an important source of knowhow and capital for mining exploration. Large firms have also profited, including Newcrest Mining, which for nearly two decades has successfully and largely anonymously operated the Gosowong gold mine in the eastern province of North Maluku.⁵⁷ Furthermore, Santos, an Australian exploration and production company, has interests in several producing Indonesian oil and gas projects⁵⁸.

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Australian firms have struggled to operate in the opaque Indonesian resource policy environment. Rio Tinto, along with joint venture partner BP, decided in 2003 to sell its interest in the major Kaltim Prima Coal mine⁵⁹. Rio now has no direct ownership of assets in Indonesia, but continues to hold a joint venture share of Freeport McMoran's Grasberg mine. Amid more assertive resource nationalism, the project has become a flashpoint for many government priorities, prompting in several instances the withholding of the mine's export permit⁶⁰. Such disruptions have reduced profits and bolstered concern about Freeport's ability to operate in the future.

Not all challenges facing resource companies in Indonesia are the consequence of resource nationalism. Garden variety crises can occur at any moment. Santos, for example, was a non-operating minority partner in an oil and gas project (Lapindo) where negligent drilling practices set off an environmental catastrophe in the form of a mud volcano⁶¹. Although not responsible for the drilling, Santos found itself facing both serious financial obligations as well as reputational risks⁶². The project's operator, owned by one of Indonesia's most politically connected families, deployed an array of tactics to push its claim that the disaster was a natural phenomenon and not the result of its negligence⁶³. The government decreed that it would be responsible for disaster management, while subsequent revisions effectively capped the developer's financial obligations with respect to rectifying the impacts and compensating victims⁶⁴.

The dual-listed Australian-Canadian miner Intrepid Mining spent nearly \$100 million proving an East Java copper and gold resource, seen as among the most prospective regional discoveries of the past several decades. However, Intrepid did not have clear title to the mining license, which per national regulations could not be foreign owned. Agreements to protect the company's interests were invalid under



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Indonesian law, and were of little use when the local partners transferred control to domestic investors. Intrepid sought legal action to enforce its rights, but eventually accepted a settlement for a fraction of the resource's value brokered by subsequent investors in the mine⁶⁵.

To be sure, Australia's national interests are not automatically equivalent to the interests of these private firms. Investors go overseas with a clear understanding of the attendant risks and consequences, especially in jurisdictions with different laws, political institutions, and attitudes about corruption. It is important for Australian officials to understand and, if appropriate, be prepared to support the activities of its resource investors. However, companies need to make their own political risks assessments and price-in the risks that these demonstrate when making investment decisions in the Indonesian resource sector.

A more persuasive, albeit longer horizon, reason for Australia to cultivate an understanding about the forms and motivations for resource nationalism in Indonesia is because of the insights such phenomena provide about its politics and society. Resource nationalism is an expression of a country's political economy, including history and ideologies, the status of domestic capital, and the relationship between the state and society. These themes are fundamental to the logic of power and are the foundations of a country's political and economic institutions. Australia's bilateral relations must inevitably be informed by understanding how these political and economic factors fit together in the contest for power.

With proper management, Indonesia's resources could also provide future wealth for its citizens. This is clearly in the interest of Australia, which will benefit from Indonesia becoming more prosperous and stable. Indonesia and Australia will always be neighbours, and for the foreseeable future Indonesia will occupy outsized importance for Australia's security and strategic planning. We should not overstate the importance of natural resources to Indonesia's future economic strength – and, in fact, Indonesian officials and firms' excessive attention to the control of natural resources is a reflection of the perverse incentives for rent-seeking behavior rather than a reflection of the economic importance of these industries to the broader economy – but the windfalls possible through fastidious and forward-looking resource management could provide Indonesia with future wealth.

Given their experience with resource revenues, Australian and Indonesian officials could implement worthwhile collaborations on natural resource revenues and management. Previous and existing partnerships have worked on related issues⁶⁶. Unfortunately, however, many in Indonesia are skeptical about the benefits of



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outside assistance in managing its natural resource wealth. This is exacerbated further by the challenging bilateral history between the two countries⁶⁷. Senior Indonesian officials and politicians sometimes proffer theories about how Australia's actions are motivated by a desire to promote separatism in Eastern Indonesia or secure corporate interests⁶⁸.

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Australia has also already made, and continues to make, considerable efforts to assist Indonesia in improving the quality of its economic policies and governance. Some have proven more successful than others. Approaches from AusAID in the early 2010s to advance activities under the Mining for Sustainable Development program, failed to gain traction from counterparts. This was unsurprising given the concurrent introduction of many of the most nationalist provisions of the 2009 Mining Law. Other Australian-funded development initiatives, including the Australia-Indonesia Partnership for Economic Governance (AIPEG) and the Indonesia Infrastructure Initiative (INDII, now succeeded by the Indonesia-Australia Infrastructure Partnership, KIAT) have also worked with government partners on improving policy or providing grants for projects⁶⁹.

Ultimately, the most important consideration is how such knowledge can contribute to an expansion of ties, most notably bilateral investment ties. Investment between the two countries remains modest, with Australian investment stocks in Indonesia of only \$9 billion. This is a tiny fraction of the \$2170 billion of Australian outward investment to the end of 2016⁷⁰.

Unfortunately, stringent limits do exist for foreign direct investment in the sectors, not only for mining projects (both exploration and exploitation), but also mining equipment technology and services (the so-called 'METS' sub-sector). Australian officials could attempt to advance investment liberalisation for these sectors through the ongoing negotiation of the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA). However, there is a limited constituency in Indonesia for greater openness in the resource space to international capital and expertise. Although bilateral forums and business groups have offered support for the inclusion of METS under the IA-CEPA⁷¹, negotiations are held in private and there is no current indication a mining or energy chapter would be included in the agreement⁷². We may know soon, however, as even though the process of negotiating the IA-CEPA has been lengthy and subject to delay, the parties have offered bullish public statements about their progress and hopes to conclude negotiations during 2018⁷³.



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Conclusion

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This chapter offered an introduction to resource nationalism in Indonesia. Resources hold a special place in Indonesia's national consciousness, and its citizens have seen them seize the attentions, and at times most covetous impulses, of multinationals, foreign powers, and their political leaders. The control of resources and the dispensation of patronage is central to the historical logic of power. In Indonesia, there is convincing evidence that resource nationalism is not purely the consequence of rent-seeking, but instead is also a consequence of other factors, such as ideas, economic institutions, and industry-level attributes. Resource nationalism should also be considered in the context of a central government that sometimes lacks capacity in delivering public goods and conducting its relations with subnational governments. Some instances of resource nationalism can also be directed at domestic interests or even fellow state actors. These examples, sometimes justified through reference to developmental objectives, also demonstrate how the resource nationalist state also struggles to exercise control and meet its objectives.



CHAPTER III. Indonesia's approach to trade relations with Australia: IA-CEPA and RCEP negotiations

Poppy S. Winanti

Indonesia's approach to trade relations with Australia: IA-CEPA and RCEP negotiations

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Author: Poppy S. Winanti

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The stagnation of multilateral trade negotiations has raised questions regarding the strength of the global trade regime. Since the establishment of the World Trade Organisation (WTO) in 1995, only one trade agreement (the Trade Facilitation Agreement) has been concluded under its auspices. Yet there has been a proliferation of new regional agreements introducing new rules and issues beyond the WTO⁷⁴. As of January 2018, the WTO has received notifications for 455 Regional Trade Agreements, of which 284 are in force⁷⁵. This indicates that trade integration is much easier at the regional level than it is at the global level. These agreements are viewed as a better way to achieve consensus for rules that cannot be accomplished within the WTO framework⁷⁶.

Indonesia has been an active player in this process. The proliferation of regional trade initiatives has provided the Indonesian government with a number of new trade policy options beyond the WTO. Indonesia is currently involved in thirty-five free trade agreements (FTA), some as part of the ASEAN bloc and some as an individual country⁷⁷. These include seventeen FTAs that are still under consultation/ study, six under negotiation, three of which are signed but not yet in effect, and nine FTAs that have entered into force (see Table 1). Compared to other ASEAN countries, Indonesia's involvement in FTAs can be considered moderately active. Even though Indonesia's participation is less than some of the more developed economies (such as Singapore and Malaysia), it is one of the most active FTA negotiators amongst the developing countries within ASEAN.

Of particular importance are two of these negotiations, the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA) and the Regional Comprehensive Economic Partnership (RCEP) which involve Australia. Despite their warm political relationship and close geographical proximity, the trade relations of these countries are relatively under-developed, and neither features prominently as a trading partner for the other⁷⁸. These new FTAs therefore provide a critically important opportunity for deepening Australia-Indonesia economic ties. Indeed, the Australian government has explicitly identified both agreements as an immediate priority for strengthening its trade relationship with Indonesia. It has been argued that the IA-CEPA will strengthen *bilateral* ties through the development of commercial and investment links; while the RCEP can help stimulate regional economic integration in which both countries are well-positioned to participate⁷⁹.



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Table 1: Indonesia's FTAs

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No	Signed and in effect	Date	No	Under negotiation	Negotiations launched
1	ASEAN Free Trade Area (AFTA)	1 January 1993	1	India-Indonesia Comprehensive Economic Cooperation Arrangement (India – Indonesia CECA)	4 October 2011
2	ASEAN-People's Republic of China Comprehensive Economic Cooperation Agreement (ACFTA)	1 July 2005	2	Indonesia-European Free Trade Association Free Trade Agreement (Indonesia-EFTA FTA)	31 January 2011
3	ASEAN-[Republic of] Korea Comprehensive Economic Cooperation Agreement (AKFTA)	1 June 2007	3	Republic of Korea- Indonesia Free Trade Agreement	12 July 2012
4	Japan-Indonesia Economic Partnership Agreement (Japan – Indonesia EPA)	1 July 2008	4	Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA)	26 September 2012
5	ASEAN-Japan Comprehensive Economic Partnership (AJCEP)	1 December 2008	5	Regional Comprehensive Economic Partnership (RCEP)	9 May 2013
6	ASEAN-India Comprehensive Economic Cooperation Agreement (ASEAN-India CECA)	1 January 2010	6	Indonesia-Turkey Free Trade Agreement	6 July 2017
7	ASEAN-Australia and New Zealand Free Trade Agreement (AANZFTA)	1 January 2010			
8	Preferential Tariff Agreement-Group of Eight Developing Countries (PTA-D8)	25 August 2011			
9	Pakistan-Indonesia Free Trade Agreement (Pakistan – Indonesia FTA)	13 September 2013	Source: Asia Regional Integration Center available at https://aric.adb.org/indonesia/data (accessed 15 March 2018)		



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But what does Indonesia want from these new FTAs? To assess the impact they will have on Indonesia-Australia economic ties, this chapter evaluates Indonesia's interests, objectives and strategies in ongoing negotiations for the IA-CEPA and RCEP. The chapter argues that Indonesia seeks to achieve a diverse range of goals. From an economic perspective, Indonesia's interests in its FTA endeavours are similar to the country's main interests in multilateral trading systems. These include pursuing further trade liberalisation in its key export markets, leveraging external reform to enhance the competitiveness of its economy, protecting its domestic market and producers from unfair international trade practices, and contributing to the development of regional trade and investment rules. From a geopolitical perspective, Indonesia also hopes to reinforce its leadership role, both within ASEAN and the Indo-Pacific region more broadly. Considering that RCEP involves wider participants that are often Indonesia's major trading partners, the RCEP is seen as a better avenue to achieve the country's economic and geopolitical objectives. Furthermore, previous discussion also reveals the Indonesian government's preference for regional rather than bilateral mechanisms. Thus, it can be argued that the RCEP is perceived as being significantly more important for Indonesia than bilateral mechanisms such as the IA-CEPA.

