



Perth USAsia Centre

THE POWER
OF PROXIMITY:
**ENHANCING
AUSTRALIA-INDONESIA
ECONOMIC RELATIONS**

Australia-Indonesia Working Group Report

September 2017



Acknowledgements

Professor L. Gordon Flake would like to express sincere thanks to the members of the Working Group and to Mr Omar Harris, Vice Consul to Perth, Republic of Indonesia, Ms Mila Tarigan, Assistant to the Consul to Darwin, Republic of Indonesia and to the Perth USAsia Centre events team.

This report may be cited as:

This report may be cited as: Perth USAsia Centre, "The power of proximity: Enhancing Australia–Indonesia economic relations". Outcomes from the meeting held on 21st July 2017.



Perth USAsia Centre

M265, 3rd Floor, Old Economics Building,
The University of Western Australia,
35 Stirling Highway, Crawley WA 6009,
Australia

@ perthusasiacentre@uwa.edu.au
🐦 @PerthUSAsia 📘 PerthUSAsia
🌐 PerthUSAsia.edu.au
📌 linkedin.com/company/perth-usasia-centre

CONTENTS

2 INTRODUCTION

3 KEY TAKEAWAYS

6 RECOMMENDATIONS

7 ABOUT THE PERTH USASIA CENTRE'S AUSTRALIA-INDONESIA WORKING GROUP MEETING REPORT

MEETING HELD ON 21 JULY 2017

8 ENDNOTES





THE POWER OF PROXIMITY: ENHANCING AUSTRALIA-INDONESIA ECONOMIC RELATIONS



INTRODUCTION

Indonesia is one of Australia's most important bilateral partners and Indonesia will continue to grow in geostrategic importance over the next twenty five years. Indonesia's economy is on track to continue growth at a rate of 3 percent per year driven by demographics alone but if reforms are undertaken, growth in Indonesia may reach 6 percent per year. However, Australia's existing levels of economic engagement with Indonesia do not reflect the importance of the relationship or account for Indonesia's future position in the global economic order. Reports such as¹ *The World In 2050* by PwC forecast Indonesia will become the world's fourth largest economy by the midpoint of this century, that Indonesia will move into the G8 and that Australia would likely drop out of the G20. The cost, therefore, of Australia failing to fully maximise economic engagement with Indonesia is self-evident.

"If Australia does not dramatically deepen its trade and investment relationship with Indonesia today when the two economies are at relative parity, its ability to influence that relationship can only decrease.

In short, despite robust diplomatic, political and military ties Australia and Indonesia have yet to fully take advantage of the power of proximity."

In July 2017, Perth USAsia Centre convened a group of 18 experts on trade policy, diplomacy, and business to meet with distinguished guests, Dr Marty Natalegawa, Indonesia's former Minister for Foreign Affairs and Dr Mari Pangestu, Indonesia's former Minister for Trade and later Minister for Tourism and the Creative Economy.

This full-day event asked participants to look ahead to the year 2050 and examine ways Australia and Indonesia could cooperate in the economic realm. The group sought to answer the following questions:

1. **What are the basic assumptions about Indonesia's trajectory?**
2. **What should Australia focus on with its economic engagement with Indonesia?**
3. **How do we encourage Indonesia and Australia to view each other as strategic partners?**
4. **What does an ideal trade and investment agreement with Indonesia look like?**

The group had an extensive, in-depth discussion and, this report provides a summary of key takeaways and ten recommendations developed by the group to move the Australia-Indonesia relationship forward.



ENHANCING AUSTRALIA-INDONESIA ECONOMIC RELATIONS

Disclaimer: This report is a summary of the discussion held during the Australia-Indonesia Working Group meeting and does not necessarily reflect the views of individual members of the Working Group or of their respective organisations and government departments.

KEY TAKEAWAYS

The group discussed a number of features (listed below) that describe the current Australia-Indonesia relationship. These provide context to the Australia-Indonesia Working Group discussions and to the recommendations proposed by the participants.

- **Economic relations between the two countries are underdeveloped.** Indonesia is not among Australia's top ten trade partners. Australia's investment stocks in Indonesia are currently USD6.3 billion, which accounts for both a tiny fraction of Australian outbound and Indonesian

inbound foreign investment (*see table 1 below*). Indonesia is Australia's 14th largest trade partner (2.0 percent of total trade); while Australia is Indonesia's 9th largest partner (2.8 percent of total trade) (*see table 2 below*).

