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Archipelago of Potential: Prospects and Challenges in Australia – Indonesia economic engagement

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Introduction

During his first visit to Jakarta as Australian Prime Minister in October 2013, Tony Abbott singled out Indonesia as Australia's most important bilateral relationship, on account of "its size, proximity and potential"¹⁹⁷. This, however, is not reflected in the two countries' bilateral trade and investment relationship. Indonesia is only Australia's 12th largest trading partner and 11th largest export market, and 19th largest investment destination.¹⁹⁸ Likewise, Australia ranks as Indonesia's 9th largest import source and 10th export destination.¹⁹⁹ The Australian and Indonesian Governments, business and academic communities agree the bilateral economic relationship is not living up to its full potential.

From an Australian business perspective, it is easy to overlook Indonesia and focus on the larger, highly-developed North Asian economies. Australia's success selling iron ore to support China's economic growth certainly attracts the bulk of Australia's economic attention. This year, Australia made big strides in its economic diplomacy with countries in North Asia, signing free trade deals with Korea in April, Japan in July and China in November. Public views are similar: Australians consistently rank China and Japan as their country's 'top friends' in Asia and few rank trade and investment as significant policy priorities in Australia – Indonesia relations.²⁰⁰

But Indonesia is an emerging economic powerhouse that offers Australian exporters and investors a wealth of opportunities. Its GDP is nearing US\$1 trillion, making it by far the largest economy in Southeast Asia, and it is projected to be the world's seventh largest economy by 2030. Over the past 10 years, average annual GDP growth has been more than 5.8 per cent, helping to reduce poverty levels. With a population of almost 250 million, Indonesia now

¹⁹⁷ The Hon Tony Abbott MP, Prime Minister of Australia "Building an Indonesia-Australia Relationship for the 21st Century", (speech, Jakarta, 1 October 2013), <https://www.pm.gov.au/media/2013-10-01/building-indonesia-australia-relationship-21st-century>.

¹⁹⁸ Australian Department of Foreign Affairs and Trade (DFAT), "Australia and Foreign Investment", accessed 10 November 2014, <http://www.dfat.gov.au/trade/investment/australias-investment.html>.

¹⁹⁹ DFAT, "Indonesia Fact Sheet", accessed 31 October 2014, <http://www.dfat.gov.au/geo/fs/indo.pdf>. <http://www.dfat.gov.au/geo/>.

²⁰⁰ Lowy Institute Poll, 2014, accessed 13 November 2014, <http://www.lowyinstitute.org/publications/lowy-institute-poll-2014>.

boasts the world's third-fastest growing consumer market and a rapidly-growing middle class²⁰¹ (currently around 45 million²⁰²).

Indonesia does, however, face many domestic economic challenges, such as poor infrastructure, declining foreign investment, a weak manufacturing sector and a heavy dependence on commodity exports, expensive fuel subsidies, corruption and excessive red tape. Its new president, Joko Widodo (popularly known as “Jokowi”) has outlined an ambitious program of reforms to overhaul, restructure and reinvigorate the Indonesian economy.

This paper outlines some of the opportunities and challenges facing the Indonesian economy and Widodo Government's reform program. We discuss ways to remove barriers to bilateral trade and investment, to help grow the economic ties between Australia and Indonesia. A bilateral free trade agreement (FTA) has been touted as a positive way forward, but negotiations for such an agreement, the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), stalled in 2013. We will look at how IA-CEPA might build on the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA), and highlight some other avenues for removing trade and investment barriers. Also examined is agriculture, a sector where there is much potential to expand trade and investment ties between Australia and Indonesia.

Indonesia's Economy: Opportunities & Challenges

Indonesia is entering not only a new political and social era, but a new era of economic opportunity too. Its president, Joko Widodo, who took office on 20 October 2014, presides over an archipelago brimming with economic potential.

Indonesia has enjoyed average annual real Gross Domestic Product (GDP) growth of 5.9 per cent²⁰³ and, despite some challenges, continues to attract

²⁰¹ Austrade, “Indonesia: Market Overview”, accessed 13 November 2014,

<http://www.austrade.gov.au/Export/Export-Markets/Countries/Indonesia/Market-profile#.VGntSUuKhFI>

²⁰² DFAT, “Indonesia Country Brief”, accessed 13 November 2014,

https://www.dfat.gov.au/geo/indonesia/indonesia_brief.html.

²⁰³ World Trade Organization, “Trade Policy Review of Indonesia: Report by the Secretariat,” (WT/TPR/S/278/Rev.1) 16 July 2013.

foreign investment from major countries in Asia and elsewhere. Economic growth has reduced poverty, with the World Bank estimating that the national poverty rate fell from 23.4 per cent to 12.5 per cent between 1999 and 2011. However, the poverty reduction rate is slowing, with around 65 million people still living dangerously close to the poverty line.²⁰⁴ Business consulting firms share a positive outlook on Indonesia's economic prospects and growth potential as a market for consumer products:

- McKinsey & Company estimate Indonesia will be the world's seventh largest economy by 2030 and will have 135 million middle-class consumers.²⁰⁵
- Boston Consulting Group (BCG) projects that Indonesia will have 141 million "MACs" (middle-class and affluent consumers) by 2020, with MACs on the island of Java alone numbering more than the whole population of Thailand.²⁰⁶

Indonesia's youth are a notable feature of its new economic era. Millions of young Indonesians will enter the job market every year until 2030. The population of working-age Indonesians will grow more rapidly than the dependent population, freeing up economic resources for investment, consumption and a greater quality of life. To reap the economic benefits of this "demographic dividend", Indonesia will have to create more jobs and pursue effective labour, health and education policies that promote worker productivity: McKinsey estimates productivity must grow 60 per cent faster than it did between 2000 and 2010.²⁰⁷ Higher sustained growth is also needed,

²⁰⁴ "Reducing extreme poverty in Indonesia," World Bank Briefs, 22 October 2014,

<http://www.worldbank.org/en/country/indonesia/brief/reducing-extreme-poverty-in-indonesia>.

²⁰⁵ "The Archipelago Economy: Unleashing Indonesia's Potential," McKinsey Global Institute, September 2012,

http://www.mckinsey.com/~media/McKinsey/dotcom/Insights%20and%20pubs/MGI/Research/Productivity%20Competitiveness%20and%20Growth/The%20archipelago%20economy/MGI_Unleashing_Indonesia_potential_Full_report.ashx.

²⁰⁶ "Asia's Next Big Opportunity: Indonesia's Rising Middle-Class and Affluent Consumers," The Boston Consulting Group, March 2013,

https://www.bcgperspectives.com/Images/Asias_Next_Big_Opportunity_Mar_2013_tcm80-128797.pdf.

²⁰⁷ "The Archipelago Economy: Unleashing Indonesia's Potential," McKinsey Global Institute, September 2012,

http://www.mckinsey.com/~media/McKinsey/dotcom/Insights%20and%20pubs/MGI/Research/Productivity%20Competitiveness%20and%20Growth/The%20archipelago%20economy/MGI_Unleashing_Indonesia_potential_Full_report.ashx.

as GDP growth rates of under 6 per cent are simply not enough to provide sufficient jobs for Indonesia's youth.