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Indonesia's goals in IA-CEPA negotiations

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The initiative to establish Indonesian and Australian economic cooperation began in 2005 and was followed by a Joint Feasibility Study to assess the benefits of the cooperation in 2007. A study which was conducted in 2009 showed that a comprehensive Free Trade Agreement (FTA) between Indonesia and Australia would be beneficial for both countries. Considering their geographical proximity, trade relations between Australia and Indonesia are poorly developed. Australia is not one of Indonesia's top 5 trading partners, either as an export destination country or import origin country⁸⁰, nor is Indonesia significant for Australia⁸¹. This fact reflects the findings in a report published by the Perth USAsia Centre in 2016. The report illustrates that Australia is listed as Indonesia's 9th biggest trading partner. More intriguingly, Indonesia is not even one of Australia's top 10 trading partners, instead occupying 14th place⁸². In this regard, the IA-CEPA is expected to accelerate and deepen the economic cooperation between the two countries⁸³. Negotiations were launched in 2010 but progress was initially slow. They stalled in 2013, before being relaunched in March 2016, and have become more frequent since then.



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Box 1. Issues Negotiated on IA-CEPA⁸⁴

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000 Like many other FTAs, the IA-CEPA is intended to facilitate the free flow of goods, services and investment, as well as the elimination of trade barriers (both tariff and non-tariff) and other technical issues. The negotiations of the IA-CEPA cover a wide range of issues:

- a. Trade in goods and services
- **b.** Investment

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c. Rules of origin

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- d. Moving of natural persons
- e. New trade issues such as e-commerce, competition policy, government procurement, intellectual property rights, small and medium enterprises, and labour.

Furthermore, the negotiations also include governance and a framework on transparency, exceptions, a dispute settlement mechanism and sanitary and phytosanitary (SPS) measures.

It should be noted that the IA-CEPA is mainly an extension of the ASEAN Australia New Zealand Free Trade Area (AANZFTA), which is regarded as one of the most ambitious trade agreements for both ASEAN and Australasia. The AANZFTA is the first ASEAN trade agreement that covers all trade sectors, including trade in goods, services, investment and intellectual property rights. This has made the AANZFTA the most comprehensive of ASEAN's five 'Plus One' trade agreements. The AANZFTA, therefore, is used as the point of departure to set the tariff for goods under the IA-CFPA.

Indonesia has several key interests regarding the following trade issues. Market access is one of the main concerns of the Indonesian government in almost all trade negotiations. There are at least two main sectors that need particular attention in IA-CEPA negotiations related to market access, namely, the agricultural sector and financial services. Since 2012, Indonesia has suffered from a trade deficit with Australia⁸⁵. This trade deficit is primarily due to the importation of agricultural





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products, especially wheat, meat, and milk products. Indonesia's dependence on these commodities contributes greatly to the trade deficit and it is worsened by the fact that Indonesia's exports to Australia mostly consist of raw commodities, including crude petroleum, wood, cocoa butter, rubber, etc. which do not add significant value.

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Additionally, Indonesia still encounters obstacles in accessing the Australian food market due to Indonesian producers' inability to meet the high Australian standards for these commodities⁸⁶ IA-CEPA negotiations are therefore expected to assist Indonesian products to meet Australian standards. This, in turn, is projected to open new opportunities for Indonesian producers to increase their production capacity and to access the Australian market⁸⁷.

In order to ensure Indonesian products meet Australian standards for food products, both parties have agreed to a Mutual Recognition on Food Standards. Australia has a very high standard for food products and implements rigorous standards for quarantine and *Sanitary and Phytosanitary* (SPS) measures, which even exceed international requirements⁸⁸. By having this mutual recognition, Indonesian producers will have a comprehensive understanding of Australian regulations and, more importantly, will be able to improve their capacity to meet those standards. This effort, in turn, is projected to increase Indonesia's export of food products to Australia.

Alongside agricultural market access issues, the Indonesian government also pays particular attention to food security. As a part of achieving this goal, the Indonesian government seeks Australian investment in Indonesian food products. However, to invest in this sector, investors from Australia are required to have a joint venture with local partners. This process facilitates the transfer of knowledge and skills between investors and local businesses. Furthermore, joint ventures are expected to expand the production capacity and to strengthen production chains in the food industry. This is expected to support Indonesia's ambition to become the centre of food production in ASEAN⁸⁹. In addition, Indonesia's interest in achieving food security through the IA-CEPA will be addressed by gaining access to Australian technical assistance, Australia being known for its technological developments in agriculture and the food industry⁹⁰.

IA-CEPA negotiations also discussed ways to improve Indonesia's small and medium sized enterprises, enhancing their access to the food production market. For this reason, the Australian government has agreed to establish the Indonesian Food Innovation Center (IFIC). This center provides capacity building programs to



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assist Indonesian producers to comprehend and meet Australian SPS standards. Furthermore, this center is designed to provide technical assistance to Indonesian SMEs regarding food product standards and food safety. This is also strengthened by Australia's role as the co-chair of the Food Safety Cooperation Forum (FSCF) of APEC which is responsible for providing technical assistance to developing countries in order to improve their capacity to develop and implement SPS standards in their respective countries⁹¹.

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Through the IA-CEPA, Indonesia also intends to ensure energy security and trade in extractive industries. This is generally achieved by inviting Australian investors from those sectors to partner with Indonesian companies. Following the introduction of the 2009 Law on Minerals and Coal, which prohibited the export of raw materials and required the building of a domestic smelter, the majority of Australian investors have diverted their investment into Africa, Latin America and the Middle East⁹². In this regard, the Indonesian government, particularly the Ministry of Trade, intends to use the IA-CEPA to improve regulations on investment in extractive industries and energy.

In addition to facilitating the trade of goods, the IA-CEPA also covers trade in services, with a particular focus on the reduction of trade barriers on professional services, health services, educational services, vocational education, training and vocational workers, and financial services. In order to reduce trade barriers on professional services, IA-CEPA negotiations focus on mutual recognition agreements based on international standards and increasing investment opportunities in this sector in both countries.

Financial services is the Australian economy's fourth largest sector. It contributes 8.1% of GDP or the equivalent of 81 billion Australian dollars from 2008 to 2009⁹³. In this regard, the financial services and insurance sector is as significant as the mineral and extractive industry which have become the main component of the Australian economy. Indonesia has implemented liberal policies on financial services. It has allowed for foreign investors to own up to 99% in the banking sector and up to 80% of insurance companies. The only restriction on financial services in Indonesia is the obligation to hire foreign employees. However, despite the fact that Indonesia has an open policy for financial services domestically, the existence of Indonesian banks overseas is still limited. Enhancing market access for Indonesian banks operating in Australia is therefore regarded as one of the main issues for Indonesia in IA-CEPA negotiations.



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The IA-CEPA is expected to support the establishment of Indonesia and Australia as the hub for regional production in Asia. The establishment of this regional network is intended to enhance market access to third party markets⁹⁴. Indonesia has a competitive advantage on manufacturing due to its abundance of cheap labor and its competitive wage standard. On one hand, Australia has a competitive advantage on technology, design industry, marketing and research development. Australia's competitive advantage is needed by the Indonesian business community to develop high quality products. On the other hand, Australia needs local partners in Indonesia that have low operational costs, cheap labor and an availability of raw materials. The IA-CEPA is therefore expected to enhance a complementary partnership between the two parties and to establish a regional production network as a gateway to third party markets for both countries.

Indonesia's interest in the Regional Comprehensive Economic Partnership (RCEP)

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The Regional Comprehensive Economic Partnership (RCEP) was first introduced in November 2011 during the 19th ASEAN Meeting in Bali. RCEP negotiations started in 2013 and were initially expected to conclude by the end of 2015. Despite this, negotiations have been extended to date. The fourth, and latest, RCEP Intersessional Ministerial Meeting was held in Singapore on 3 March 2018. The chief objective of RCEP negotiations is to achieve "..a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement among the ASEAN Member States and ASEAN's FTA Partners"⁹⁵. Negotiations for the RCEP will acknowledge ASEAN's centrality in the emerging regional economic architecture. The RCEP is now also regarded as one of the most important initiatives in the global arena. Additionally, the RCEP has also gained momentum since the TPP, widely deemed as its foremost competing initiative, was significantly modified due to the US withdrawal. As a result, the TPP was transformed into the TPP-11, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and was officially signed on 8 March 2018. However, balancing different developmental levels and interests regarding the degree of liberalisation and the scope of negotiations among such a large group of countries is the biggest challenge of RCEP negotiations.

The RCEP was established to expand and deepen the existing economic cooperation between ASEAN and the partners with which it currently has a 'Plus One' FTA: Australia, New Zealand, China, Japan, South Korea and India. The RCEP is therefore expected to integrate these existing FTAs into a single, region-wide agreement⁹⁶. Through the RCEP, ASEAN member countries expect to strengthen their bargaining



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position with the other economic powers in Asia, including China, Japan and India. The centrality of ASEAN in the negotiation process, thus, is crucial to ensuring ASEAN's role as an agenda setter and that the agreement is serving the interests of ASEAN member countries. According to Fukunaga⁹⁷, ASEAN centrality in the RCEP can be seen in the form of both 'facilitator of process', which reflects ASEAN's role in initiating, hosting and chairing the meetings and 'driver of substance' which highlights ASEAN's position in directing and shaping the negotiation outcomes. Indonesia's concern regarding the centrality of ASEAN in the RCEP negotiations has been highlighted by Indonesia's top policy makers. This is especially true for those officials from the Ministry of Trade⁹⁸. More importantly, the RCEP negotiations, first introduced in 2011, took place when Indonesia was assuming the Chairmanship of ASEAN. Furthermore, Indonesia was appointed as the ASEAN coordinator to chair the RCEP negotiations. Ensuring ASEAN speaks with one voice, however, is not an easy venture especially considering the diversity of ASEAN members in terms of their economic development and national interests.

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Historically, ASEAN economic integration started in the early 1990s with the establishment of the ASEAN Free Trade Area (AFTA). However, a more meaningful regional integration in ASEAN was only evident two decades later, in 2015, with the establishment of the ASEAN Economic Community (AEC). The AEC is one of the pillars of the ASEAN community. It also consists of the ASEAN Political Security Community (APSC) and the ASEAN Socio-Cultural Community (ASCC). As stated in its blueprint, the establishment of the AEC is part of an endeavour to strengthen ASEAN's collective attractiveness and competitiveness through the more liberal movement of goods, services, investment, workers, and capital in Southeast Asia. The AEC, in this regard, is expected to create a single market and a production base for 634 million people⁹⁹ and, collectively, ASEAN member countries are predicted to be the fourth largest economy in the world by 2050¹⁰⁰. However, anxiety as to whether ASEAN will be able to reach its AEC objectives is still widely prevalent¹⁰¹. These doubts are mainly due to the fact that most ASEAN members have similar commodities and tend to compete with each other in the global market.

Furthermore, ASEAN member states' trade relations are arguably in need of an upgrade. Intra-regional trade among ASEAN members is lower than their extra-regional trade relations. The ASEAN Economic Community Chartbook 2017 shows that intra-ASEAN trade in goods has not changed significantly since 2005 and remains at around 23% of the total region's trade in goods. In this regard, it can be argued that the AEC may not be able to achieve meaningful progress, especially in promoting export-import activities among ASEAN members. This also reflects



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the fact that ASEAN members have low level trade interdependency in the region. Considering this circumstance, Indonesia, as the biggest market in ASEAN, will not gain much from market expansion under the AEC, particularly because Indonesia's domestic market is larger than some other ASEAN member states combined. On the contrary, Indonesia can offer a big market and can be the main target for foreign investment for the other ASEAN member states. Therefore, expanding the ASEAN regional cooperation to the other six countries will be more beneficial for Indonesia rather than only under the AEC.

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The initiative to expand regional cooperation outside ASEAN only started in the early 2000s. It took around a decade to consolidate ASEAN FTAs with other Asian countries through the establishment of the RCEP. The RCEP is proposed by ASEAN as a compromise to reconcile two different approaches proposed by China and Japan. China proposed a limited FTA under the East Asia Free Trade Area (EAFTA) involving ASEAN+3 (China, Japan and the Republic of Korea). This was intended to ensure China's leadership in the process. On the contrary, Japan wanted to have a broader FTA to include other trading partners outside East Asia by recommending the Comprehensive Economic Partnership for East Asia (CEPEA). By broadening the membership to include Australia and India, Japan intended to mitigate China's sole influence. These two positions reflect the rivalry between the two major economic powers in the region¹⁰².

