

# Strategic Analysis Paper

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## Indonesian Perspectives: Economic and Security Relations with Australia

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### Key Points

- Over the next decade, Australia may become increasingly less relevant to Indonesian economic interests.
- The current trade relationship is skewed in Australia's favour and Indonesia is likely to look towards other, larger, markets to counter that deficit.
- Australia has gradually reduced the amount of foreign aid to Indonesia while, at the same time, Australian investors are deterred by the generally poor Indonesian business environment.
- There may be an opportunity for Australia to adapt its defence exports to Indonesia's minimum essential force needs.
- The strongest ties lie in police-to-police links, aimed at combatting terrorism. That relationship could be used as a model for other bilateral linkages.

### Summary

As Indonesia's economy continues to grow and its population swells, the relationship with Australia is becoming more and more asymmetric. From the Australian perspective, it presents some opportunities but, as a counterbalance, Indonesia may be seeking to engage more closely with other, larger, powers in the region. This paper will look at the current

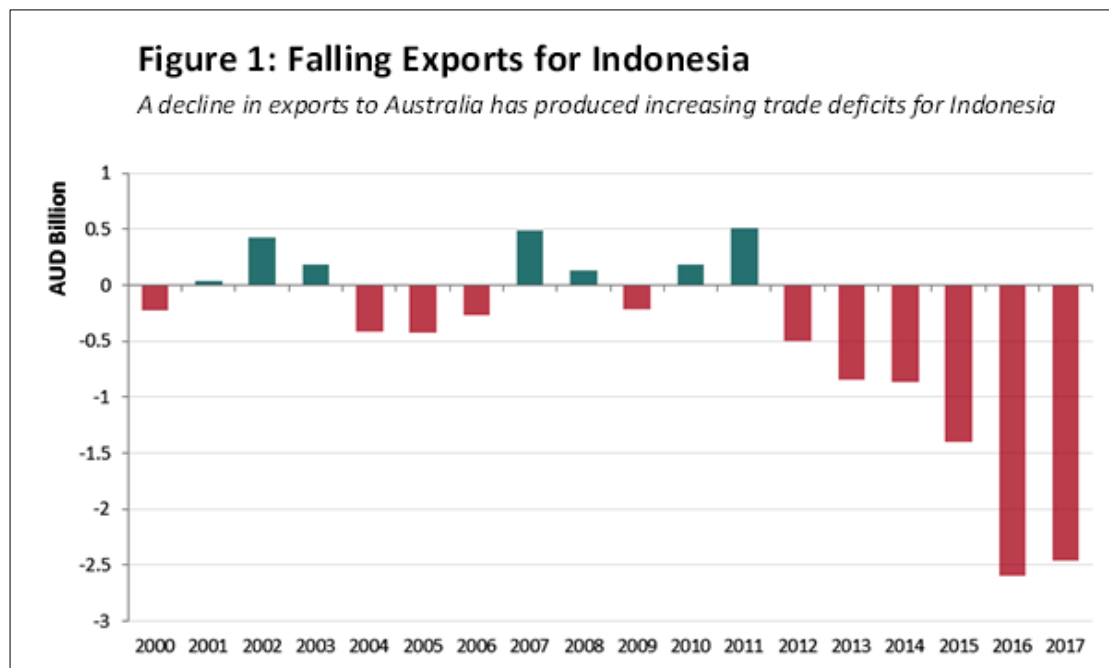
economic and security ties in that context and explore some of the possible future prospects for the bilateral relationship.