Obviously, Indonesia's economic growth will depend on the new Widodo Government's ability to develop and implement good economic policies to address internal challenges, of which there are many. Indonesia must make more progress in eradicating corruption and tackling the bureaucratic inefficiencies that cripple the country's competitiveness. The country performs poorly on the World Bank's *Ease of Doing Business Index*: in 2014 Indonesia's rank was 120, 4 points lower than in 2013. This places it below its neighbours Singapore and Malaysia.²⁰⁸ Likewise, it ranks very low (175) in terms of the ease of starting a new business; posing a serious challenge to the development of small and medium-sized enterprises. Corruption is ubiquitous, with Indonesia ranking 107 out of 175 in Transparency International's *Corruption Perceptions Index*.²⁰⁹

Indonesia's current economic success is linked precariously to China's resource demands. Mining has been a key industry driving Indonesia's economy for the past decade, making significant contributions to GDP, exports, tax revenue, employment and regional development.²¹⁰ Much like Australia, Indonesia's mining industry faces falling demand from China. Weak Chinese demand for nickel, coal and tin was blamed for Indonesia's GDP growth slipping to 5 per cent in the third quarter of 2014, its slowest in five years.²¹¹ China aside, Indonesia's own nationalist policies threaten the viability of its mining industry. New foreign direct investment in the industry has been discouraged by government regulations requiring divestment by foreign companies and banning the export of unprocessed minerals.

Thus, Indonesia's economy presents equally large opportunities and challenges. On the one hand, it has consistent GDP growth, a growing middle-class,

²⁰⁸ World Bank Group, "Doing Business 2014 – Economy Rankings," accessed 27 October 2014, <http://www.doingbusiness.org/rankings>.

²⁰⁹ Transparency International, "2014 Corruption Perception Index," accessed 11 November 2014, <http://www.transparency.org/cpi2014/results>.

²¹⁰ "Challenging times ahead for the Indonesian mining sector," PwC, February 2014, http://www.pwc.com/id/en/media/challenging_times_ahead_for_the_indonesian_mining_sector.jhtml.

²¹¹ Ben Otto, "Indonesia Economy Tests New President as Growth Slows," *The Wall Street Journal*, 5 November 2014, <http://online.wsj.com/articles/indonesia-economy-grows-at-slowest-pace-in-five-years-1415166907>.

favourable demographics and it is rich in resources. On the other, the country faces significant internal problems such as corruption, an inefficient bureaucracy, government policies that discourage direct investment and a mining industry too dependent on China. Into this mix comes a new president with a can-do, pragmatic attitude and a willingness to address Indonesia's most difficult economic problems.

Taking Stock of Widodo's Economic Ambitions

A successful businessman, President Widodo's stated economic objectives include the ambitious tasks of increasing GDP growth to 7 per cent and reducing Indonesia's fuel subsidies, which currently gouges out roughly 18 per cent of the national budget. Achieving this GDP growth goal will require, amongst other things, growth in exports and significant improvements in labour productivity; necessitating policies that educate the workforce and improve its health, increase agricultural productivity, strengthen the manufacturing sector and improve infrastructure.²¹² The resources for these policy pathways, especially those improving health and education, are to be found in freeing up the portion of the budget currently spent on fuel subsidies. If Widodo can successfully wean Indonesia off fuel subsidies, he has a greater chance of transforming Indonesia's economy.

How do the President's policy objectives match up with the reforms needed? Will they take advantage of Indonesia's youthful population? The most comprehensive overview of Widodo's policy intentions arrived just a month before the presidential election. In May 2014, Widodo and his running mate, and now Vice-President, Jusuf Kalla, submitted their "Vision-Mission and Action Program" (*Visi-Misi dan Program Aksi*) to the General Elections Commission (*KPU*). In it, they outlined their basic policy goals across all spheres including foreign policy, education, defence, and economics.

According to the Jakarta Post's English-language translation of the *visi-misi* statement, Widodo's intended reforms as they relate to the economy are:²¹³

²¹² Ibid.

²¹³ Margareth S. Aritonang and Rendi A. Witular, "Widodo-Kalla hawkish on economic policies," *The Jakarta Post*, 21 May 2014, <http://www.thejakartapost.com/news/2014/05/21/Widodo-kalla-hawkish-economic-policies.html>.

Increasing productivity and competitiveness:

- Construct 2000km of new roads.
- Develop 10 new airports and 10 new seaports.
- Provide a streamlined, one-stop service for the processing of investments and business licenses with a completion target of 15 days.
- Set up development and infrastructure banks.
- Build regional science and technology parks, academies and vocational schools.

Economic independence and development of domestic sectors:

- Set up a bank for farmers and small businesses.
- Open one million hectares of rice paddies outside Java.
- Cut energy imports by promoting exploration at home.
- Construct gas pipelines.
- Prioritise use of coal and gas to generate electricity.
- Protect existing agricultural land.
- Expand irrigation networks for rice fields.
- Achieve a financial inclusion ratio target of 50 per cent.
- Target a tax ratio of 16 per cent.
- Restrict the sale of national banks to foreign investors.
- Increase research in agriculture and industry.

Other economy-related points listed elsewhere in the document:

- Reduce the impact of globalisation, regional economic integration, and free trade.
- Push regional administrations to cut their overhead costs and allocate more for public services.
- Increase educational and training quality through the Smart Indonesia program, with 12 years of compulsory and free education.
- Issue a government regulation in lieu of law (Perppu) to replace Upstream Oil and Gas Regulatory Special Task Force (SKKMigas) with a new energy management system.
- Revise the Oil and Gas Law to prioritise the development of national capacity and provide legal certainty for businesses.

The *visi-misi* statement highlights Widodo's commitment to providing education and vocational training for young Indonesians. And his track record of delivering practical services to the people during his tenure as mayor of Solo and governor of Jakarta indicates he will put similar effort into providing healthcare and quality education services to Indonesians at the national level. These are precisely the kind of practical policies that will help Indonesia reap the benefits of its "demographic bonus", by increasing the productivity of the millions of young Indonesians joining the workforce each year. If Widodo can indeed undertake these initiatives, it should create the right policy environment for Indonesia to become the world's seventh-largest economy by 2030.

Drawing on his business background, Widodo promises to streamline processes for business and investment licenses. Reducing the cumbersome bureaucracy that gets in the way of obtaining business licenses will encourage the growth of small and medium-sized enterprises in Indonesia, in turn creating more jobs.

Although his policy stance is generally pro-business, Widodo's *visi-misi* statement reveals he does lean towards economic nationalism, a feature of Indonesia's past economic policies. Indeed, economic nationalism is deeply rooted in the country's national identity as a former Dutch colony. Indonesians share the view that the Dutch grew rich by exploiting Indonesia's national resources, while Indonesia was left impoverished.²¹⁴ Immediately following the country's independence President Sukarno nationalised Dutch companies and confiscated foreign-owned property and assets. These nationalist sentiments remain alive in Indonesia today and manifest themselves in policies designed to protect Indonesian businesses from foreign competition and develop Indonesian-owned industries.