To resolve this situation, ASEAN then proposed a different model, emphasising ASEAN leadership by establishing the RCEP¹⁰³. Even though in terms of its membership, ASEAN's RCEP is closer to Japan's position, ASEAN centrality has become the main characteristic of RCEP. RCEP negotiations, however, are predicted to be a difficult process considering the historical conflicts and unresolved disputes, especially regarding border and territories, among Japan, China and South Korea. Furthermore, India, which is regarded as the new economic power in Asia, is also a notoriously difficult country to negotiate with in international trade negotiations¹⁰⁴. Nevertheless, it is necessary for RCEP to cope with some overlapping problems resulting from different regulations and rules under the ASEAN+1 FTA.RCEP is therefore intended to solve the 'noodle bowl' effect in the region¹⁰⁵.

As is evident from the IA-CEPA negotiations, RCEP intends to expand the free market and reduce trade barriers (both tariff and non-tariff barriers) as well as harmonising the existing trade regulations.



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Box 2. Issues Negotiated on RCEP ¹⁰⁶

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The negotiations of RCEP cover a wide range of issues including:

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- a. Market access for both trade in goods and services
- b. Investment and competition policy
- c. Sanitary and Phytosanitary (SPS) measures

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- d. Dispute settlement mechanisms
- e. Rules of origin
- f. Custom procedures and trade facilitation
- g. New trade issues such as the environment, labor, intellectual property rights protection, e-commerce, movement of natural persons, small and medium enterprises, government procurement.

If RCEP negotiations can be concluded, the RCEP will be one of the most comprehensive regional economic

cooperations in the world. So far, it has already

been perceived as a more advanced regional cooperation mechanism compared to the existing FTAs in the region, such as the ASEAN Free Trade Area (AFTA) and the other FTA initiatives under the ASEAN-Plus (either ASEAN+1 FTAs or ASEAN+3)¹⁰⁷. During the latest RCEP Intersessional Ministerial Meeting in March 2018, the ministers reiterated their commitment to expedite negotiations on rules, trade facilitation and investment in order to enhance the expansion of regional value chains¹⁰⁸.

Similar to the country's interests in the IA-CEPA, Indonesia also aims to utilise the RCEP to enlarge its market access and reduce trade barriers implemented by trading partners involved in the RCEP. Furthermore, Indonesia expects that the RCEP can support the flow of regional production in the Asia Pacific region. Each member of the RCEP has its own competitive advantage and can be complementary in supporting the regional production network. The RCEP is therefore expected to integrate the fragmented production process in the Asia Pacific region. In doing so, as the extension of ASEAN economic integration, once concluded the RCEP will provide a platform for countries in the region to act collectively and to increase their influence in the global economy¹⁰⁹.



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Conclusion

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With the stagnation of the global trading system under the WTO, the Indonesian government is actively pursuing its main international trade interests through various FTAs, including the IA-CEPA and the RCEP. In general, the Indonesian government has similar objectives in both of these trade initiatives. These objectives include increasing market access, reducing trade barriers (both tariff and non-tariff barriers), protecting the domestic market and producers, improving the country's global competitiveness, as well as promoting a regional production network. Previous explanations have shown that, in its effort to achieve its international trade objectives through trade liberalisation, the Indonesian government is strategically maximising its role by actively designing the rules of the game. Furthermore, it can also be argued that Indonesia's involvement in these two initiatives reveals Indonesia's endeavour to become an agenda maker, not just an agenda taker, in international trade negotiations.

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Although Indonesia's main interests are similar in both IA-CEPA and RCEP negotiations, one can argue that the Indonesian government may put more effort into RCEP than IA-CEPA negotiations for several reasons. Firstly, as previously discussed, the existing data shows that Indonesia has been involved in more regional trade negotiations than bilateral initiatives. This indicates the Indonesian government's preference to achieve its international trade objectives via a regional approach rather than a bilateral one. Secondly, reaching an agreement in IA-CEPA negotiations will be significantly more difficult since the IA-CEPA includes a lot more 'sensitive' topics and sectors such as finance, agriculture, and services. Thirdly, supporting the first reason, given that RCEP involves much wider participants, the majority of which are major Indonesian trading partners, Indonesia will clearly prioritise the RCEP over the IA-CEPA (or any bilateral trade initiatives). To conclude, it can be argued that improved Indonesia-Australia economic relations could be better achieved through a regional strategy, such as the RCEP, rather than through a bilateral strategy, such as the IC-CEPA.



снартев IV. Indonesia–India relations in the Indo-Pacific

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Natalie Sambhi

Indonesia-India relations in the Indo-Pacific

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Author: Natalie Sambhi

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The Indo-Pacific is the prime geostrategic construct for Indonesia and India. Covering both the Indian and Pacific Oceans, it reflects Indonesia's self-conception as a critical nexus between them, located at the heart of Southeast Asia. As a result, the Indonesian government has shown greater interest in the Indo-Pacific construct in recent years. In early 2018, Indonesian President Joko Widodo unveiled a vision for the Indo-Pacific with "Indonesian characteristics" during the ASEAN– India meeting in New Delhi, based on principles of "openness, transparency and inclusion"¹¹⁰.

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Being at this critical location also means vulnerability for Indonesia. With 260 million inhabitants and the world's 16th largest economy, Indonesia is a significant regional player. But it is not yet a regional power, at least as measured in security and military terms. Nor is the stability and the security of the region guaranteed. An uncertain US role in regional security, China's militarisation of South China Sea land features, recurrent standoffs with the North Korean regime, as well as pressing environmental and technological challenges, all demand long-term thinking and regional cooperation. If Indonesia is not proactive in shaping how states in the region behave it could be subject to the whims of stronger states. As Indonesian Foreign Minister, Retno Marsudi, noted in a speech earlier this year: "Indonesia, along with Southeast Asian countries... MUST continue to be the prominent player in the creation of a regional architecture"¹¹¹ (emphasis in original).

In the absence of key levers of military power or economic heft, Indonesia's regional strategy must rely on diplomacy and norms. There are a number of multilateral fora that cover the Pacific and Indian Ocean areas, the most significant of which include the Association for Southeast Asian Nations (ASEAN), the East Asia Summit (EAS), and the ASEAN Regional Forum (ARF). While these institutions offer a patchwork of treaties, norms and rules, there is no overarching institution that provides regional governance for the Indo-Pacific region¹¹². With India's regional ambitions growing under Prime Minister Narendra Modi, Indonesia and India could collaborate to help transform the Indo-Pacific from being primarily a geostrategic construct to one with more-developed normative and institutional architectures.

This chapter explores the growing relationship between Indonesia and India in the context of the Indo-Pacific, focusing on the prospects for developing Indo-Pacific norms and institutions. The first part examines the history of Indonesia–India ties, from 1945 to the Jokowi–Modi era, to help identify the potential for and limits of



future cooperation. The second discusses Indonesia's vision of the Indo-Pacific and India's place within this, before critically assessing three proposed Indo-Pacific frameworks.

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History of Indonesia-India relations

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In addition to early trade interactions, Indonesia and India share a common cultural and religious heritage rooted in Hinduism, Buddhism and Islam. Some of Indonesia's best known architectural treasures are Prambanan, a Hindu temple, and Borobudur, a Mahayana Buddhist temple, both constructed in the 9th century in Central Java. In the middle of Indonesia's capital Jakarta, there is a dramatic statue depicting the Hindu figures Arjuna and Krishna riding a chariot pulled by horses. Indonesia's national emblem is the *Garuda*, a mythical bird found in three of India's oldest religions, while the name is also synonymous with the country's national airline carrier and is used for the military's peacekeeping contingents.

Despite the enduring cultural and religious linkages, Indonesia and India's diplomatic ties were, until recently, relatively underdeveloped. They share a common experience as postcolonial nations born during the aftermath of World War II, a current status as emerging market democracies, and share foreign policy principles such as nonalignment. Thus, there has been great potential for foreign policy convergence and cooperation. Three main periods mark the diplomatic relationship. The first from 1945 to the late 1950s heralded a promising beginning, characterised by an anti-colonial outlook and close personal ties between the leaders. A second period of coolness occurred from the early 1960s to the early 1990s, when Indonesia progressively aligned with the US while India aligned with the Soviet Union. A third is marked by growing convergence since the 1990s, with India's Look East policy, Suharto's departure in 1998, and the arrival of populist and reformist leaders in the form of Narendra Modi and Joko Widodo.

There is resonance between the founding ideologies of Indonesia and India which, in short succession, gained their independence from colonising powers¹¹³. This ideology was expressed in the 1955 Asian–African Conference (also known as the Bandung Conference) hosted by Indonesia's first president Sukarno. This conference which was a show of solidarity with leaders, mostly from newly independent Asian and African states. Set against the backdrop of the Cold War, it addressed several issues of common concern including the lack of agency of African and Asian states in the global order, increasing China–US tensions, and colonialism.

The Bandung conference later developed into the Non-Aligned Movement (NAM) in 1961, which included Sukarno and India's first Prime Minister, Jawaharlal Nehru, as



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two out of the five founders. NAM's aims were to resist neocolonialism, colonialism and imperialism; and to safeguard the interests of (mostly developing) states not wishing to side overtly with either of the Cold War superpowers. As evidence of the early tight-knit relationship, Sukarno was invited as the first chief guest at India's inaugural Republic Day commemoration in 1950¹¹⁴. In this era, both countries adopted the tenet of 'nonalignment' which in their foreign policy and strategic outlook. However, this early affinity between Indonesia and India did not develop further into strengthened ties during the decades that followed.

From the early 1960s, diplomatic relations cooled significantly. Sukarno's increasingly close ties with China stood in stark contrast with the Sino-Indian border dispute of 1962. Relations deteriorated further over Indonesia's support of Pakistan in the Indo-Pakistan war from August to September 1965. Indonesia's foreign policy also moved away from nonalignment, with the transfer of power from Sukarno to Suharto in 1966. Under Suharto, Indonesia's foreign policy focused on the stability and security of the immediate region in order to foster economic growth. This meant immediately ending Konfrontasi with Malaysia, building ties with the West, and joining with four other non-Communist Southeast Asian states to form ASEAN in 1967. As Dewi Fortuna Anwar has put it, "Suharto was not one for displays of Third World solidarity"¹¹⁵. For its part, India's nonalignment did not withstand the test of Cold War politics. In light of Pakistan's relationships with the US and China, coupled with the Sino-Indian War in 1962, India and the Soviet Union signed the Treaty of Peace, Friendship and Cooperation in 1971. The Soviet Union became a major arms supplier of India's military.

The post-Cold War era saw several changes that helped draw Indonesia and India closer together. With the end of alignment, Indonesia was able to play a more active role in the NAM and help redefine the organisation in search of a new raison *d'etre*. As chairman of NAM, Suharto also sought to build dialogue between developed and developing economies by seeking a meeting with the leaders of the G7¹¹⁶. As the Soviet Union was India's main strategic and trade partner, the dissolution of the superpower forced India to liberalise its economy and diversify its strategic relationships. Significantly, Prime Minister P.V. Narasimha Rao initiated a 'Look East' policy in 1991, designed to develop closer ties between India and Southeast Asia. India's relationship with ASEAN also blossomed: becoming a strategic dialogue partner in 1992; signing ASEAN's Treaty of Amity and Cooperation (TAC) in 2003; and negotiating the India-ASEAN Comprehensive Economic Cooperation Agreement (IA-CECA) in 2004.



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In 1998, Suharto stepped down and Indonesia ushered in a new era of *Reformasi* and democratisation. Indonesia's occupation of East Timor had strained relations with the US over the Dili massacre in 1991 and ruptured relations with Australia over perceptions of interference in sovereignty issues. However, the imperatives of counterterrorism cooperation in a post-9/11 and post-Bali Bombing era helped foster better relations. Under successive presidents from B.J. Habibie onwards, Indonesia's foreign policy grew increasingly globalist; culminating in the second term of the Susilo Bambang Yudhoyono administration between 2009 and 2014. With GDP growth of 7% per annum and a rising middle class, Yudhoyono sought a role for Indonesia as a diplomatic actor and norms builder commensurate with its growing global status.