There are many factors which help explain the relatively low level of bilateral economic engagement. As two economies heavily dependent on natural resources, Australia and Indonesia are more naturally competitors and currently lack the complementarity that defines more vibrant bilateral ties.

Table 1: Significance of Australia-Indonesia bilateral investment, 2015

		AUSTRALIAN STOCKS IN INDONESIA	INDONESIAN STOCKS IN AUSTRALIA
Bilateral Investment (USD)	Total	\$6347 million	\$1055 million
	FDI	\$4177 million	\$7 million
	Portfolio	\$2170 million	\$1048 million
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.

Sources: Australian Bureau of Statistics (2016), International Investment Position, Australia: Supplementary Statistics (Cat No. 5352.0) and UNCTAD (2017), UNCTADStat Database.

Table 2: Australia and Indonesia Top-10 two-way merchandise trade partners, 2016

RANK	AUSTRALIA			INDONESIA		
	Country	Value (USD billions)	Share (%)	Country	Value (USD billions)	Share (%)
1	China	104.2	27.5	China	48.5	17.3
2	Japan	40.9	10.8	Singapore	29.1	10.4
3	US	30.5	8.0	Japan	28.3	10.1
4	Korea	20.9	5.5	US	22.7	8.1
5	Thailand	13.5	3.6	Thailand	14.5	5.2
6	UK	12.8	3.4	Malaysia	14.1	5.0
7	NZ	12.1	3.2	Korea	13.7	4.9
8	Germany	11.4	3.0	India	13.1	4.7
9	India	11.2	2.9	Australia	7.8	2.8
10	Malaysia	10.4	2.7	Vietnam	6.7	2.4
	World	379.0		World	280.1	
14	Indonesia	7.6	2.0			

Source: UNCTAD (2017), UNCTADStat Database.

THE POWER OF PROXIMITY: ENHANCING AUSTRALIA-INDONESIA ECONOMIC RELATIONS

Perceived risks and uncertainties in Indonesia mean potential projects need a higher rate of return to attract investment. This often prices out otherwise attractive investment projects. It is difficult to identify two bordering G20 countries who trade and invest in each other as little as Australia and Indonesia, meaning that bilateral economic engagement has not kept pace with political and security efforts. These relatively weak business and trade ties are surprising given that the geographic proximity of the two countries results in fast and low-cost transport routes between the two nations (as an example, it takes a grain ship a total of nine days to sail from the Kwinana Grain Terminal in Western Australia to Makassar and back).

- **The Indonesia – Australia Comprehensive Economic Partnership Agreement (IA-CEPA), will help reinvigorate bilateral economic ties and highlight the importance of the relationship.** IA-CEPA is currently being negotiated and when finalised, will be Indonesia's the second substantive bilateral trade and investment deal². Key provisions of importance include customs procedures, investment rules, services trade provisions, and sectoral cooperation (particularly in education and primary industries). However, IA-CEPA cannot be expected to solve all problems in the bilateral relationship; rather the agreement needs to be supported and by business ambition reinforced by more frequent bilateral economic dialogues between the relevant Australian and Indonesian ministries.
- **There is still a need for regular, structured meetings at the highest levels of government.** The implementation of an economic 2 + 2 dialogue with Australian and Indonesian Finance and Trade Ministers could build on the success of the Australia –Indonesia Foreign and Defence Ministers 2 + 2 Dialogue and the meetings of the Indonesia –Australia Ministerial Council on Law and Security. It is also important for Australian and Indonesian public servants to know their counterparts all the way up and down the hierarchy.
- **Bilateral crises derail progress on economic issues and Australia and Indonesia lack a mechanism to manage and communicate during diplomatic crises.** For example, IA-CEPA negotiations began in 2013 and then stalled. Negotiations did not start again until 2016.
- **Australia's past engagement with Asia has been focused on providing natural resources to China, Japan, and Korea.** Asia's development, growth and demand for natural resources like iron ore and natural gas were the driving force behind Australia's engagement with Asian neighbours over the past few decades. Australia will now need to take the initiative to drive the next phase of its engagement with Asia and in particular to redefine its relationship with Indonesia. Australia needs to recognise the importance of gateway cities and their proximity, such as Perth and Darwin in the ongoing dialogue with Indonesia
- **There are seven strategic challenges facing Indonesian innovation which provide opportunities for Australia:**
 1. Building human capital, particularly in an Indonesian education sector that delivers quality and matches skills to the right industries
 2. Opening access to development of natural resources
 3. Growing ideas into businesses through entrepreneurship
 4. Gaining access to traditional and innovative forms of finance and capital
 5. Increasing Indonesia's access to overseas markets and opening up Indonesia's markets to foreign businesses
 6. Developing a technology start-up ecosystem
 7. Loosening government regulation to allow Indonesia to fully support innovation.