The Widodo Government is unlikely to diverge far from this policy trend. Indicative of this are the President's pledges in his *visi-misi* statement to restrict the sale of national banks to foreign investors and to cut energy imports in favour of domestic exploration. And his newly-appointed Energy and Mineral Resources Minister, Sudirman Said, has already made it clear the government will maintain Indonesia's controversial ban on exporting unprocessed minerals.

²¹⁴ Stephen Greenville, "How to manage economic nationalism in Indonesia," *The Interpreter*, Lowy Institute, 3 June 2014, <http://www.lowyinterpreter.org/post/2014/06/03/Indonesia-economic-nationalism.aspx?COLLCC=1537672964&>.

Widodo's plan to build ports, roads, and other much-needed infrastructure will require significant foreign investment. Chronic under-development and under-investment in infrastructure has been a major bottleneck for Indonesia's economic growth.²¹⁵ Indonesia recognises this and is, for example, working with countries like the Netherlands to develop maritime infrastructure.²¹⁶ The need for infrastructure development presents opportunities to Australian contractors with experience in delivering large-scale projects, such as in Australia's northwest for the mining industry.

Encouragingly, in November 2014 President Widodo signalled his intentions to improve Indonesia's business and investment climate, implement tax reforms and cut fuel subsidies during his speeches at the APEC Economic Leaders' Meeting in Beijing and at the G20 Leaders' Summit in Brisbane. At the APEC meeting, he urged fellow members to invest in Indonesia, highlighting the need for infrastructure development, whilst acknowledging the problems investors faced in Indonesia. At the later G20 Summit, Widodo confirmed his commitment to cut fuel subsidies, which will free up money to fund infrastructure projects. These official statements should reassure investors in the short-term, but will need to be followed up relatively quickly with concrete policy reforms. There are already signs that the president will push hard for these reforms, with Widodo announcing a 30 per cent price increase for subsidised fuel on 17 November 2014.

Trade and Investment: A Weak Link in Australia-Indonesia Relations

Australia and Indonesia's economic ties, whilst not insignificant, are nowhere near as strong as they should be for such close neighbours, especially given the size, strong economic performance and relative complementarity of the two economies. As noted earlier, Indonesia is only Australia's 12th largest trading partner. In contrast, tiny New Zealand is Australia's sixth largest trading partner and third largest investment destination, thanks largely to a

²¹⁵ Shiro Armstrong and Sjamsu Rahardja, "Survey of Recent Developments", *Bulletin of Indonesian Economic Studies* 50:1 (2014): 22.

²¹⁶ "Indonesia, Netherlands Agree to Build Maritime Ties," *Antara News*, 5 November 2014, <http://www.antaraneews.com/en/news/96421/indonesia-netherlands-agree-to-build-maritime-ties>.

comprehensive, long-standing bilateral free trade agreement (FTA). Malaysia, which has around one-tenth the population and less than half the GDP of Indonesia, is Australia's seventh largest trading partner.²¹⁷

A bilateral FTA between Australia and Indonesia has been advocated for some time as a good way to grow the trade and investment relationship. Back in July 2007, the Australian and Indonesian Governments agreed to conduct a joint feasibility study on the merits of a bilateral FTA. Released in July 2009, the study found that, given the complementarities between the two countries' economies, a comprehensive and ambitious FTA covering goods, services and investment "could improve trade and investment links, deepen bilateral and regional economic integration and provide positive outcomes in key agricultural and manufacturing sectors of importance to both Australia and Indonesia"²¹⁸, providing "significant opportunities" for business and exporters. It showed that, to achieve the greatest possible gains, all tariffs, non-tariff barriers, and barriers to bilateral services trade should be eliminated, as should be the widest possible range of barriers to Australian investment in Indonesia.²¹⁹

On the basis of the study's findings, negotiations for a bilateral FTA, the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), commenced in September 2012. However, little progress was made before tensions in bilateral relations, coupled with the Australian and Indonesian electoral cycles, effectively put the negotiations on ice.

Now that bilateral relations are improving and Australia has completed a trifecta of FTAs (with Korea, Japan and most recently China), the Abbott Government has indicated its interest in reviving the IA-CEPA negotiations. In speech to the Australia-Indonesia Business Council on 4 December, Australian Foreign Minister Julie Bishop said that "in 2015, as President Widodo's new cabinet settles in, we will seek to reinvigorate these [IA-CEPA] negotiations".²²⁰

²¹⁷ DFAT, "Australia's Trade at a Glance", accessed 29 October 2014, <http://www.dfat.gov.au/trade/australias-trade-at-a-glance/index.html>.

²¹⁸ Australian Department of Foreign Affairs and Trade and Indonesian Ministry of Trade, "Australia-Indonesia Free Trade Agreement Joint Feasibility Study", April 2009, http://www.dfat.gov.au/fta/iacepa/aus-indon_fta_jfs.pdf.

²¹⁹ Ibid

²²⁰ The Hon Julie Bishop MP, Australian Minister for Foreign Affairs, "Address to Australia-Indonesia Business Council", (speech, Melbourne, 4 December 2014), http://foreignminister.gov.au/speeches/Pages/2014/jb_sp_141204.aspx

Following Widodo's election, the consensus seems to be that it is up to Indonesia when negotiations resume and at what pace. In the next section, we discuss the short-term prospects for restarting IA-CEPA negotiations. And we look at other avenues for enhancing Australia's economic ties with Indonesia, including an existing trade agreement, AANZFTA.

Growing Economic Ties through AANZFTA:

Australia already has a free trade agreement in place with Indonesia, albeit a regional one. The ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA) is Australia's largest and first multi-country FTA. Signed in 2009, it encompasses Australia, Indonesia and 10 other countries (Brunei, Cambodia, Laos, Malaysia, Myanmar, New Zealand, the Philippines, Singapore, Thailand and Vietnam), a population of over 650 million and a combined GDP of over US\$4 trillion²²¹. To date, it is ASEAN's most comprehensive trade agreement, covering trade in goods and services, investment, intellectual property, electronic commerce, the temporary movement of business people, competition and economic cooperation. AANZFTA's provisions applied to Australia from 1 January 2010²²² and to Indonesia from 10 January 2012.²²³

AANZFTA has significantly liberalised trade in goods between Australia, Indonesia and its other member countries:

- Applied tariffs have been set ("bound") at existing low levels, so that they cannot be increased to levels permitted by the World Trade Organization (WTO) agreements.
- Countries have agreed to eliminate tariffs by 2025 on between 85.2 per cent and 100 per cent of products.²²⁴
- In the case of Australia, tariffs have been eliminated on 96.5 per cent of products imported from Indonesia and other AANZFTA

²²¹ DFAT, "ASEAN-Australia-New Zealand Free Trade Agreement", accessed 31 October 2014, <http://www.dfat.gov.au/fta/aanzfta/>.

²²² DFAT "Overview and Key Outcomes of the ASEAN-Australia-New Zealand Free Trade Agreement", accessed 29 October 2014, http://www.dfat.gov.au/fta/aanzfta/aanzfta_overview_and_outcomes.html

²²³ DFAT, "ASEAN-Australia-New Zealand FTA: Indonesia Entry Into Force", accessed 29 October 2014, <https://www.dfat.gov.au/fta/aanzfta/AANZFTA-Indonesia-entry-into-force.html>.