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During this period there were a number of significant bilateral developments. In 2005, during a state visit to India, Yudhoyono and Indian Prime Minister Manmohan Singh signed a Joint Declaration on Establishing a Strategic Partnership. In 2011, Yudhoyono was invited as chief guest at India's Republic Day, for only the second time after Sukarno. During that visit, a number of agreements were signed, including one to launch negotiations for the Bilateral Comprehensive Economic Cooperation Agreement¹¹⁷. During Singh's visit to Indonesia in 2013, both sides agreed to strengthen the Strategic Partnership in five areas: Strategic Engagement, Defence and Security Cooperation, Comprehensive Economic Partnership, Cultural and People-to-People Links, and Cooperation in Responding to Common Challenges¹¹⁸. The strong economic growth of both states, their growing international clout and increasing diplomatic ties formed a strong foundation for subsequent administrations to develop into shared leadership and deeper cooperation in the Indo-Pacific.

The Jokowi-Modi era

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The Indonesia–India relationship has continued to develop with the election of both Jokowi and Modi in 2014. Jokowi's grassroots appeal and results-oriented approach propelled him from Governor of Jakarta to being the seventh President of the Republic of Indonesia. Jokowi's key foreign policy priorities relate to his vision of Indonesia as a 'Global Maritime Fulcrum' (*Poros Maritim Dunia*), situated strategically between the Indian and Pacific Oceans. His vision includes significant investment in the country's major ports and highways, alongside upgrades to Indonesia's maritime defence capabilities. Jokowi's foreign policy also differs significantly from the internationally-focused style of his predecessor. In addition to supporting the Global Maritime Fulcrum, Jokowi's "pro-people's diplomacy" means the country's diplomatic efforts will be directed towards areas that reap direct



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benefits for the people, particularly economic diplomacy, with diplomats charged with attracting investment and promoting Indonesian products¹¹⁹.

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Jokowi is known for eschewing grand foreign policy gestures and multilateral engagements. Nonetheless, there are vestiges of Indonesia's post-Independence activism in his hosting of the Asian–African Conference in 2015, which commemorated the 60th anniversary of the first meeting. Themed "Strengthening South-South Cooperation to Promote World Peace and Prosperity", the conference aimed to reinvigorate the 'Bandung spirit' of solidarity among developing states. It aimed to address the "use of unilateral force without a clear UN mandate" and "to eliminate the domination of one group of countries over other countries".¹²⁰ Such initiatives are nascent but modest attempts to encourage Indonesia's leadership in the Indo-Pacific.

Modi's political career has followed a similar trajectory. He also had an ambitious domestic agenda focused on development, based on his successes as Chief Minister of Gujarat. India's foreign policy under Modi therefore is geared towards, among other things, attracting foreign direct investment to help transform India's manufacturing sector into a global hub. However, greater strategic competition between China and India has provided further impetus for the latter to seek strengthened partnerships. India has boosted ties with Southeast Asia through a new-look Look East Policy called 'Act East', which was announced by Modi at the 12th ASEAN–India Summit and 9th East Asia Summit in 2014. The Act East policy aims to increase India's clout by boosting strategic engagement with partners through "connectivity, culture and commerce"¹²¹. In January 2018, Modi hosted the ASEAN–India Commemorative Summit in New Delhi to mark the 25th anniversary of dialogue ties, during which all ASEAN leaders were invited collectively as the chief guests for Republic Day 2018.

The Jokowi–Modi era is marked by an intensifying of bilateral ties. On Jokowi's first bilateral visit to India in December 2016, the leaders issued a joint statement saying:

Prime Minister Modi and President Widodo noted that India and Indonesia are friendly maritime neighbours with deep civilizational links between the people of the two countries, including the common heritage of Hinduism, Buddhism and Islam. They underscored the importance of pluralism, democracy, and rule of law as key values to achieve peaceful co-existence. They welcomed the convergence in the political, economic and strategic interests of the two countries that provides an enduring basis for a long-term strategic partnership¹²².



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Notably, the leaders issued a separate statement on maritime issues and welcomed the signing of a Joint Communiqué on illegal, unregulated and unreported (IUU) fishing¹²³. In January this year, both foreign ministers met in Jakarta for the fifth meeting of India–Indonesia Joint Commission in New Delhi, discussing a number of topics including terrorism, trade and tourism¹²⁴.

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India-Indonesia relations were elevated to a new level in May 2018, during an official visit by Modi to Indonesia. This summit produced a landmark statement – *the Shared Vision of India-Indonesia Maritime Cooperation in the Indo-Pacific*¹²⁵ – which built upon and greatly extended previous developments. First, it marked first time the two countries had used the "Indo-Pacific" as a frame for their bilateral relationship, anchoring it in a mutually-agreed concept of what constitutes the region. Second, it included a normative statement of values on how the region should be governed, emphasising a "*free, open, transparent, rules-based, peaceful, prosperous and inclusive Indo-Pacific*". Third, it outlined a range of concrete collaborative mechanisms the two government would initiate to achieve this vision, which included:

- 1. Efforts to enhance trade and investment flows (both bilaterally and regionally), with a focus on maritime issues and connectivity between the Andaman and Nicobar (India) and Sumatera (Indonesia) islands.
- 2. Sustainable development of marine resource, including stock management, deterrence of illegal fisheries, and combating marine pollution
- **3.** Cooperation in disaster management, through geotechnical information sharing, preparedness planning and joint response exercises.
- 4. Fostering people-to-people links via tourism, education and cultural exchanges
- 5. Augmenting regional maritime security, with an objective of developing the Indo-Pacific security architecture "anchored in ASEAN mechanisms"
- 6. Science and technology cooperation, focused on the space and marine domains

The articulation of this 'shared vision' indicates a growing awareness of, and appetite for, the impact which India-Indonesia collaboration may have on the development of a new Indo-Pacific regional architecture. Moreover, the flurry of activity prior to and within this vision represents a growth in bilateral ties based on maritime cooperation; which could potentially serve as a basis for other areas of cooperation in other areas. But while the two countries now have a declared 'shared vision' of the Indo-Pacific, there nonetheless remains some differences in how they are incorporating it into their foreign policies and strategic outlooks. Given these commonalities and differences, it is worth exploring the utility of the 'Indo-Pacific'



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Chapter IV: Indonesia-India relations in the Indo-Pacific // Natalie Sambhi

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as the shared geostrategic construct within which bilateral collaboration and cooperation will increasingly be located.

Indonesia's view of the Indo-Pacific

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Indonesia's current orientation towards the Indo-Pacific must be read in the context of its domestic and broader foreign policies. Since Jokowi's election in October 2014, foreign policy has been more focused on progressing domestic goals such as attracting investment. Only recently has Jokowi shown explicit interest in the Indo-Pacific as a construct.

Indonesia's vision for the Indo-Pacific has its genesis in the Yudhoyono era. Indonesia first came to adopt the concept in Yudhoyono's second term (2009–2014). Speaking in 2013, Foreign Minister Marty Natalegawa defined the Indo-Pacific as "an important triangular [sic] spanning two oceans, the Pacific and Indian Oceans, bounded by Japan in the north, Australia in the south-east and India in the southwest, notably with Indonesia as its center... [The Indo-Pacific comprises] some of the most dynamic economies in the world, with a rising role not only in the evolving global economic architecture, but also in the political arena as well"¹²⁶. Natalegawa championed the idea of an Indo-Pacific-wide treaty of friendship and cooperation as a normative framework to build trust and confidence, commit parties to respect a code of conduct, and provide a "new paradigm in the region's inter-state relations" that entailed an absence of preponderant power¹²⁷.

The concept of an Indo-Pacific had largely remained dormant in the first years of Jokowi's presidency. In unveiling his Global Maritime Fulcrum vision in November 2014, Jokowi preferred the term 'PACINDO' to refer to the interconnected system of the Indian and Pacific Oceans¹²⁸. However, the Indo-Pacific has appeared more prominently in Jokowi's speeches, particularly in his New Delhi pronouncements in January. He believes, an "ASEAN-lead mechanism and partnership between ASEAN and India will bring a peaceful, stable and prosperous Indo-Pacific"¹²⁹. His vision of Indo-Pacific management involves preventing power projection of any one country, using a 'building-blocks' approach to strengthen bilateral and plurilateral frameworks, and integrating Indian and Pacific Ocean cooperation mechanisms.

Indonesia does not see the Indo-Pacific as a means of containing China. As Evelyn Goh recently observed, the historic role of Southeast Asia as crossroads means the sub-region does not think of sides, but expects there to be 'competing powers'¹³⁰. In Indonesia's case, the weight of nonalignment coupled with that historic role means Indonesia's foreign policy is receptive to China. For Jokowi, this bodes well as domestic policies of infrastructure development are dependent



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on Chinese investment. There are some quarters of the government, bureaucracy and military that view China's militarisation in the South China Sea with suspicion. However, Indonesia's pronouncements are not as pointed towards China as those of others. At India's Raisina Dialogue in January this year, Indonesian Defence Minister, Ryamizard Ryacudu, identified disputes in the South China Sea as a crucial security issue; yet praised China's goodwill and its willingness to cooperate on security architecture¹³¹. In stark contrast, in February the US' Pacific Command Chief Admiral Harry B. Harris called China's military build-up "provocative and destabilizing" and dismissed China's claim that the build-up was a forced response to US freedom of navigation as disingenuous¹³².

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India's view of the Indo-Pacific

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India's view of the Indo-Pacific is more complex than Indonesia's, largely due to negative perceptions of China's role in regional security. As the 2017 China– India border dispute in the Doklam region attests, there is potential for military confrontation due to miscalculation between the two land powers¹³³. Therefore, for India, it is critical that major players such as the US, Japan and Australia are engaged in the Indo-Pacific. To that end, and despite its long-held nonaligned posture, India has improved its strategic ties with other major powers in the region. This was marked by the signing of the 'US–India Joint Strategic Vision for the Asia-Pacific and Indian Ocean Region' in 2015¹³⁴. In recent years India and Japan's relationship has intensified from a 'Global and Strategic Partnership' in 2006 to a 'Special Strategic and Global Partnership' in 2014¹³⁵. India is also expanding defence cooperation in Southeast Asia, with India and Vietnam recently stepping up strategic ties¹³⁶.

Amidst this diversification of strategic partnerships, Modi has unveiled a greater leadership role for India in the Indo-Pacific during his keynote speech at the Shangri-La Dialogue in June 2018. The speech unequivocally demonstrated that India has adopted the Indo-Pacific as a key pillar for its foreign policy and strategic thinking. In Modi's words, "the destiny of the world will be deeply influenced by the course of developments in the Indo-Pacific region."¹³⁷ While his speech did not deviate from the substance of policies such as Act East, Modi cleverly reworked the utility of the Indo-Pacific concept for his purposes, stating that oceans have had "an important place in Indian thinking since pre-Vedic times."¹³⁸ Modi presented India as the defender of regional order, stating towards the end that his country would "promote a democratic and rules-based international order, in which all nations, small and large, thrive as equal and sovereign."¹³⁹



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However, strategic non-alignment remains an element in – if no longer a formal doctrine guiding – Indian foreign policy. While the phrase 'non-alignment' was not explicitly used, emphasis was placed on the diversity (and non-exclusivity) of the diplomatic ties which India is seeking to build in the Indo-Pacific. To underscore the point, Modi touched on India's many strategic partnerships, particularly with Japan, Russia and the US. The importance of good Sino-Indian relations were also central, with Modi arguing that "strong and stable relations between our two nations are an important factor for global peace and progress".