## Analysis

### Economic Relations

#### *Australia as an Export Market*

As noted in a previous FDI [Strategic Analysis Paper](#), Australia’s economic relationship with Indonesia has begun to falter. Looking at 2017 trade figures from [Bank Indonesia](#), Australia makes up 5.1% of Indonesia’s goods market. In comparison, Indonesia’s largest trading partners in 2016 included China (which imported 13 per cent of Indonesia’s exported goods), Japan (13%) and Singapore (11%). While Australia’s position in the Indonesian market is sizeable, increasing deficits have marred trade relations from Indonesia’s perspective. As seen in Figure 1, between 2000 and 2011 the value of imports closely matched the value of exports; bilateral trade never resulted in a deficit of much more than \$500 million for either country. Since then, Indonesian exports to Australia have fallen in value, resulting in a trade deficit for Indonesia of \$2.6 billion in 2016, the largest shortfall in the trading relationship to date.



The saving grace of Jakarta’s economic relationship with Canberra lies in Australia’s contribution to the Indonesian tourism industry. Defined as “travel exports” in services trade statistics, tourism is a vital part of the Australian-Indonesian economic relationship and is the single largest source of income for Indonesia in that relationship. When services exports are taken into account, the \$2.6 billion trade deficit that Indonesia experienced in 2016 is reduced to \$593 million.

Looking to the longer-term, however, Australia does not appear to be the primary market for Indonesian plans to expand its tourism industry. As a previous FDI [Strategic Analysis Paper](#) has discussed, Indonesia is expected to focus on increasing the inflow of Chinese and Muslim tourists. Arrivals from China have rapidly overtaken those from Australia and now make up the bulk of international tourists visiting Indonesia. At the same time, the Indonesian Government is working to promote Halal tourism, an approach that holds promising potential, given that Indonesia is the largest Muslim country in the world.

From Indonesia's perspective, the declining level of its goods exports to Australia is a weak point in the bilateral economic relationship. That may not improve for some time. With Australia's relatively small population of 24 million, Indonesia is potentially better off seeking to expand trade in other, larger, markets. Historically, China, India and the United States have been the largest and fastest-growing export markets for Indonesia. In the past five years, however, growth in the Chinese and Indian markets has begun to stagnate and, at times, fall. Based on the last five years of Indonesian exports, the Philippines and Vietnam have replaced China and India as the fastest growing markets for Indonesia. Compared to Australia, the Philippine and Vietnamese markets for Indonesian exports are larger, faster-growing and also in close proximity to Indonesia.

It is unlikely that the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA) will lead to Australia becoming a primary market for Jakarta. Negotiations surrounding the agreement have been difficult and failed to conclude by the revised December 2017 deadline. That said, when implemented, the IA-CEPA will play an important role in boosting bilateral trade and investment, just not at a level comparable to Indonesia's larger economic relationships. According to the Australian [Department of Foreign Affairs and Trade](#), the IA-CEPA aims to address impediments to bilateral trade, including both tariff and non-tariff barriers, to improve access to each other's services markets and to cut the red tape preventing Australian investment in Indonesia.

### **Investment**

Canberra's investment relationship with Jakarta has room for improvement from Indonesia's perspective. According to [statistics](#) from Indonesia's Investment Coordinating Board (BKPM), Australia ranked as the tenth-largest investor in Indonesia during first quarter of 2018, investing \$172.52 million through 176 different projects. That has seen Australia move up in the ranks of the top investors in Indonesia compared to the first quarter of 2017, even though total investment slightly decreased from 2017. In the first quarter of 2017, Australian investment realisation reached \$185.65 million through 158 projects, ranking twelfth.

While Australia is placed among the top ten overall investors in Indonesia, that position is more due to the fact that comparatively few countries invest significant sums in Indonesia. Additionally, as seen in Figure 2, investment realisation from Australia sits at almost half that of Malaysia and approximately twenty times less than that of Singapore.



Investment in Indonesia also accounts for a very small portion of Australia’s total overseas investment. Of the \$2.3 trillion overseas investment by Australia in 2017, Indonesia received only \$10.7 billion, approximately 0.46% of outbound Australian investment. In comparison, Singapore received \$59.4 billion as the largest destination for Australian investment in South-East Asia. Additionally, Australian investment in the Indonesian economy is similar to that of its investment in the Malaysian and Philippine economies, which are arguably less attractive for investors when comparing the raw size of the three economies.