²²⁴ These commitments are on "tariff lines", i.e. products as defined in tariff schedules.

countries. Tariffs on 100 per cent of products will be eliminated by 2020.²²⁵

- AANZFTA provides regional, flexible rules of origin (criteria used to determine a product's country of origin), an important outcome in today's world of global value chains. These rules allow for regional accumulation,²²⁶ whereby producers in one member country may use input materials from another member country without losing preferential treatment.

AANZFTA's outcomes on trade in services are more modest, but improve certainty and transparency for service providers. Many are 'WTO-plus', going beyond countries' commitments in the WTO General Agreement on Trade in Services. The main outcomes are:

- Existing levels of market openness have been bound (guaranteed) in some sectors, such as professional services, construction services, financial services, mining-related services, education and telecommunications.
- Disciplines on domestic regulation have been imposed (including specific disciplines for financial and telecommunications services).
- Certain legal protections for investment are guaranteed.²²⁷

Other notable features of AANZFTA include:

- Improved post-establishment legal protections for investors.
- Commitments and regulatory disciplines to improve the temporary entry of business people, professionals and skilled workers.
- A comprehensive economic cooperation work program of capacity-building and technical assistance to help ASEAN countries implement the agreement.²²⁸

Importantly, AANZFTA is a "living agreement". It contains a number of built-in agendas and review mechanisms covering areas such as services, investment

²²⁵ DFAT, "AANZFTA Fact Sheets", accessed 31 October 2014, http://www.dfat.gov.au/fta/aanzfta/factsheets/fact_sheets.pdf.

²²⁶ Ibid.

²²⁷ DFAT, "Overview and Key Outcomes of the ASEAN-Australia-New Zealand Free Trade Agreement", accessed 29 October 2014, http://www.dfat.gov.au/fta/aanzfta/aanzfta_overview_and_outcomes.html.

²²⁸ Ibid.

and non-tariff barriers.²²⁹ This means that AANZFTA has the potential to further liberalise trade and investment flows between its member countries, including Indonesia and Australia.

AANZFTA and Indonesia

Indonesian exports and investors face few and relatively low barriers in the Australian market, with Australia having one of the world's most open economies.²³⁰ While Indonesia's economy is not as open, AANZFTA has removed many impediments to trade and investment, particularly with respect to tariffs:

- Indonesia has eliminated tariffs on 78 per cent of products (tariff lines), up from 11 per cent, and agreed to eliminate tariffs on 92 per cent of products by 2015 and 94 per cent by 2025. These commitments cover Australian exports such as wheat (our largest export to Indonesia), breeding animals, crude petroleum, beef, aluminium, cotton, gold, pharmaceuticals, butter, most cheeses, most seafoods, pigments and preparations and most copper and lead products.
- Indonesia will reduce tariffs on a range of other products, so that by 2025 only 3.3 per cent of tariffs will be over 5 per cent.²³¹

Indonesia has taken steps towards opening up its services sectors, including banking and insurance, construction, education and legal services. For instance:

- Foreign lawyers are permitted to work in Indonesian law firms (although Indonesia has placed limits on numbers).
- Foreign equity limits have been raised for joint ventures in construction services and for educational institutions established with a local partner.²³²

²²⁹ Ibid.

²³⁰ World Trade Organization (WTO), "Trade Policy Review of Australia: Report by the Secretariat", WT/TPR/S/244, 1 March 2011, accessed at http://www.wto.org/english/tratop_e/tpr_e/tp344_e.htm.

²³¹ DFAT, "ASEAN-Australia-New Zealand FTA: Indonesia Entry Into Force", accessed 29 October 2014, <https://www.dfat.gov.au/fta/aanzfta/AANZFTA-Indonesia-entry-into-force.html>.

²³² DFAT, "ASEAN-Australia-New Zealand FTA: Indonesia Entry Into Force", accessed 29 October 2014, <https://www.dfat.gov.au/fta/aanzfta/AANZFTA-Indonesia-entry-into-force.html>.

It is much too early to assess AANZFTA's impact on Australia and Indonesia's economic relationship, as the agreement's provisions have applied to Indonesia since only January 2012. The full impact of an FTA on trade and investment flows takes several years to be realised as exporters and investors gear up to take advantage of new market opportunities. In 2012-13, Australia's exports of primary products to Indonesia grew by 9.7 per cent, exports of manufactures fell by 11.5 per cent and exports of services grew by 4.5 per cent. As for Indonesia's exports to Australia, primary products fell by 4.1 per cent, manufactures grew by 21.4 per cent and services by 10.6 per cent.²³³

Remaining Barriers to Trade and Investment

Despite the above improvements, impediments still exist to trade and investment flows between Australia and Indonesia. Detailed information is provided in the joint feasibility study and in the Indonesia-Australia Business Partnership Group's comprehensive position paper on IA-CEPA.²³⁴

Australian goods and services exporters and investors face barriers across a range of areas. Major goods exports such as sugar, rice, wine and spirits were excluded from Indonesia's tariff reductions under AANZFTA and are subject to high tariffs. Other exports confront significant non-tariff barriers such as import quotas, import licensing requirements, complex and overlapping regulations and procedures, complicated standards and certification processes and excessive labelling requirements.²³⁵ For example:

- Wine and spirits face tariffs of up to 170 per cent.
- Sugar, Australia's second-largest export to Indonesia in 2013 is highly regulated by the Indonesian Government, with long-standing measures in place covering production, prices and trade. Australian sugar exports face tariffs of Rp 550/kg (for raw cane sugar) and Rp 790/kg (for other sugars), as well as other restrictions such as import licensing.²³⁶
- Live cattle, Australia's third-largest export to Indonesia in 2013, is subject to a low tariff (currently 5 per cent, to be reduced to 2.5 per cent

²³³ DFAT, "Australia's Trade with East Asia 2013", October 2014, https://www.dfat.gov.au/publications/stats-pubs/trade_eastasia.html.

²³⁴ Indonesia-Australia Business Partnership Group, "Position Paper on Considerations Towards the Indonesia-Australia Comprehensive Economic Partnership Agreement", 31 October 2012.

²³⁵ Ibid.

²³⁶ USDA Foreign Agricultural Service, "Indonesia Sugar Annual Report 2014", 14 April 2014.

by 2025),²³⁷ but also to import permits based on a reference price system.²³⁸

In many instances, these trade barriers form part of a deliberate Indonesian strategy to boost self-sufficiency, develop and protect local industry.