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India has also engaged in Indo-Pacific cooperation via participation in the recently revived Quadrilateral Security Dialogue (known as the Quad). The Quad has emerged as an informal strategic dialogue among the Indo-Pacific states of Australia, India, Japan and the United States. Although first initiated in May 2007, the Quad was relaunched in November 2017 as officials met at the ASEAN and East Asia Summit in Manila¹⁴⁰. India views the Quad as an important alternative mechanism through which it can advance its strategic interests, particularly in relation to China¹⁴¹. Yet the perception in Beijing that it is an 'Asian NATO' designed to contain China¹⁴² could dissuade Indonesia and other Southeast Asian states from close association.

How India balances its ambitious vision of the Indo-Pacific alongside participation in the Quad remains unclear. Modi poignantly omitted any reference to the grouping in his Shangri-La address, pointing out instead that "India does not see the Indo-Pacific Region as a strategy or as a club of limited members."¹⁴³ The most noteworthy developments thus far bode well for Indonesia's pronouncements on the Indo-Pacific, pointing to greater convergence between India's and Indonesia's strategic interests.

Norm building in the Indo-Pacific

Indonesia has three potential avenues for advancing its vision for the Indo-Pacific architecture. The first uses an ASEAN-centric framework. As Jokowi argued in January 2018, there are ASEAN-centric agreements and mechanisms that could form the basis of Indo-Pacific architecture¹⁴⁴. ASEAN has a successful track record in encouraging states to either accede to or partner with its mechanisms. This includes the ASEAN Regional Forum, the requirement to sign the TAC to join the East Asia Summit, and its network of six 'ASEAN+1' free trade agreements. This 'ASEAN-Plus-partners' approach could be used to connect important Indo-Pacific partners to the much-broader set of ASEAN dialogue and coordination mechanisms. This would ensure ASEAN Centrality would be preserved, its interests would be foregrounded, and that the norms of non-interference and the renunciation of threat or use of force would continue¹⁴⁵.



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However, this approach could constrain Indonesian policy options. If Indonesia sees ASEAN as a critical fulcrum around which Indo-Pacific norms are built, ASEAN will need greater institutional capacity and sense of unity amongst the membership. In practical terms, that means properly funding and staffing the ASEAN Secretariat in Jakarta, and/or being prepared to lobby other states to do so. As funding comprises equal contributions from members, increases are therefore limited by the contributions of the smallest economies. An ASEAN-centric approach might work also against Indonesia's 'free and active' foreign policy posture. Dewi Fortuna Anwar makes this point, stating that the NAM provided Indonesia greater latitude as a diplomatic actor compared to the "smaller and more limiting ASEAN forum"¹⁴⁶. Without the constraint implied by the ASEAN norms and processes, there are opportunities for a more flexible foreign policy agenda. ASEAN's consensus-based decision making could also impede agreement on controversial issues in the security sphere.

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The second approach is a hybridrisation of regional frameworks. One of Jokowi's proposals for an Indo-Pacific framework is to integrate Indian and Pacific Ocean fora¹⁴⁷. This would mean fostering greater linkages between existing multilateral processes, which would encouraging a hybrid regime of overlapping and organic institutions to arise. The challenge of this approach is finding convergence between a large number of actors and initiatives spread over a geographically expansive region. This is especially pronounced given the relative under-development of Indian Ocean institutions when compared to their Asia-Pacific counterparts¹⁴⁸, and the constraints this imposes for cross-regional linkage building.

Looking at just the Indian Ocean half of the Indo-Pacific, there have been positive but only nascent developments. During Indonesia's chairmanship between 2015 and 2017, IORA produced three key strategic documents. In March 2017, regional heads signed the Jakarta Concord which contains several commitments, including the promotion of maritime security and trade¹⁴⁹; adopted the IORA Action Plan 2017–2021¹⁵⁰; and signed the 'Declaration on Preventing and Countering Extremism and Violent Extremism'¹⁵¹. However, unlike other regional fora, IORA is still characterised by low-levels of institutionalisation. At present, IORA hosts several official-level and ministerial-level meetings in areas including marine tourism and women's empowerment. However, these remains far less developed than those of ASEAN or APEC, both in terms of their number, scope, and degree of institutionalisation¹⁵². While a hybridisation model linking Indian Ocean and Asia-Pacific institutions may be attractive, it is also a long-term strategy which would require considerable prior efforts at institution building within IORA.



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A third proposal would be for a grouping of democracies, potentially through Indonesian engagement with the Quad countries (which is sometimes characterised as a 'democratic' grouping). The shared value of democracy is a powerful way for leaders to justify closer cooperation. However, it is unclear whether the Quad states would use the dialogue mechanism to promote democratic values more overtly. In encouraging security cooperation with non-democratic partners like Vietnam, the Quad states do not seem to require democracy as a precondition for security cooperation¹⁵³. This raises the question: is a grouping of democracies appropriate for Indonesia, if regional cooperation necessitates working together with partners such as Vietnam and China? A democracy-based normative framework is likelier to survive by overlapping with other Indo-Pacific frameworks, rather than as the framework for the Indo-Pacific.

Conclusion

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Indonesia and India are key players in the Indo-Pacific region, and in 2018 publicly declared a shared vision for the new regional construct. It is in Indonesia's and India's respective interests that the Indo-Pacific region develop normative and institutional frameworks to foster conditions for regional peace and stability. However, Jakarta's hitherto ASEAN-centric approach may not fully align with India's broader-based approach to Indo-Pacific diplomacy. The prospects for future growth in bilateral relations will depend on whether they adopt ASEAN-, linkage- or democracy-based frameworks for guiding their regional diplomacy initiatives. To this end, emerging regional powers such as Indonesia and India will have to work together with a sense of urgency to develop the future governance of a peaceful Indo-Pacific.



CHAPTER V. MIKTA as a potential node of Australia-Indonesia cooperation

Melissa Conley Tyler, Evan Keeble and Ellisa Kosadi

MIKTA as a Potential Node of Australia-Indonesia Cooperation

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Author: Melissa Conley Tyler, Evan Keeble and Ellisa Kosadi

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Australia-Indonesia relations are facing a time of change. Political and economic relativities have shifted. The old stereotypes of Australia as rich and Indonesia as poor have transformed with Indonesia projected to rise to one of the world's five largest economies; by contrast Australia will at best remain in the top 20¹⁵⁴. Australia's approach to its relationship with Indonesia will need to adjust to different realities and navigate this change. One of the biggest issues will be to retain some attention from an Indonesia that increasingly sees itself as a bigger, more important country than its southern neighbour. Are there institutions that can potentially assist with the changing relations between these two sometimes tense neighbours?

This article looks at a case study of a relatively new multilateral initiative, the Mexico, Indonesia, Korea, Turkey and Australia (MIKTA) grouping, to determine whether it offers the potential to boost Australia-Indonesia cooperation. Is the MIKTA grouping a potential node for cooperation between Indonesia and Australia? If so, how might it be used?

A detailed analysis of how MIKTA fits into Australia's and Indonesia's approaches to foreign policy suggest that it has limited potential for Indonesia-Australia relations, and is not likely to become a major node for Australia-Indonesia cooperation. While MIKTA fits well within Australia's conception of itself as a middle power, it does not fit well with either Indonesia's current foreign policy objectives nor its conception of its role in international affairs. Coupled with MIKTA's low profile in Indonesia, this means it is unlikely to be considered as a significant forum for Indonesia-Australia cooperation.

What is MIKTA?

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MIKTA is an acronym for the grouping of Mexico, Indonesia, Korea, Turkey and Australia. This grouping was created on the sidelines of the September 2013 UN General Assembly meeting in New York, and has held meetings at foreign minister, senior officials and non-government levels since then.

At first glance the nature of the grouping is not obvious: there is no shared language or geography, no shared culture, and no strong historical ties. The countries, however, all define themselves as 'democracies that benefit from open economies with robust growth rates and a significant level of economic power'¹⁵⁵. They see themselves as strategically located and strongly linked to their surrounding



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regions in all aspects. All MIKTA nations are also G20 members, which is where their relationship is rooted. These are assets which provide a strong foundation for the grouping¹⁵⁶.

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MIKTA is a direct analogue to the BRICS grouping: Brazil, Russia, India, China and South Africa¹⁵⁷. Made up of five of the seven G20 nations belonging to neither the BRICS nor the G7, MIKTA is sometimes explicitly referred to as a 'middle power' grouping¹⁵⁸, although others dislike this moniker as selling short Australia 'as a real player with real interests'¹⁵⁹. Alex Oliver argues:

"[Calling] such a group "middle powers" is beside the point: It's what they do, not what they're called, that counts"¹⁶⁰.

MIKTA can be seen as a vehicle to increase its members' influence in the international sphere through a group of their own. MIKTA nations are able to pool resources, exchange points of view, consult and promote coordination on issues of common interest. They also possess the potential to establish a block of 'swing vote shareholders' within international fora¹⁶¹. Together, MIKTA members ought to have the potential for more serious impact in international fora than they would have alone¹⁶².

While not determining any formal program, the eight Joint Communiqués released by MIKTA to 2017 identify many areas for increased collective effort including counter-terrorism, resisting protectionism, aid effectiveness, the post-2015 development agenda, cyberspace security, climate change, human rights and migration, as well as the need for UN Security Council reform¹⁶³. On these issues MIKTA can act as a counterbalance to potential domination by the G7 and BRICS, and therefore as an attempt to increase its member nations' international influence. In the 2014 Joint Communiqué, MIKTA foreign ministers noted that "the gradual transformation of the international system opens a window of opportunity for their countries to further develop their constructive and conciliatory role in tackling pressing international issues"¹⁶⁴.



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MIKTA's track record and prospects

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MIKTA has not set itself overly ambitious goals. Its focus has been on regular and consistent engagement at both foreign minister levels and below. From its inception in 2013 to 2017, MIKTA has convened twelve senior level meetings and issued eight joint communiqués¹⁶⁵. It has also released fourteen joint statements on issues such as disaster relief, climate change, development, North Korean nuclear testing, terrorism, human rights, gender equality and good governance. Instead of aiming to focus on one particular issue, MIKTA has looked to increase its role in global governance to give the grouping greater clout in the international community.

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MIKTA has hosted exchanges for young professionals, journalists and diplomats and has created an academic network¹⁶⁶. To date, MIKTA has held twelve workshops on issues such as trade and investment, e-commerce, development cooperation, and gas security. In addition to this, it has also hosted several outreach events, including a 2016 International Women's Day event in Canberra and an interfaith and intercultural dialogue in Yogyakarta.

MIKTA has been able to engage with important members of the community such as academics, the private sector and youth. For example, during Australia's term as chair in 2016 MIKTA held dialogues on issues including: counter-terrorism and security, trade and economy, gender equality, good governance, sustainable development and international energy governance¹⁶⁷.

It can be argued that MIKTA's relatively low profile up to this point is caused by a lack of something specific to do. Andrew Carr has characterised MIKTA as "cooperating without a purpose"¹⁶⁸. Andrew Cooper has suggested that to avoid the group's momentum slowing down, MIKTA nations must meet at the leader level to amplify their impact and to ensure that their presence in the hub of global governance is maintained¹⁶⁹. However, to date MIKTA has rejected the idea. MIKTA sees itself as more of a tool of diplomacy as opposed to a coalition of nations. As such, its members believe it is most appropriately driven at the foreign ministry level¹⁷⁰.

MIKTA can arguably best be understood through soft power and persuasion as part of "a broader model of international statecraft"¹⁷¹. MIKTA's members have a significant interconnection of alliances and overlapping institutional memberships, meaning that the senior officials regularly meet with one another in a large variety of international settings.

One possibility for MIKTA, then, is to focus on creating solutions for shared global problems and leveraging its soft power to encourage others to adopt these



solutions. Indeed, MIKTA has made efforts to do exactly that. At the UN in May 2017 on the 2030 Agenda for Sustainable Development, the MIKTA foreign ministers made a joint statement urging the UN to "deliver integrated strategic analysis and policy advice as well as facilitate resource mobilization" in order to best assist the international community to achieve sustainable development and eradicate poverty¹⁷². MIKTA has the potential to find success in these actions due to its "genuine combination of such geographical diversity with an abundance of common interests ... [that] enables member countries to build cultural, social, geographical, and economic bridges in its multilateral debates"¹⁷³.