ENHANCING AUSTRALIA-INDONESIA ECONOMIC RELATIONS

- **Difficulty in the movement of people between both countries continues to be an issue.** While there has been considerable progress in improving visa applications and other processes in recent years, Indonesians do not rank among the top 10 countries of origin for short-term visitors to Australia despite being “next door”. While Indonesia is second most popular destination for Australian short-term visits (mostly tourists), Indonesia has restrictions which discourage Australians from working and studying in Indonesia.
- **The global geopolitical “centre of gravity” is shifting to the Indo-Pacific region, where Australia and Indonesia are at the fulcrum, a new Indo-Pacific narrative is needed.** The economic rise of the Indo-Pacific region provides an ideal context for a narrative in which Australia and Indonesia work together towards their shared national interests of prosperity and security.
- **Looking ahead to 2050, our most pressing issues will require regional solutions.** Many of the non-traditional security concerns like people smuggling, climate change, and illegal fishing will require Australia and Indonesia to find ways to work together for the betterment of the Indo-Pacific.



The Working Group on Australia – Indonesia Relations delegation on 21 July



THE POWER OF PROXIMITY: ENHANCING AUSTRALIA–INDONESIA ECONOMIC RELATIONS



RECOMMENDATIONS

The following recommendations for taking advantage of “proximity” follow from the high-calibre working group discussion:

1. The Indonesia – Australia Comprehensive Economic Partnership Agreement (IA-CEPA) should be completed by the end of 2017. While negotiators should seek the highest quality agreement possible, they should not make the perfect the enemy of the good. The process is almost as important as the content, and without an agreement by the end of this year, it is unlikely the Jokowi Administration will be able to move forward beyond 2018.
2. Australia and Indonesia should establish an annual “economic 2 + 2” ministerial level meeting between Indonesia’s finance and trade ministers and Australia’s treasurer and trade minister.
3. The Prime Minister of Australia should commission a forward-looking Indonesian Economic Strategy White Paper to outline how Australia can support Indonesia’s economic reforms and to chart a pathway to improved economic relations by 2035. This would be similar to the India Economic Strategy report Prime Minister Malcolm Turnbull commissioned in April 2017, to be led by former Secretary of the Department of Foreign Affairs and Trade, Mr Peter Varghese.³
4. Australia and Indonesia should reframe their relationship as a partnership in the emerging Indo-Pacific.
5. Australia and Indonesia should work together with other countries in the Indo-Pacific region, using trilateral dialogues, existing country groupings (such as MIKTA (Mexico, Indonesia, Korea, Turkey, Australia), the Association of South East Asian Nations (ASEAN) and Indian Ocean Rim Association (IORA)) to find solutions for specific non-traditional security concerns.
6. Education and immigration regulators in both nations should work together to devise streamlined visa application processes to encourage the growth of mutually beneficial education exchanges, work training, and tourism.
7. The Australian government should work with Indonesian counterparts to formulate strategies that incentivise the pursuit of Indonesia’s domestic economic reform and its World Bank “ease of doing business” index⁴. This can be achieved through regional trade agreements and multilateral institutions like the Asia Development Bank (ADB). The newly-established Asian Infrastructure Investment Bank (AIIB) provides another opportunity to close ‘infrastructure gaps’ both within and between Asian countries.
8. Australia and Indonesia should expand the activities of the Australia–Indonesia “Parliamentary Friendship Group” in order to promote the Indo-Pacific narrative among Australian policymakers and to ensure Indonesia remains on the policy agenda.
9. Both countries should examine frameworks that encourage people-to-people engagements based on successes already observed. These include sister-state relationships, cultural exchanges, sporting links, arts collaboration (film, fashion, tv), school and cooperation in tertiary education including the Australian TAFE curriculum.
10. Both countries should endeavour to promote business-to-business links in technology, clean energy, and the development of infrastructure in eastern Indonesia. Clean, renewable energy solutions like wind and solar can service remote areas and small islands.