Australian services exporters face barriers in many sectors of the Indonesian market, including in education, legal, accountancy, construction and architecture services and telecommunications. For instance:

- Indonesia limits foreign direct investment in higher education to 49 per cent and requires Australian investors to partner with a local institution.
- Australian law firms cannot establish offices in Indonesia.
- Australian accountancy firms are only able to operate in Indonesia via a cooperation agreement with an Indonesian accountancy firm. Indonesian citizenship is required to practise as a licensed accountant.²³⁹

Australian investment in Indonesia has been curtailed by impediments such as foreign equity limits, complex business, labour and bankruptcy regulations and infrastructure limitations.²⁴⁰

From Indonesia's perspective, while its exporters and investors confront significantly fewer barriers, Australia currently imposes low tariffs on important Indonesian exports such as textiles, clothing and footwear, consumer and furniture products and passenger motor vehicles. These and all other Australian tariffs will be eliminated in 2020 (under AANZFTA). Indonesian service providers experience difficulties obtaining relevant licenses in Australia and in

²³⁷ Indonesia has eliminated the tariff on live pure-bred breeding cattle. DFAT, "ASEAN-Australia-New Zealand FTA: Indonesia Entry Into Force", accessed 5 November 2014, <https://www.dfat.gov.au/fta/aanzfta/AANZFTA-Indonesia-entry-into-force.html>.

²³⁸ The Indonesian Government releases import permits each quarter, with the number determined by how close the price of beef is to an 'affordable' reference price. Matt Brann, "Indonesia's Beef Price Still High Despite Import Surge", *ABC Rural News*, 3 April 2014, accessed 5 November 2014, <http://www.abc.net.au/news/2014-04-03/indonesian-beef-price-high-despite-imports/5362870>.

²³⁹ Australian Department of Foreign Affairs and Trade and Indonesian Ministry of Trade, "Australia-Indonesia Free Trade Agreement Joint Feasibility Study", April 2009, http://www.dfat.gov.au/fta/iacepa/aus-indon_fta_ifs.pdf.

²⁴⁰ Ibid.

securing temporary employment opportunities in Australia.²⁴¹ And Indonesian investors in Australia face a screening threshold of \$248 million.²⁴²

The Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA)

A bilateral FTA between Australia and Indonesia should address these remaining barriers to trade and investment and accelerate the tariff elimination commitments made in AANZFTA. Indeed, AANZFTA is envisaged by the Australian Government to be a “platform” for the negotiation of bilateral FTAs with ASEAN countries, to achieve “AANZFTA-plus outcomes”.²⁴³ To date, Australia has concluded a bilateral FTA with Malaysia (the Malaysia-Australia Free Trade Agreement, MAFTA), which took effect in January 2013.²⁴⁴

MAFTA provides a good model for IA-CEPA, and for that matter any other future Australian FTAs with ASEAN countries. It improves on AANZFTA’s market access for goods and services by cutting or eliminating a wider range of tariffs, addressing specific non-tariff barriers to trade, guaranteeing Australian investors the right to majority ownership in companies across a wide range of services sectors in Malaysia, improving the temporary movement of business people and reducing other barriers to bilateral trade. Also, it contains a significant economic development component, providing a program of economic and technical cooperation projects in agriculture, automotives, tourism, clean coal technology and electronic commerce.²⁴⁵

It is envisaged IA-CEPA will be comprehensive in scope, covering trade in goods and services, investment, movement of natural persons, electronic commerce, competition policy, government procurement, intellectual property rights, environment and labour and other new relevant new and emerging

²⁴¹ Ibid.

²⁴² Foreign Investment Review Board (FIRB), “Monetary Thresholds”, accessed 2 December 2014, http://www.firb.gov.au/content/monetary_thresholds/monetary_thresholds.asp.

²⁴³ DFAT, “Overview and Key Outcomes of the ASEAN-Australia-New Zealand Free Trade Agreement”, accessed 6 November 2014, http://www.dfat.gov.au/fta/aanzfta/aanzfta_overview_and_outcomes.html.

²⁴⁴ MAFTA negotiations were originally launched in April 2005 but were suspended in 2006 while AANZFTA negotiations were underway. Formal MAFTA negotiations resumed in August 2009 and the agreement was signed in May 2012. DFAT, “Malaysia-Australia Free Trade Agreement”, accessed 6 November 2014, <https://www.dfat.gov.au/fta/mafta/>.

²⁴⁵ DFAT, “Malaysia-Australia Free Trade Agreement”, accessed 6 November 2014, <https://www.dfat.gov.au/fta/mafta/>.

issues.²⁴⁶ Like MAFTA, capacity-building and economic cooperation will be an important feature, as noted by the Australian and Indonesian Governments in their joint feasibility study. For instance, cooperation will likely be strengthened in customs services, sanitary and phytosanitary measures, technical regulations and standards and trade and investment promotion.²⁴⁷

Before stalling, two rounds of IA-CEPA negotiations were held, the last in July 2013. The negotiations' guiding principles, objectives and organisation were agreed, a number of procedural matters finalised, economic cooperation and stakeholder engagement discussed and an agricultural pilot project launched to improve beef cattle production in Indonesia.²⁴⁸

The Way Forward

A WTO-consistent, AANZFTA-plus bilateral trade agreement covering goods, services and investment would deepen, strengthen and expand trade, investment and economic cooperation between Australia and Indonesia; if AANZFTA is the cake, IA-CEPA would be the icing. More broadly, a bilateral FTA would be positive for the overall bilateral relationship. It would help improve each country's understanding of the other and signal the importance placed on the bilateral relationship.

It will likely be a few months before the Widodo Government is in a position to restart IA-CEPA negotiations. As it settles in, the government's focus will be on the president's ambitious domestic economic agenda. But export growth and foreign investment are needed to help achieve the President's GDP growth goal and build the roads, ports, railways and other key infrastructure outlined in his *visi-misi* statement. And Indonesia is falling behind in the race to conclude FTAs. Most of Indonesia's FTAs are ASEAN-negotiated agreements, like AANZFTA. It has just two bilateral FTAs, with Japan (Indonesia's largest investor) and Pakistan, of which only the former has been implemented.

²⁴⁶ "Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA): Guiding Principles, Objectives and Organisation of Negotiations", 27 March 2013, <https://www.dfat.gov.au/fta/iacepa/ia-cepa-guiding-principles.html>.

²⁴⁷ Australian Department of Foreign Affairs and Trade and Indonesian Ministry of Trade, "Australia-Indonesia Free Trade Agreement Joint Feasibility Study", April 2009, http://www.dfat.gov.au/fta/iacepa/aus-indon_fta_jfs.pdf.

²⁴⁸ DFAT, "Indonesia-Australia Comprehensive Economic Partnership Agreement Negotiations", accessed 6 November 2014, <https://www.dfat.gov.au/fta/iacepa/>.

Concluding an FTA with a developed neighbouring country such as Australia should be an easy decision for the Widodo Government.

Once they restart, the IA-CEPA negotiations should be conducted at a pace with which Indonesia is comfortable. As a minority coalition government, the Widodo Government will not want to risk political backlash over an FTA with Australia. The Indonesian public's attitude towards FTAs is generally negative, with the ASEAN-China FTA seen to have prompted a flood of Chinese imports.²⁴⁹ And, as discussed above, economic nationalism is strong in Indonesia. In recent years, government regulations on investment, imports and exports have been designed to manage trade, not liberalise it, and to protect domestic producers.²⁵⁰

Although the conclusion of IA-CEPA may be some time away, there are other avenues available for addressing trade and investment barriers in the meantime. These include AANZFTA, bilateral mechanisms and initiatives, APEC, RCEP and the WTO.