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There is no lack of suggestions as to how MIKTA can achieve the goals it has set including: taking a common stand on important international issues, instituting common agencies, offering services for dispute mediation, sharing lessons with developing countries and acting together to build global governance¹⁷⁴. However, MIKTA's activities need to reflect its membership and the level it meets. The MIKTA countries have some sway in international affairs, but are by no means great powers. The key limitation for MIKTA is that it can only function where there is a commonality of interest on a particular issue. This can be hard to achieve, especially with such a geographically and culturally diverse membership.

An example of this is the issue of nuclear non-proliferation. Colakoglu argues that this is one area where MIKTA nations can act successfully, since no MIKTA nation is a nuclear power¹⁷⁵. However, in practice MIKTA countries have not presented a united front on this issue. On the UN General Assembly Resolution L.41 to convene negotiations in 2017 on a legally binding instrument to prohibit nuclear weapons leading towards their total elimination, Indonesia and Mexico voted in favour of the resolution while Australia, South Korea and Turkey all voted against it¹⁷⁶. Australia cited several reasons for opposing the resolution including that the measure would be premature, ineffective and would potentially have adverse consequences for regional and global security¹⁷⁷. This suggests that while the MIKTA countries may be able to find and work on common ground, on issues of strategic significance MIKTA will take a backseat.



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Australia's approach to MIKTA

Australia's Minister for Foreign Affairs, Julie Bishop, has been enthusiastic towards MIKTA. After hosting the eighth MIKTA foreign ministers' meeting in November 2016, Bishop praised MIKTA's "informality and its agility", and pointed to MIKTA's ability to deal with any regional or global challenges, as opposed to being limited to a narrow agenda, as a key strength¹⁷⁸. Australia took on the role of chair in 2016, hosting the Second Senior Officials' Meeting in January, the Second MIKTA Speakers' Consultation in October, and the Eighth MIKTA Foreign Ministers' Meeting in November.

The Department of Foreign Affairs and Trade has identified achievements in multiple arenas, including: counter-terrorism and security, trade, gender equality and sustainable development¹⁷⁹. Australia has displayed a willingness to be involved in MIKTA and a high level of commitment towards it. Observers see Australia's active involvement in MIKTA in line with its initial decision to become part of MIKTA to increase Australia's

"weight and reputation as a competent, creative and active member of the international community"¹⁸⁰.

The most useful way of viewing Australia's involvement in MIKTA is through the often-used idea of a 'middle power'. While a debate on the definition of 'middle power' has raged for decades¹⁸¹, it is a role definition that has often be used to describe Australia's foreign policy¹⁸². Carl Ungerer points out that, while the concept of Australia as a 'middle power' has been both inconsistent and malleable, since 1945 the concept "has provided the one and perhaps only consistent framework for the conduct of Australian diplomacy"¹⁸³.

The term 'middle power' can be used descriptively or normatively. Descriptively, Australia is demonstrably a middle power, as one of "a diverse group of states that are neither 'great' nor failing, but which occupy a conceptual territory between these extremes"¹⁸⁴. As well as describing Australia's place in an imagined league table, the term 'middle power' can also be used normatively to suggest how Australia should respond to its place in the international system. In the words of former Minister for Foreign Affairs, Gareth Evans, "As a middle power, not a great power, not a major power, we don't have the clout militarily, economically or politically, to rely on anything other than our capacity to persuade"¹⁸⁵.

This suggests that Australia needs to be both activist and internationalist: activist in using its diplomatic skills and energy in pursuit of national interests and



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internationalist in employing multilateral diplomacy¹⁸⁶. It also extends to being activist about the international system itself: a key characteristic of middle powers is "their commitment to multilateral institutions, the rule of law and norms constraining the use of power"¹⁸⁷. According to then Shadow Minister for Foreign Affairs Kevin Rudd:

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The central characteristic of Australian middle power diplomacy has been coalition building with like-minded states in order to create the political momentum necessary to bring about multilateral diplomatic outcomes. This is because while Australia is not a super power, it is nonetheless a significant power, with a keen interest in shaping the strategic order.¹⁸⁸

If the best characterisation of MIKTA is to see it as a case of five nations working together as classic 'constructive middle powers' – that is, countries that 'firmly believe in institutional frameworks to solve disputes and reach consensus on different areas of the international agenda'¹⁸⁹ – it is a multilateral initiative that fits comfortably within a conception of Australia as a 'middle power'.

Indonesia's approach to MIKTA

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When the initiative was established in 2013, some considered Indonesia's participation in MIKTA surprising, as Indonesia rarely refers to itself as a "middle power" country¹⁹⁰. Unlike Australia's long history of using the term, Indonesia almost always consider itself a "big country", a view which emphasises a self-perception of Indonesia's importance and influence on the world's stage that has been ingrained since its founding days¹⁹¹. The evidence to date appears to bear this out.

Despite its high-level meetings, MIKTA has not received credit for any major breakthrough or collaboration, with the consequence that the initiative remains relatively unknown by the Indonesian public. Since 2015, fewer than ten articles by *Kompas, Okezone.com, Antaranews.com, Detik.com* and *The Jakarta Post* have mentioned MIKTA at all. Even among experts it does not have a high profile. One Indonesia-based expert noted "I haven't heard anyone talk about it"¹⁹² while in forums like the Australia-Indonesia Dialogue it is rarely mentioned. The lack of opinion and news on MIKTA suggests that the initiative is not heavily promoted by the Indonesian government.

Indonesia is expected to take a more active approach in 2018, as it takes the chair for the first time. Rizka Prabaningtyas suggests that Indonesia's leadership will encourage Indonesia to be more active in order to leave a 'legacy' from its time as



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chair¹⁹³. She compares the situation to Indonesia's leadership in the Indian Ocean Rim Association (IORA) between 2015-17. IORA, which was established in 1997, also did not receive much local coverage until Indonesia took on the leadership and held a summit in 2017.

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Given President Jokowi's interest in stimulating the domestic economy and trade, Indonesia will most likely pursue the economic potential of the MIKTA initiative. During the Eleventh MIKTA meeting in December 2017, Indonesian Vice Minister of Foreign Affairs A.M. Fachir outlined plans to focus on the creative economy sector as well as peacekeeping and security initiatives while continuing to support MIKTA's other core missions including energy, sustainable development, gender equality and good governance and democracy¹⁹⁴.

The underlying problem is the mismatch between MIKTA's membership and middle power ambitions, versus Indonesia's more expansive views of its potential global role. Indonesia's size as the largest archipelago, and one of the most populated countries in the world, has given Indonesia its confidence as a nation. The country has long realised its rising prominence and potential to be influential in the world stage, which was repeatedly emphasised by President Susilo Bambang Yudhoyono. More recently, President Jokowi has emphasised the pursuit of international leadership by prioritising strengthened national security and identity as a maritime country in his campaign and his Nawa Cita leadership guidelines¹⁹⁵.

Whether Indonesia can achieve its 'big country' aspirations is a different question. Indonesia has arguably never played an agenda-setting role in any of the multinational groupings it is involved in¹⁹⁶ and faces a set of challenges such as an unclear economic trajectory, an underdeveloped diplomatic capacities and a weak military¹⁹⁷. This raises questions about its potential for performing a 'major power' role.

Indonesia is not likely to walk away from MIKTA. Indonesia has good relationships with other MIKTA members and it can be useful to extend outreach and trade to South America through Mexico, a region with which Indonesia does not have strong ties. It can be a tool to further Indonesia's relationship with Turkey, as fellow Muslim-dominated developing countries where religion plays an important role in gaining political popularity. There are pressures from the Indonesian public for the nation to play a more important role in international affairs¹⁹⁸, and chairing MIKTA presents the opportunity to do so.



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This suggests there will be a focus on MIKTA during its chairing year, especially on economic initiatives. The question will be whether it has any longer-term traction as an important grouping for Indonesia.

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MIKTA's potential for Australia-Indonesia cooperation

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MIKTA has limited potential as a node for Indonesia-Australia cooperation. First, evidence suggests that MIKTA has a low profile in Indonesia. This makes it unlikely to be the 'go to' forum used for important national interests. While MIKTA could potentially be used to multilateralise issues that Australia and Indonesia find difficult to discuss bilaterally, there is no evidence of it being used in this way to date, and its low profile makes it unlikely to be considered as such a forum in the future. While it is possible to imagine Australia trying to refer such topics to MIKTA where the weight of other MIKTA members may assist in getting Indonesia's attention, it is not clear that this would be effective in resolving difficult bilateral matters.

Second, given the importance placed on economic issues by the Indonesian government, there is a mismatch between MIKTA's agenda and Indonesia's international priorities. Unless MIKTA sharply focuses its agenda to show more potential to boost economic development and trade, its part in Indonesia's international diplomacy will remain marginal.

Third, MIKTA does not equally fit with both countries' conceptions of their role in international affairs. There is a mismatch between how Australia and Indonesia see their involvement in MIKTA as part of their approaches to foreign policy:

- The MIKTA case fits well within Australia's 'middle power' role conception of engaging in multilateralism with the motive of increasing its influence in the international system. This fits whether this middle power behaviour is conceived of as an 'influential rule of law state' or 'thought leader' or as a 'good international citizen', the latter of which has been described as one of Australia's primary foreign policy identities¹⁹⁹. Australia's engagement with MIKTA can be seen as fitting this role conception.
- By contrast, Indonesia has a role conception of a 'big country' that focuses more on fulfilling its aspirations to be a major global player and leader of the region²⁰⁰. In line with this, the Jokowi administration has adopted foreign policies less focused on the perspective of the international community and with little interest in nurturing foreign relations that do not have direct and tangible advantages for the Indonesian domestic economy. This is evident from the agenda proposed by Indonesia as the new MIKTA chair²⁰¹.



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MIKTA's vision statement, which demonstrates a focus on tackling global challenges through the frameworks of the UN and international law²⁰² (MIKTA, 2015), is closer to Australia's vision than Indonesia's.

MIKTA is thus unlikely to emerge as a significant node for Indonesia-Australia cooperation. It undoubtably has useful benefits, such as allowing for meetings and exchanges between Australian and Indonesian officials and civil society. The positives of such contact should not be underestimated. However, this is far from becoming a major mode for cooperation.



CHAPTER VI. Economic ties: The missing piece in the Australia-Indonesia relationship?

Kyle Springer and Jeffrey Wilson



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Economic ties: The missing piece in the Australia-Indonesia relationship?

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Authors: Kyle Springer and Jeffrey Wilson

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Despite their proximity, and extensive set of bilateral cooperation mechanisms, it is difficult to describe Australia and Indonesia as economic partners. The two have unexpectedly low levels of trade and investment links for economies which share a border. Yet they share characteristics that suggest economic relations could be stronger. Australia and Indonesia are large, open and diversified economies. Both countries are democracies. Indonesia has strategic significance for Australia, both from a security and economic points of view. All of Australia's trade with Northeast Asia passes through the Indonesian archipelago. Indonesia will become more important for Australia as its economy grows and becomes the world's fourth-largest economy by 2050²⁰³.

A brief overview of trade relations amongst the G20 economies reveals the paucity of Australia-Indonesia economic ties. Table 1 on next page lists the share of two-way trade in 2016 amongst the sixteen contiguous dyads within the G20 (states which share either a land or maritime border). It reveals that Indonesia and Australia have the lowest bilateral trade volumes of any contiguous pairing within the G20, accounting for 2.8 and 2.0 percent of each other's two-way trade respectively. Even Russia - which was the subject of economic sanctions by some G20 members during 2016 - had deeper trade relations with several of its sanctioners than those between Australia and Indonesia! The economic relationship between Australia and Indonesia is far weaker than their shared border, and joint status as global economic powers, would seemingly imply.

The main bilateral initiative deployed to rectify this gap in Australia-Indonesia economic relations is the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA). It is currently under negotiation. The goal of the agreement is to create a framework for closer economic connections, by addressing barriers to trade (both tariffs and non-tariff barriers) while improving mutual access to service markets. It also seeks to increase bilateral investments through facilitation and regulatory cooperation measures. The Australian and Indonesian governments launched IA-CEPA in 2010, and they held the first formal negotiation rounds in 2013²⁰⁴. After a hiatus, negotiations recommenced in 2016. The current target to finalise negotiations is October or November 2018²⁰⁵.