As Future Directions International [has previously assessed](#), one of the primary factors behind the low level of Australian investment is a poor business environment within Indonesia. There is a strong correlation between the countries that Australian firms choose to invest in and the ease of doing business in those countries. According to the rankings used by the World Bank, Indonesia is placed ninety-first of 190 economies in the “Ease of Doing Business Ranking” (EDBR). That is primarily due to factors such as: limitations and caps on foreign investment, excessive permit requirements and costs, a shortage of skilled labourers and low productivity. In the longer-term, business reforms will hopefully address some of those issues and attract greater numbers of Australian investors.

Faltering trade and a lack of confidence on the part of investors is a disappointing transition from the previous donor-recipient relationship with Indonesia. With Official Developmental Aid (ODA) to Indonesia falling each year (from \$888 million in 2012 to \$316 million expected this year), Australia does not seem to have achieved its [stated](#) goal of moving ‘from a donor-recipient model to an economic partnership of equals’. Instead, from Indonesia’s perspective, Australia has gradually cut off its ODA while importing less and investing little.

## Defence and Security

### ***Importing Australian Military Equipment***

Indonesia is currently working to upgrade its defence force through the Minimum Essential Force (MEF) programme, under which it seeks to upgrade its naval, air and land capabilities. Current efforts so far have included: importing a range of military equipment, including fighter jets; the joint development of new military technology with South Korea; and the revitalisation of its indigenous defence industry. To date, Australia has played a very minor role in the MEF programme with Indonesia, preferring to collaborate with countries such as Russia, South Korea and the United States. That could potentially change, however, as Australia has signalled its [intention](#) to revitalise its defence exports industry, in the hope of becoming one of the top ten global defence exporters within the next decade.

In the Australian Government's [Defence Export Strategy](#), South-East Asia has been identified as a priority market, along with the wider Indo-Pacific. While Indonesia is not specifically mentioned, it has since 2013 become a major importer of Australian arms, receiving 28 per cent of Australian arms exports since then.<sup>1</sup> As a market for defence exports, Indonesia is not without its challenges, however, with the Department of Defence listing the following obstacles: 'protracted procurement processes, indigenous industry development and offset policies, transparency and integrity risks, and improving levels of regulation of exports.' In the case of Indonesia, the first two obstacles are especially relevant. Jakarta has a history of using [difficult and unclear bidding processes](#) for projects and is committed to building up its domestic defence industry at the expense of defence imports.

Despite those challenges, looking at the longer-term, there is an opportunity for Australia to become an attractive source of defence materiel for Indonesia. Jakarta has prioritised increasing its naval capabilities through the MEF programme, to secure its territorial waters and combat both terrorism and piracy in the region. Indonesia is an archipelagic country and borders some of the most important global shipping routes. Consequently, maintaining and then growing its naval capacity will continue to be a priority for Jakarta well past the 2024 deadline of the MEF programme. That makes it a suitable market for Australia; especially given that 66 per cent of Australian defence exports over the past five years have been naval-related. It will be difficult, however, for Australia to compete with other countries that already have a foothold in the Indonesian defence industry, such as South Korea. A number of [obstacles](#) facing the Australian shipbuilding industry could exacerbate these concerns.

### ***Maritime Security***

According to Peter Chalk, in *The Maritime Dimension of International Security*, Indonesia would need 300 vessels operating around the clock to adequately protect and monitor its three million square kilometres of archipelagic waters.<sup>2</sup> The Indonesian Navy (TNI-AL), however, only has approximately 178 naval vessels in active service. While it is aiming to have up to 274 vessels in service by 2024 under the MEF programme, it is highly unlikely that

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<sup>1</sup> Data taken from Stockholm International Peace Research Institute.