AANZFTA, as outlined above, contains a built-in review mechanism, which could be used to further reduce tariff and non-tariff barriers to trade and investment flows between its members, including Australia and Indonesia.

Bilateral mechanisms and initiatives can be designed to help resolve specific issues and irritants. A good example is the Indonesia-Australia Partnership on Food Security in the Red Meat and Cattle Sector, an initiative designed help prevent a recurrence of tensions and disruptions in the bilateral live cattle trade (discussed later in this paper). The partnership, which first met in April 2014, brings together government and industry to strengthen bilateral business, trade and investment ties across the red meat and cattle sector, develop Indonesia's cattle sector, and foster greater dialogue, cooperation and understanding.²⁵¹

²⁴⁹ Yose Rizal Damuri, "Trade Policy in Swing: Indonesia's Attitude to Liberalisation and the TPP", *East Asia Forum*, 19 March 2014, <http://www.eastasiaforum.org/2014/03/19/trade-policy-in-swing-indonesias-attitude-to-liberalisation-and-the-tpp/>.

²⁵⁰ Shiro Armstrong and Sjamsu Rahardja, "Survey of Recent Developments", *Bulletin of Indonesian Economic Studies* 50:1 (2014): 15.

²⁵¹ Official Communiqué of the First Meeting of the Indonesia-Australia Partnership on Food Security in the Red Meat and Cattle Sector, 17 April 2014, <http://www.agriculture.gov.au/about/media-centre/communiqués/indonesia-australia-food-security>.

APEC (the Asia-Pacific Economic Cooperation forum) is an important, although perhaps unfashionable, regional vehicle for promoting economic growth, cooperation, trade and investment. Its extensive activities cover trade and investment liberalisation, business facilitation and economic and technical cooperation. Strong business engagement is one of APEC's strengths and the forum has an active APEC Business Advisory Council.

APEC's 21 members²⁵² have reached the only tariff-cutting multilateral arrangement in 17 years, agreeing in 2012 to reduce tariffs to 5 per cent or less on a list of 54 environmental goods by the end of 2015.²⁵³ (This list provides the basis for the WTO's Environmental Goods Agreement negotiations, launched in July 2014).²⁵⁴ APEC's long-term vision of a Free Trade Area of the Asia-Pacific (FTAAP) was given fresh impetus by APEC Leaders at their November 2014 meeting in Beijing, after they agreed to a two-year study on FTAAP.

In addition to its formal agenda, APEC's busy schedule of meetings provides opportunities for bilateral trade and investment issues to be discussed on the sidelines by government ministers, officials and business representatives. Both Australia and Indonesia are active members and worked closely together during Indonesia's APEC host year in 2013.

The Regional Comprehensive Economic Partnership (RCEP) negotiations offer Australia and Indonesia another means to address trade and investment barriers, and improve on AANZFTA's market access commitments. While the Trans-Pacific Partnership (TPP) negotiations have captured the world's attention, RCEP negotiations have been quietly bubbling along. Launched in November 2012, RCEP is an ASEAN-led proposal for a regional free trade area, with its 16 participants comprising ASEAN and ASEAN's FTA partners, Australia, China, India, Japan, Korea and New Zealand. Together, these countries account

²⁵² Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Russia, Singapore, Taiwan, Thailand, the United States and Vietnam.

²⁵³ APEC Committee on Trade and Investment media release, "APEC Opening Environmental Goods Market", 21 August 2014, http://www.apec.org/Press/News-Releases/2014/0820_EG.aspx.

²⁵⁴ World Trade Organization, "Azevêdo Welcomes Launch of Plurilateral Environmental Goods Negotiations", 8 July 2014, http://www.wto.org/english/news_e/news14_e/envir_08jul14_e.htm.

for nearly half of the world's population, almost 30 per cent of global GDP and around a quarter of global exports.²⁵⁵

RCEP's goal is to deepen economic integration and untangle the web of FTAs between its parties. It will cover trade in goods and services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement and other issues (including new and emerging issues affecting business). RCEP aims to eliminate progressively tariff and non-tariff barriers on goods, restrictions and discriminatory measures on services and to create a "liberal, facilitative and competitive investment environment".²⁵⁶

To date, five negotiating rounds have been held, with a sixth scheduled for December 2014. The parties aim to complete negotiations by the end of 2015²⁵⁷, but it appears unlikely this timetable will be met.

Although its Doha Round of trade negotiations seems permanently stalled, the WTO has other avenues for addressing barriers to trade and investment:

- As noted earlier, negotiations are underway between 14 WTO members, including Australia, to liberalise trade in environmental goods. While Indonesia is not a participant, the negotiations are open to any WTO member to join.²⁵⁸
- Negotiations to update the WTO Information Technology Agreement (ITA), which liberalises trade in IT products, have begun. The focus is on expanding product coverage, increasing membership and addressing non-tariff barriers. WITA's 75 participants include both Australia and Indonesia.²⁵⁹
- The WTO's Trade Policy Review Mechanism provides a forum for highlighting trade and investment barriers. The trade policies and

²⁵⁵ DFAT, "Regional Comprehensive Economic Partnership Negotiations", accessed 7 November 2014, <http://www.dfat.gov.au/fta/rcep/>.

²⁵⁶ "Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership", 31 July 2013, <http://www.asean.org/images/2012/documents/Guiding%20Principles%20and%20Objectives%20for%20Negotiating%20the%20Regional%20Comprehensive%20Economic%20Partnership.pdf>.

²⁵⁷ DFAT, "Regional Comprehensive Economic Partnership Negotiations", accessed 7 November 2014, <http://www.dfat.gov.au/fta/rcep/>.

²⁵⁸ World Trade Organization, "Azevêdo Welcomes Launch of Plurilateral Environmental Goods Negotiations", 8 July 2014, http://www.wto.org/english/news_e/news14_e/envir_08jul14_e.htm.

²⁵⁹ DFAT, "Information Technology Agreement (ITA)", accessed 7 November 2014, http://www.dfat.gov.au/trade/negotiations/info_tech.html.

practices of individual WTO members are reviewed regularly and rigorously by both the WTO Secretariat and fellow members. Members are permitted to ask detailed questions of the member under review about the latter's trade and investment policies and practices.

Although Indonesia is not a participant, this paper would not be complete without discussing the Trans Pacific Partnership (TPP) regional trade agreement negotiations. The 12 negotiating parties, Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam, account for 38 per cent of global GDP, 11 per cent of the world's population and 25 per cent of world trade.²⁶⁰

Like RCEP, the TPP is designed to address traditional and new barriers to trade and investment and promote economic integration. However, it is intended to be a "platinum standard"²⁶¹ trade liberalisation agreement, one significantly more ambitious in scope and depth than RCEP and AANZFTA. And it appears that the TPP members are getting close to a basic deal; according to Australian Trade Minister Andrew Robb, they are "within reach of the finish line".²⁶²

For Indonesia, TPP membership seems a distant possibility. The current members intend the grouping to expand over time to include other Asia-Pacific economies²⁶³, but want to complete the agreement first.²⁶⁴ While countries such as Korea, Taiwan and the Philippines are keen to join, the previous Indonesian Government (led by President Yudhoyono) did not seem to share their

²⁶⁰ DFAT, "Trans-Pacific Partnership Agreement", accessed 7 November 2014, <http://www.dfat.gov.au/fta/tpp>.