This chapter explores the factors which have kept Australia and Indonesia from realising a trade and investment relationship concomitant with their regional



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Partner A	Partner B	Share of A's trade with B	Share of B's trade with A
US	Canada	14.9%	64.0%
US	Mexico	14.3%	63.5%
Russia	EU	44.4%	2.1%
Turkey	EU	42.8%	1.6%
Korea	China	23.5%	6.9%
China	Japan	7.5%	21.7%
Brazil	Argentina	7.0%	20.0%
Germany	France	7.6%	16.5%
Italy	France	9.8%	7.4%
Russia	China	14.2%	1.9%
Korea	Japan	8.0%	5.7%
India	China	11.4%	1.9%
Indonesia	India	4.7%	2.4%
Russia	Japan	3.2%	1.3%
Russia	US	3.7%	0.6%
Indonesia	Australia	2.8%	2.0%

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Table 1: Two-way trade amongst contiguous members of the G20, 2016

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Source: Authors' calculations, from UNCTADStat Database

economic status and geographic proximity. It examines the state of their trade and investment ties – both with each other, and with other partners in Asia – to measure how Australia-Indonesia economic relations compare. It then reviews the factors which have posed barriers to deeper economic ties, in order to identify policy mechanisms and strategies could be employed to address the problem. Finally, this chapter will argue that Australia and Indonesia should simultaneously pursue both bilateral and regional efforts for economic cooperation, which will provide better results than a strict focus on bilateral trade through IA-CEPA.



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Australia-Indonesia economies ties in context

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Taking stock of the Australia-Indonesia economic relationship in its regional context helps to gauge the relative performance of bilateral ties. Figure 1 shows Australia's two-way trade with key Asian partners. Reflecting the importance of geography for trade ties, the data show that Australia has a high level of trade integration with Asia. In 2016, Asian partners accounted for two-third of Australia's trade; with most relationships relatively stable while China's grew dramatically over the last decade due to surging resource exports. However, Indonesia forms a relatively small component. It has consistently sat at around 2 percent of Australia's trade, with no discernible growth for over a decade. It is consistently smaller than trade with India (despite advantages of geographical proximity); and is only a fifth the size of trade with the rest of the ASEAN bloc (despite Indonesia's prominent role within this grouping). Australia trades far more with distant economies in the region than with its closest neighbour.

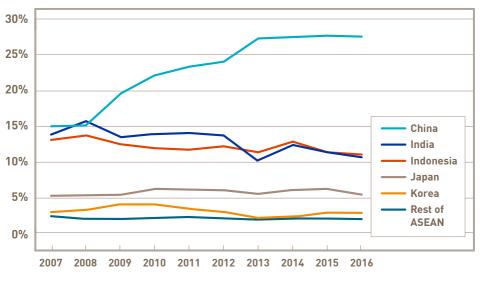


Figure 1: Share of Australian two-way trade with Asian partners, 2007-16



Source: Authors' calculations, from UNCTADStat Database.

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Figure 2 shows Indonesia's trade relationships in the region, revealing a similar pattern. Given Indonesia's positioning within regional value chains spanning the ASEAN economic bloc, its trade with ASEAN is somewhat higher (26 percent to Australia's 11 percent), but the two countries otherwise share a similar focus on regional partners. Like Australia, Indonesia's trade is heavily biased to Asian partners, with particular growth with China in recent years driven by resource exports. And Australia is not a leading trade partner. Australia accounts for a marginally larger portion of Indonesia's two-way trade than the reverse (around 3 percent), but the share is low and has remained so for some time. For both sides, geographical advantages have clearly not translated into an economically meaningful trade relationship.

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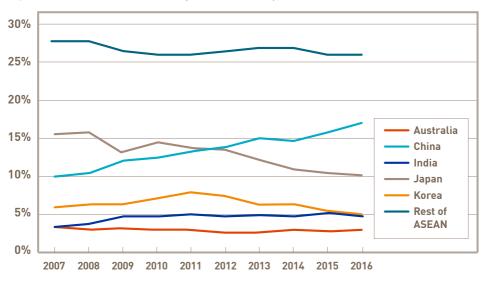


Figure 2: Share of Indonesian two-way trade with Asian partners, 2007-16

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Source: Authors' calculations, from UNCTADStat Database



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While Australia's exports to Asia (and China in particular) attracts considerable public attention, it should be remembered that investment is equally important as trade in goods and services.²⁰⁶ Australia's investment is far more successfully integrated with English-speaking countries than any other country grouping. Australia's top two sources of foreign investment stocks are the United States (\$896.9 billion) and the United Kingdom (\$481.4 billion). They also attract the most investment from Australia: USA (\$664.5 billion) and United Kingdom (\$333.1 billion). Australia's top sources of investment from Asia include Japan (\$219.2 billion) and Hong Kong (\$116.6 billion). Top destinations for Australian investment in Asia include Japan (\$125.1 billion) and China (\$77.1 billion)²⁰⁷.

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Table 2 below shows that bilateral investment flows between Australia and Indonesia are perilously small. There is a small amount (USD 6 billion) of Australian investment stocks in Indonesia, with the direct investment component accounting for only 1 percent of Australia's outbound and 3 percent of Indonesia's inbound. While Indonesian investment in Australia is negligible (and primarily concentrated in residential property), this is less surprising given their different development levels and Indonesia's role as a net capital importer. Nonetheless, the comparatively low Australia-to-Indonesia flows are a cause of concern. Investment is a crucial indicator of economic integration, because it reflects a high level of confidence in the receiving country's regulatory environment, requires a more significant commitment than flexible trade flows. Trade and investment flows are also connected. Research has shown that foreign investment boost exports between investment partners²⁰⁸.

		Australian stocks in Indonesia	Indonesian stocks in Australia
Bilateral Investment (USD millions)	Total	6347	1055
	FDI	4177	7
	Portfolio	2170	1048
FDI shares	Of sender outward	1.05%	Neg.
	Of recipient inward	2.86%	Neg.
Total investment shares	Of sender GDP	0.52%	0.01%
	Of recipient GDP	0.74%	Neg.

Table 2: Significance of Australia-Indonesia bilateral investment, 2015

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Source: Authors' calculations, from ABS (2016), *International Investment Position, Australia: Supplementary Statistics* (Cat No. 5352.0) and *UNCTADStat Database*.



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What holds bilateral economic relations back?

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This picture of how Australia and Indonesia's economic relationship is performing in its regional context allows for an examination of the factors leading to low levels of bilateral trade and investment. Broadly speaking, six explanations have been offered for the comparative weakness of the relationship

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- 1. A lack of economic complementarity
- 2. Persistent tariff and non-tariff trade barriers
- 3. Excessive regulation

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- 4. Risk perceptions amongst businesses (especially Australian businesses toward Indonesia)
- 5. Lack of connectivity due to distant population centres
- 6. Trade diversion due to the "noodle bowl" of regional free trade agreements

The complementarity argument posits that the two economies are sectorallystructured in such a way that there are few gains to be made from trade: what Indonesia exports Australia doesn't need, and vice versa. Trade is relatively small because there is not substantial demand in either country for the other's major exports; and without trade there is little to crowd-in bilateral investment. Palm oil provides one example. Indonesia is the world's largest producer and exporter. However, demand is low in Australia because it is a controversial product blamed for deforestation. Meanwhile, Australia's top export, iron ore, is principally sold to Northeast Asia because Indonesia does not have a large steel industry. Compounding this problem, both economies are rich in energy resources such as coal and natural gas, and compete with each other for market share in regional consumption centres²⁰⁹.

One area of trade in which there is complementarity is in agriculture. Wheat has been one of Australia's leading exports to Indonesia for the past sixty years. Australia has a comparative advantage here since wheat does not grow in Indonesia's tropical climate. Live cattle are another area, because Australia has an abundance of grazing land that does not need to be cleared. Indonesia has a comparative advantage in food processing due to low labour costs, which accounts for 20 percent of Indonesia's manufacturing sector output²¹⁰. However, its export of processed foodstuffs remains challenging because of Indonesia's food security policy, its desire to become the centre of ASEAN's food production and protectionist measures placed on imports of agricultural products²¹¹.



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Second, this lack of economic complementarity is compounded by a range of trade barriers in those sectors where complementarity does exist. Protectionist measures on both sides can be blamed throughout the history of Australia-Indonesia relations. For example, in 1974 Indonesia banned the import of fully assembled cars and in 1975 Australia placed quotas on Indonesian textile imports²¹². More recent examples include fluxing Indonesian quotas on Australian live cattle and Australia's temporary ban on live cattle exports (which has a similar effect as a protectionist measure)²¹³, and Australia imposing 'dumping duties' on Indonesian paper exports²¹⁴.

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Through free trade agreements like the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA), both countries have reduced many tariffs; however some significant barriers still remain. AANZFTA aimed to cut tariffs on certain goods and covered competitive Australian agricultural products like wheat and beef²¹⁵. Australian wine and liquor have tariffs up to 170 percent. Live cattle face a five percent tariff. The relatively modest level of tariff reductions in AANZFTA reflects its status as an ASEAN+1 FTA, which reflected the preferences of the ASEAN bloc as a whole (rather than reforms specific to the Australia-Indonesia trade relationship). The bilateral IA-CEPA is expected to provide tariff liberalisation better tailored to the two countries' needs, but delays in negotiation and uncertainty over its completion mean this may take some time to take effects.

Third, broader (non-trade) regulatory frameworks within both countries sometimes also hold back otherwise trade and investment relations. As early as 1986, McCawley²¹⁶ noted that Indonesia and Australia have complementary labour markets: un- and semi-skilled versus skilled ones. This would normally be expected to result in the export of labour-intensive commodities from Indonesia to Australia, and the export of services in the reverse direction. "Guest worker" arrangements - particularly in Australia's labour-intensive and export-oriented horticultural sectors - would provide a mechanism to facilitate such a pattern. However, social and political concerns in the intervening years have rendered exchanges like this politically sensitive in both countries²¹⁷. Other regulations and processes discourage investment. In Indonesia, businesses cannot be wholly owned by foreign entities, and there are restrictions on the types of property foreigners can buy. This poses barriers to Australian investment in Indonesia, and the export of capital, skills and knowledge that such investment flows bring.

Fourth, another explanation is that Australian businesses either assess Indonesia as posing too great investment risks; and/or don't perceive the country as a significant opportunity market or investment destination. We have seen above that while Australia's trade is highly integrated with Asian economies, the bulk of



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its outbound investment flows to mature and low-risk jurisdictions such as the US and EU. These economies have similar political institutions and business culture to Australia, and very reliable regulatory environments by international standards. In contrast, Indonesia poses a very different operating environment to those with which Australian firms have experience. Australian businesses are averse to problems like corruption, the market distorting effects of state owned enterprises (SOEs), and risks associated with intellectual property rights - all of which are perceived to be barriers to investment in Indonesia.

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Yet despite the low levels of bilateral trade and investment, a few cases exist which suggest Australia can do business successfully with and in Indonesia. A prominent example is the long-term LNG sales agreement of 2017 between Woodside and Indonesia's Pertamina, which is expected to go into force in 2019. Another is the Interflour processing mill in Cilegon West Java, a joint venture between Indonesia's Salim Group and Australia's CBH²¹⁸. Australian businesses also work successfully in complex regulatory environments and different business cultures across Asia, particularly in China and Japan. These cases suggest there is no a priori reason that different business systems and risk profiles should entirely prohibit bilateral investment relationships between the two countries. Rather, what is lacking is a narrative within both business communities that joint projects between Australia and Indonesia offer unique opportunities for both sides.