ABOUT THE PERTH USASIA CENTRE'S AUSTRALIA – INDONESIA WORKING GROUP

The Perth USAsia Centre's Working Group on Australia – Indonesia Relations is a track two initiative convened to address the imperative for Australia to pursue better relations across a broad range of issues with its closest Asian neighbour. The group consists of scholars, defence and foreign policy thought leaders and business and civil society leaders with expertise and deep interest in Indonesia. The initiative aims to constructively contribute to the public policy process to enable Australia and Indonesia to take advantage of the multitude of opportunities that exist. To this end, and leveraging Perth's proximity to Jakarta and the community of Indonesia expertise located in Perth, the working group will develop and commission a range of programs and research initiatives to improve Australia – Indonesia relations.

Meeting held on 21 July 2017

Perth USAsia Centre thanks those who generously gave their time and effort to participate in the Working Group meeting:

- **Mr Faris Al Fadhat**, Asia Research Centre, Murdoch University
- **Professor John Blaxland**, Director, Southeast Asia Institute, Australian National University
- **Mr Bryan Clark**, Director, Trade and International Affairs, Australian Chamber of Commerce and Industry
- **Mr Tom Connor***, Assistant Secretary, Southeast Asia Maritime Division, Department of Foreign Affairs and Trade
- **Mr Jonathan Fievez**, Chief Technology Officer, Carnegie Clean Energy
- **Mr Greg Gaunt**, Executive Chairman, HHG Legal Group
- **Professor Gordon Flake**, Chief Executive Officer, Perth USAsia Centre
- **Mr Hendro Fujiono**, Principal, Fujishepherd & Associates
- **Ms Caroline McCarthy***, Free Trade Agreement Division, Department of Foreign Affairs and Trade
- **Hon. Bill Johnston* MLA**, Western Australian Minister for Asian Engagement
- **Mr Paul Mercer**, Country Manager, Indonesia, Western Australian Department of Jobs, Tourism Science, and Innovation
- **Dr Marty Natalegawa**, former Minister of Foreign Affairs, Republic of Indonesia
- **Dr Mari Pangestu**, former Minister of Trade, former Minister of Tourism and the Creative Economy, Republic of Indonesia
- **Ms Natalie Sambhi**, Research Fellow, Perth USAsia Centre
- **Mr Ade Padmo Sarwono**, Consul General to Perth, Republic of Indonesia
- **Professor Krishna Sen**, Professor of Indonesian Studies, UWA
- **Mr Andre Siregar**, Consul to Darwin, Republic of Indonesia
- **Mr Kyle Springer**, Program Manager, Perth USAsia Centre
- **Mr Ross Taylor**, President, Indonesia Institute
- **Mr Phil Turtle**, National President, Australia Indonesia Business Council
- **Dr Jeffrey Wilson**, Research Fellow, Perth USAsia Centre

*participated as an observer



THE POWER OF PROXIMITY: ENHANCING AUSTRALIA–INDONESIA ECONOMIC RELATIONS



ENDNOTES

¹ Other reports include *Indonesia's Rising Middle Class and Affluent Consumers*. BCG Perspectives. 5 March 2013; and *The archipelago economy: Unleashing Indonesia's potential*. McKinsey Global Institute, McKinsey & Company. September 2012.

² The other is an Indonesia – Japan Economic Partnership Agreement which came into force in July 2008. Indonesia does have an FTA with Pakistan. However, that agreement only covers goods.

³ Accessed via: <https://www.pm.gov.au/media/2017-04-11/address-indiaaustralia-business-dinner>.

⁴ Indonesia's doing business rank was 91 out of 190 in 2017 see "Doing Business: Measuring Business Regulations". World Bank website: <http://www.doingbusiness.org/data/exploreeconomies/indonesia>.





Perth USAsia Centre