²⁶¹ Peter Varghese AO, Secretary of the Australian Department of Foreign Affairs and Trade, "Speech to the Committee for Economic Development of Australia", (Perth, 20 May 2013), <http://www.dfat.gov.au/media/speeches/department/130520-ceda.html>.

²⁶² The Hon Andrew Robb AO MP, Australian Minister for Trade and Investment, (comments made at the concluding press conference of the Trans-Pacific Partnership (TPP) Agreement Ministerial Meeting, Sydney, 28 October 28, 2014), <http://www.andrewrobb.com.au/Media/Speeches/tabid/73/articleType/ArticleView/articleId/1742/categoryId/1/Andrew-Robb--TRANS-PACIFIC-PARTNERSHIP-TPP-AGREEMENT-MINISTERIAL-MEETING--CONCLUDING-PRESS-CONFERENCE-SYDNEY.aspx>.

²⁶³ DFAT, "Trans-Pacific Partnership Agreement", accessed 8 November 2014 <http://www.dfat.gov.au/fta/tpp>.

²⁶⁴ In a media release on Korea's interest in the TPP, United State Trade Representative Michael Froman said "the possible entry of any new country would be expected to occur after the negotiations among the current members are concluded". Office of the United States Trade Representative, "Statement by US Trade Representative Michael Froman on Korea's Announcement Regarding the Trans-Pacific Partnership", 29 November 2013, <http://www.ustr.gov/about-us/press-office/press-releases/2013/November/Froman-statement-TPP-Korea>.

enthusiasm²⁶⁵, preferring the less ambitious RCEP. Major economic and trade policy reforms would be required for Indonesia to meet the TPP's high, WTO-plus standards. But if the TPP members manage to conclude a deal, this might kindle Indonesia's interest in the TPP. And a bilateral FTA with Australia would be a good stepping-stone to eventual TPP membership.

Using Agriculture to Build Australia – Indonesia Bilateral Ties

Agriculture, already an important component of trade between Australia and Indonesia, is a sector with much promise for deepening bilateral relations across trade, investment and economic cooperation. Australia is well-poised to meet growing Indonesian demand for agricultural products, as well as to provide the services, investment and technical expertise needed by Indonesia to develop its agricultural sector. In turn, Indonesian investors have shown some interest in investing in Australia's agricultural sector. As a result of our research, we have decided to focus on two important areas of the bilateral agricultural trade: wheat and live cattle.

Wheat

Indonesia is the largest and fastest-growing market for Australian wheat, with Australian exports of wheat growing by 38 per cent between 2008 and 2013.²⁶⁶ In 2012, Australia accounted for 71 per cent of Indonesia's wheat imports²⁶⁷ and in 2013 Indonesia purchased \$1.2 billion worth of Australian wheat.²⁶⁸ The Indonesian noodle and baked goods industries are the main end-users, with Australian wheat used mostly for noodle production. Fuelled by a growing middle-class, westernisation of Indonesian diets and economic growth, Indonesia's consumption of wheat-based products is growing rapidly and its

²⁶⁵ Yose Rizal Damuri, "Trade Policy in Swing: Indonesia's Attitude to Liberalisation and the TPP", *East Asia Forum*, 19 March 2014, <http://www.eastasiaforum.org/2014/03/19/trade-policy-in-swing-indonesias-attitude-to-liberalisation-and-the-tpp/>.

²⁶⁶ DFAT, Australia's Trade with East Asia, 2013, http://www.dfat.gov.au/publications/stats-pubs/trade_eastasia.html.

²⁶⁷ Jake Lloyd-Smith, "Indonesians Buying Bread to Spur Wheat Imports Like Egypt's," *Bloomberg*, 5 March 2014, <http://www.bloomberg.com/news/2014-03-05/indonesians-buying-bread-to-spur-wheat-imports-on-egyptian-scale.html>.

²⁶⁸ DFAT, "Indonesia: Economic Country Factsheet," accessed 20 October 2014, <http://www.dfat.gov.au/geo/fs/indo.pdf>.

wheat imports will continue to climb.²⁶⁹ Rabobank expects Indonesia will need to import around 10 million tonnes of wheat per year over the next five years to keep up with consumption.²⁷⁰ And the Australian Export Grains Innovation Centre predicts Indonesia will be the largest wheat-importing country globally in the future.²⁷¹

Australia has a competitive advantage over other wheat exporters (namely Canada and the United States), due its close proximity to Indonesian ports and preferential treatment under AANZFTA (tariffs on wheat are bound at zero). However, Australian wheat exports could still face non-tariff barriers such as port restrictions and quotas. In 2012, for instance, Indonesia placed an additional tariff on wheat flour imports to defend its milling industry from a surge of surplus wheat flour imported from Turkey²⁷² (Imports of wheat grain are not subject to import duties, protecting Indonesia's milling industry).

While IA-CEPA could eliminate Indonesian trade barriers such as import quotas, a more effective opportunity to expand Australia's wheat trade with Indonesia exists. Growth in baked goods consumption in Indonesia far outstrips growth in noodle consumption, but Indonesia's baked goods producers prefer US and Canadian wheat over Australian wheat.²⁷³ According to the AEGIC, Indonesian buyers have indicated they would buy more wheat from Australia if it had the same baking qualities as US and Canadian wheat.²⁷⁴ The challenge for Australian wheat producers is to seize this opportunity and grow the varieties of wheat that Indonesian buyers demand.

²⁶⁹ Rabobank, The Wheat Opportunity: Growing Indonesian Consumption Driving Imports and Investment, Rabobank Industry Note #426, Rabobank Nederland, February 2014.

²⁷⁰ "Rabobank: Indonesia to Establish Itself as a Top 3 Global Wheat Importer in Next Five Years." Rabobank Nederland, 4 March 2014, https://www.rabobank.com/en/press/search/2014/20140304_Rabobank_Indonesia_to_establish_itself_as_a_top_3_global_wheat_importer_in_next_five_years.html.

²⁷¹ Australian Export Grains Innovation Centre (AEGIC), "Understanding our Grain Markets, Positioning for the Future".

²⁷² AEGIC, "Indonesian wheat flour quotas may impact Aussie exports", 24 June 2014, <http://www.aegic.org.au/media/news/2014/06/indonesian-wheat-flour-quotas-may-impact-aussie-exports.aspx>.

²⁷³ Rabobank, The Wheat Opportunity: Growing Indonesian Consumption Driving Imports and Investment, Rabobank Industry Note #426, Rabobank Nederland, February 2014.

²⁷⁴ AEGIC, "Indonesia Hungry for More Australian Wheat", 1 March 2013, <http://www.aegic.org.au/media/news/2013/03/indonesia-hungry-for-more-australian-wheat.aspx>.