Fifth, another problem is that despite the fact that Indonesia and Australia share a maritime border, their population centres are far apart. Australia's population is concentrated in the south and eastern part of the country, while Indonesia's is concentrated on the western side of the archipelago, particularly on the island of Java. Between these two concentrations of population lies the vast Australian landmass and the Timor, Arafura, and Coral seas (see Figure 3). These natural barriers and distance between the two population centres do not lend themselves to easy, timely and low-cost exchanges of goods and/or people. Businesses have complained of high cost of shipping and a lack of frequent services to and from both countries²¹⁹.



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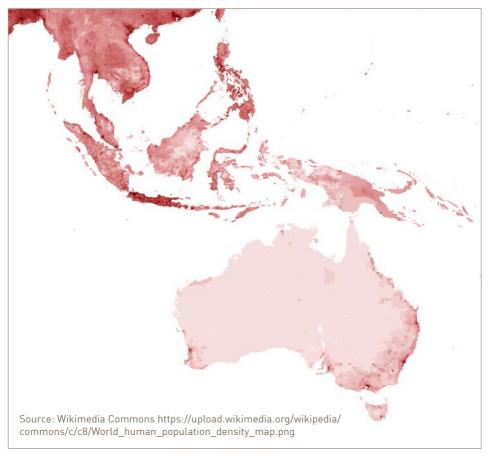
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Figure C: Population heat map of Southeast Asia and Australia



Finally, another problem which could be diverting trade away from otherwise natural partners is the "noodle bowl" problem facing the regional trade architecture. This is the proliferation of overlapping bilateral free trade agreements criss-crossing the region. These agreements have different tariff liberalisation provisions, and do not adopt consistent regulatory approaches to issues such as investment, services, customs procedures of rules-of-origin arrangements. By the end of 2015, fifty-two bilateral FTAs had been negotiated between Asia-Pacific governments, and a further fifty-four were signed with parties outside the region²²⁰.



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Trade economists see the 'noodle bowl problem as bad for trade liberalisation because it creates a multitude of different trade rules and regimes. This contributes to a phenomenon known as 'trade diversion', which occurs when trade flows are redirected to fit with the tariff preferences within bilateral FTAs rather than underlying patterns of comparative advantage and economic complementarity. The noodle bowl also undermines regional trade integration by forcing businesses to navigate and maintain compliance with complex and overlapping sets of bilateral trade rules. These transaction costs are especially prohibitive for small- and medium-enterprises, who are particularly represented in the sectors of importance for Australia-Indonesia trade (such as agriculture and services). While bilateral FTAs in the region have increased the trade between their members, they have done so as a cost of trade diversion, and in some cases have erected new barriers to trade from third parties. For this reason, trade economists typically refer to these as preferential rather than free trade agreements²²¹.

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The explanation for weak trade and investment ties between Australia and Indonesia is not monocausal. Rather, it can be attributed to a mix of these six factors, which can combine in problematic ways. In energy, there are few formal trade barriers but economic complementarity is missing. While in areas of complementarity, the prospects for trade may be undermined by trade barriers (agriculture), complex regulations (investment and services), and or distance to markets and missing infrastructure (manufactures). Across the board, this leads to very limited patterns of engagement between Australian and Indonesian businesses, such that neither side has much understanding of the other or considers it high on their priority list for new investment opportunities.

Addressing one or two of these problems alone probably would likely be insufficient to improve Australia-Indonesia economic relations. An effective solution must be to address these in unison, ensuring that their complex interactions are dealt with as a whole rather than individual parts. While this reasoning informed the launch of bilateral IA-CEPA negotiations, the long and arduous nature of the negotiations, and uncertainties around their future, indicate that alternate strategies should also be considered. One such strategy might be adopting a regionally-focussed approach, which could solve a wider array of these problems than bilateral initiatives alone.



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Beyond the bilateral: A regional approach to Australia-Indonesia economic relations

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Notwithstanding future progress on IA-CEPA, there are also a range of regional mechanisms which Australia and Indonesia can use to better institutionalise their economic relations. Three such regional mechanisms are especially prominent

- 1. Enlarging membership of the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP, also known as the 'TPP-11) to include Indonesia and other countries in Southeast Asia
- 2. Pushing for the conclusion of an effective Regional Comprehensive Economic Partnership (RCEP) agreement with significant tariff reductions
- 3. Joint collaboration within new infrastructure initiatives in the region

The CPTPP and RCEP are both 'mega-regional' trade agreements spanning many economies in the Indo-Pacific. Each offers a different model of regional economic integration, different opportunities, and different memberships. In RCEP, Australia and Indonesia are both major parties to the agreement, and are amongst the largest economies in the group. The RCEP is still under negotiation. Meanwhile the CPTPP has been finalised, but not yet in effect as it needs to be ratified by member countries. The CPTPP includes Australia but not Indonesia.

The RCEP offers a modest reform agenda, which reflects the agreement's orientation toward the trade interests of developing countries in the Indo Pacific and focusses on traditional barriers to trade like tariffs, quotas, and customs procedures²²². This regional agreement, under negotiation between the ten ASEAN members and their 'Plus Six' FTA partners²²³, includes both Indonesia and Australia. Ten out of Australia's fifteen top trade partners are parties to the agreement²²⁴. For Indonesia, the RCEP group also encompasses Indonesia's major trading partners like China, Japan, Thailand, and Singapore. If RCEP is finalised, it will go some way to further reducing tariffs and non-tariff barriers amongst its members, particularly for Indonesian tariffs on Australian agricultural products.

As Winanti argues in his book, Indonesia considers RCEP a more important agreement because of its regional scope, and will therefore prioritise RCEP over bilateral ones like IA-CEPA²²⁵. Most of Indonesia's existing agreements are regionally-focussed and are ASEAN-centred initiatives with other countries like Japan and India. Pursuing economic ties with Indonesia using a regional agenda may also match Indonesia's interests in integrating with Asia. This means that Australian trade negotiators are likely to secure better outcomes by using RCEP as a vehicle to address barriers to further the development of trade and investment ties.



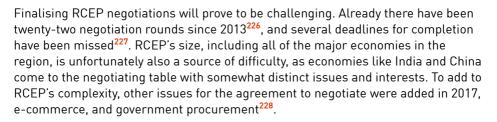
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The CPTPP offers a more ambitious model of economic reform. Signed in early 2018, it is a 'bridging' agreement that enables the former Trans-Pacific Partnership to enter into force in the absence of the US, following its withdrawal under the Trump Administration. While the CPTPP suspends several intellectual property provisions from the original TPP, the agreement still sets new "WTO-Plus" trade laws which will harmonise the regulatory policies of members that function as barriers to trade and investment²²⁹. The agreement addresses regulatory policies in areas such as labour standards, environment, transparency and anti-corruption, state-owned enterprises, investment, services and e-commerce. This could help address some of the 'behind the border' regulatory issues currently facing Australia-Indonesia trade and investment relationships.

Australia should encourage expanding the membership of the CPTPP to include Indonesia. Indonesia would offer considerable credibility and weight to the trade bloc, adding another 250 million people and add another US\$1 trillion of GDP. The CPTPP might also act as an external lever for the kinds of reforms Indonesia would need to undertake to begin to attract more investment from Australia. One of the problems identified above was that Australian businesses perceive Indonesia as a risky market. Through the chapters on labour standards, transparency and anti-corruption, and the state-owned enterprises (SEO) sector, the CPTPP would considerably raise Indonesia's attractiveness as a destination for foreign investment.

Indonesia has given some indication it is interested in joining the CPTPP. In April 2018, Indonesia's finance minister Sri Mulyani Indrawati said Indonesia wants to join the agreement but the country has other economic priorities to focus on first²³⁰. Australia should actively encourage its accession. It might help to also secure South Korea's membership and other ASEAN members. Then the CPTPP will include most of Indonesia's top trade partners (except the US and China) and most of its close neighbours including Australia, Malaysia, Singapore, and Brunei. This could create a stronger incentive for Indonesia to join, especially since some of Indonesia's competitors are already members of the CPTPP, namely Vietnam and Malaysia²³¹.



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Two new infrastructure initiatives in the region - the China-led Asian Infrastructure Investment Bank (AIIB) and the Japan-led Partnership for Quality Infrastructure (PQI) - also offer important opportunities:

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- Launched in 2015, the AIIB has US\$100 billion of subscribed capital which is specifically dedicated to fund infrastructure projects throughout the region. Both Australia and Indonesia are founding members of the bank, and Indonesia was amongst the first countries to which it made loans²³². As the AIIB moves from a start-up to operational phase, it is in need of bankable infrastructure projects in Asia in which it can invest. Opportunities exist for Australia and Indonesia to work together to ensure some of this capital is directed towards the infrastructure needed to deepen their trade relations.
- The PQI is a similar initiative, launched by Japan in 2015²³³. Working with the ADB, Japan will provide USD\$110 billion of additional capital for regional infrastructure projects by 2020²³⁴. Given the long-standing relationship between Indonesia and Japan in the infrastructure space, it is likely that much PQI activity will occur in Indonesia. Australia is also in a position of influence with Japan, having worked together to finalise the CPTPP in recent months. The PQI thus offers a similar opportunity for Australia-Indonesia collaboration to attract infrastructure investment.

Leveraging these institutions and the funds available, Australia and Indonesia can work together to ensure quality infrastructure projects are delivered in the Indo-Pacific region which promote integration and facilitate access to new markets and the movement of goods and services. New seaports, airports, railroads can help Australia and Indonesia speed goods to each other and establish efficient supply chains with other countries. Eastern Indonesia, which is Indonesia's least developed and connected part of the country, is also closest to Australia's major population centres. Improving connectivity will help commerce flow to the underdeveloped regions of Indonesia.



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Conclusion

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Australia and Indonesia's economic relationships are yet to live up to their full potential. Problems like lack of economic complementarity, trade barriers, distance of population centres, incompatibility of regulatory frameworks, and perceived investment risks keep bilateral economic ties from growing. While completion of IA-CEPA negotiations would go some way to beginning to address these issues, a bilateral trade agreement alone should not be expected to solve all these problems. Complementing bilateral efforts through regionally-focussed initiatives, such as regional trade agreements and joint efforts in multilateral development banks, would ensure a multi-pronged approach to improving economies ties.

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RCEP can reduce conventional barriers to trade such as tariffs; while the CPTPP's regulatory reforms reforms can address some of the issues which hold back bilateral investment. Infrastructure development will increase the physical connectivity on which trade and investment relies. In this regional context, bilateral efforts such as IA-CEPA can then be tailored to focus specifically on issues unique to the economic sectors which can drive the growth of Australia-Indonesia trade. Additionally, negotiators from both countries will gain experience working together on difficult trade issues, build trust, and develop better understandings of the opportunities and challenges for economic integration. Pursuing bilateral and regional efforts concurrently provides the best way to ensure a mutually beneficial and growing relationship between the Australian and Indonesian economies.



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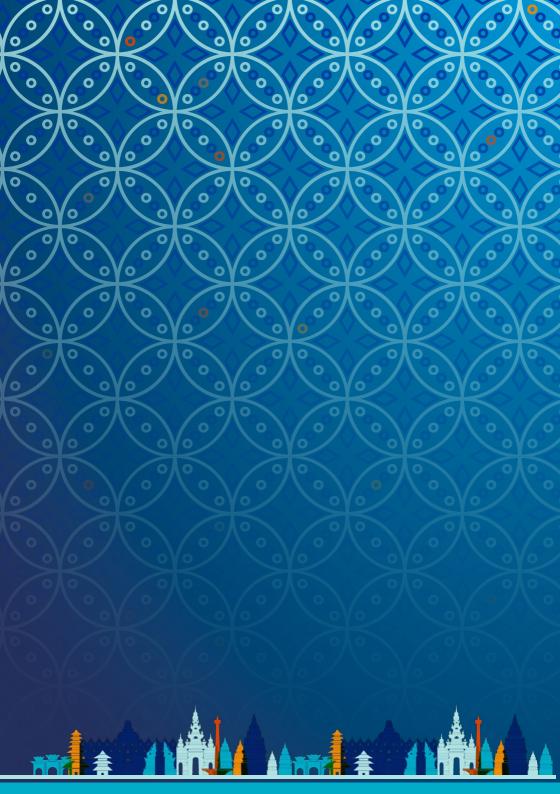
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