Live Cattle Exports

Like wheat, Indonesia is Australia's largest export market for live cattle. Live animal exports represent a \$300 million trade with Indonesia;²⁷⁵ in 2013-14 the country purchased 624,749 head of cattle and accounted for 55 per cent of total Australian live cattle exports.²⁷⁶ Darwin, Townsville, and Fremantle are the top three ports of embarkation for Australian cattle, boarding over 700,000 head of cattle for export.²⁷⁷ Live cattle exports under AANZFTA face a tariff of 5 per cent until 2025, when it will be lowered to 2.5 per cent. Demand for meat in Indonesia is predicted to continue to rise, presenting a market opportunity for Australian cattle farmers.

Live animal exports have created tensions in Australia-Indonesia relations and had significant domestic economic consequences in both countries. In 2011, the Australia Government under Prime Minister Julia Gillard imposed a six-month moratorium on all live exports, following public outcry over animal welfare issues. Indonesia was not consulted before the ban was put in place, undermining Australia's reputation as a reliable trading partner. The ban not only hurt Australia's domestic cattle industry, but increased the overall price of protein Indonesia's food economy.

Australia's exports of live cattle eventually resumed, but in 2012 Indonesia placed a cap on live cattle imports without consulting Australia. This move shocked the Australian cattle industry, which pressured the Australian Government to take legal action against Indonesia, claiming this non-tariff barrier violated AANZFTA. Indonesia's decision to cap cattle imports had domestic repercussions, increasing the price of beef and other foods.

The live export trade has since stabilised, with Australian exports increasing from \$174 million to \$461 million between 2012-13 and 2013-14.²⁷⁸ As its middle-class expands, Indonesia will continue to grow as a market for Australian cattle. While AANZFTA has secured a low Indonesian tariff on live

²⁷⁵ Ibid.

²⁷⁶ "Australian Livestock Export Industry Statistical Review 2013-14," Meat & Livestock Australia, September 2014, <http://www.mla.com.au/Prices-and-markets/Trends-and-analysis/Beef/Live-exports>.

²⁷⁷ Ibid.

²⁷⁸ "Australian Livestock Export Industry Statistical Review 2013-14," Meat & Livestock Australia, September 2014, <http://www.mla.com.au/Prices-and-markets/Trends-and-analysis/Beef/Live-exports>.

cattle imports from Australia, a bilateral FTA could prevent the imposition of non-tariff barriers like import and export bans. And the Indonesia-Australia Partnership on Food Security in the Red Meat and Cattle Sector should help rebuild trust and promote greater dialogue in this important trading relationship.

Through commercial diplomacy efforts, such as the Red Meat and Cattle Sector partnership, Australia can reassert itself as a reliable trade partner. Building stronger ‘business to business’ relationships with Indonesia will be essential. Equally important, Australian businesses and policymakers might develop strategies to attract Indonesian investment in Australian agriculture. Such investments would position Indonesia to benefit financially from the success of Australian agriculture.

Agricultural Research Cooperation

President Widodo’s stated policy objective of increasing agricultural productivity through research (see his *visi-misi* statement above) offers Australia further opportunities to engage in capacity-building and research cooperation with Indonesia. The Australian Centre for International Agricultural Research (ACIAR) has provided agricultural research support to Indonesia for over 30 years.²⁷⁹ Building on this, agricultural science departments at Australian and Indonesian universities could develop cooperative research programs focussed on improving agricultural productivity. Such programs would enhance ‘people to people’ ties between Australia and Indonesia and be the type of cooperation that the Widodo Government would likely support: practical solutions that ultimately help ordinary Indonesians and their businesses. As noted above, IA-CEPA is expected to have a substantial economic cooperation component and an agricultural pilot project is already underway, so a bilateral FTA would be a good vehicle for expanding research cooperation in agriculture.

²⁷⁹ Australian Centre for International Agricultural Research (ACIAR), accessed 20 November 2014, <http://aciar.gov.au/country/Indonesia>.

Summary

Opportunities:

- Indonesia represents a growing market for Australian wheat and live cattle exports, with demand expected to rise.
- Australia has a competitive advantage over other wheat and live cattle exporters due to its proximity to Indonesia and preferential AANZFTA tariff rates.
- Further engagement with Indonesia in the field of agricultural research, where there will likely be policy support from the Widodo Government.

Challenges/Risks:

- History of tension over live cattle exports may encourage Indonesia to look to other exporting countries.
- Indonesia could impose non-tariff barriers on live cattle imports in an effort to protect and value-add to its domestic cattle industry.
- Indonesia's preference to develop self-sufficiency in agriculture - it sees "food security" as "food self-sufficiency," rather than securing food from reliable trade partners.²⁸⁰

Recommendations:

- Australian companies looking to do business with Indonesia learn more about Indonesia's relationship-based business culture and practices.
- Australian agricultural producers work closely with Indonesian food processors, such as flour millers, to ensure they are well-positioned to meet changing dietary patterns in Indonesia.
- Australian state and federal governments continue to pursue strategies to attract Indonesian investment, particularly in the agriculture sector. This way, Indonesia has more of a stake in Australia's agricultural success.
- Australian states with large agricultural sectors, such as Western Australia, maintain an official presence in Jakarta, to promote investment opportunities and build rapport with Indonesian customers.

²⁸⁰ "Position Paper: On Considerations Towards the Indonesia – Australia Comprehensive Economic Partnership Agreement," Indonesia – Australia Business Partnership Group (IA-BPG), 31 October 2012.

- Continued development of exchanges, visits and research cooperation programs to strengthen “people to people” and “business to business” ties in the agricultural sector.

Conclusion

The outlook for Indonesia’s economy is positive if the Widodo Government can implement the right policies needed to take advantage of the country’s demographic dividend, create a business-friendly environment, attract investment, reduce corruption, and eliminate budget-draining fuel subsidies. But Widodo’s reforms may be complicated by domestic political realities. Reforming policies such as fuel subsidies will generate opposition and could hurt Widodo’s popularity. Economic nationalism and protectionism will likely continue to be tempting policy options in sectors like mining.

Indonesia’s status as an emerging economic powerhouse, coupled with a regional trade agreement, AANZFTA, provides ample scope for Australia to grow its economic ties with its most important neighbour. Australian businesses and investors would do well to take a closer, more long-term look at the huge market opportunities on their doorstep. Agriculture is one of several sectors with considerable potential in terms of both trade and investment, given Indonesia’s burgeoning demand for agricultural products, its growing middle class and President Widodo’s policy objective of improving agricultural productivity.

A comprehensive, forward-looking bilateral trade agreement that builds on AANZFTA would help Australia and Indonesia’s economic relationship achieve its full potential. Encouragingly, the Abbott Government has indicated its desire to restart IA-CEPA negotiations in 2015. At this point in time, it is unclear when the Widodo Government will be ready to sit down at the negotiating table with Australia; given the president’s ambitious economic reform agenda will likely keep his administration busy at first, it may be several months. In the meantime, there are other avenues for addressing trade and investment barriers, including AANZFTA, bilateral mechanisms and initiatives, regional forums and negotiations such as APEC, RCEP and multilateral organisations such as the WTO.