<sup>2</sup> Chalk, P., 'The Maritime Dimension of International Security: Terrorism, Piracy and Challenges for the United States', *Rand Corporation*, 2008, p. 12.

that target will be achieved given the many [challenges](#) surrounding the MEF programme. Due to the imbalance between Indonesia's vast archipelagic geography and its underequipped navy, Jakarta has put a strong focus on maritime co-operation in its bilateral relationships. That has primarily consisted of joint maritime patrols and intelligence sharing, with a particular focus on countering illegal fishing, smuggling and counter terrorism.

Given that Australia does not yet have a defence export market targeted at Indonesian needs, maritime co-operation should perhaps be the focal point of the defence relationship. Both governments have shown commitment to closer maritime co-operation, having [signed](#) on 16 March 2018 a Maritime Co-operation Plan of Action (MCPA), which implemented the Joint Declaration on Maritime Co-operation signed in February 2017. Under the agreement, both countries will work to combat illegal fishing and transnational crime, improve search and rescue co-ordination and strengthen navy-to-navy links, in addition to a range of other commitments. In a [press release](#) following the signing of the MCPA, Foreign Minister Julie Bishop also announced a four-year bilateral Maritime Capacity Building Initiative in Indonesia, which will see Australia allocate increased resources to help strengthen that country's maritime capabilities.

From Indonesia's perspective, however, it could be argued that ties with Australia are too unpredictable and that it is better off focusing on improving defence ties with its closer South-East Asian neighbours. January 2017, for instance, saw the [sudden suspension](#) of Australia-Indonesia defence ties, following the showing of what was deemed offensive material at a joint-training session between Indonesian Special Forces group *Kopassus* and the Australian Special Air Service. This incident cast doubt over the prospects for long term co-operation.

While the ties with Canberra can be fragile at times, the Royal Australian Navy outstrips the naval capabilities of Indonesia's South-East Asian neighbours. Despite its comparatively small fleet size, Australian vessels are stronger, more modern and boast superior technology, in part due to having the twelfth-largest defence budget in the world and a close defence partnership with the United States. Australia also has the highest number of submarines in the region, on par with Singapore. Maintaining strong defence ties with Australia through maritime co-operation is an immensely valuable resource in securing Indonesian waters from non-state threats.

### ***Counterterrorism***

Indonesia has also sought co-operation in countering terrorism. While Indonesia suffers from fewer terrorism incidents than the Philippines, it does contain the [largest jihadist community](#) in South-East Asia. Monitoring that community is a monumental task and virtually impossible to manage completely. To lighten the load, the Indonesian Government has sought co-operation from a variety of governments, including Australia, New Zealand and the United States, in addition to its ASEAN neighbours. Historically, those efforts have been criticised as weak and token in nature due to a prevailing emphasis on sovereignty above all else, especially among the ASEAN states. In recent years, however, notable

advances in both intelligence sharing and joint operational procedures have been achieved, especially in its co-operation with Australia.<sup>3</sup>

Following the 2002 Bali bombings, the Indonesian and Australian Governments signed a series of Memoranda of Understanding, to expand co-operation in combatting terrorism within Indonesia. Those MoUs included steps such as: information sharing; building up the capacity of Indonesian counter-terrorism forces; and combatting terrorist financing. The aligned interests between Australia and Indonesia following the Bali bombings also highlighted counterterrorism co-operation as a focal point from which the broader strategic relationship could potentially flourish. In the months following the signing of the MoUs, both governments continued to work closely and, along with the US, formed Special Detachment 88 (*Densus 88*) on 30 June 2003. This is a specialist anti-terrorist branch of the Indonesian National Police (*Kepolisian Negara Republik Indonesia*, or POLRI). Since then, the Australian Government has continued to fund and train the special unit, which has been [widely praised](#) for its successes in arresting terrorists and foiling attacks.

Today, counterterrorism continues to be a focal point of Indonesia's security relationship with Australia and it has led to close collaboration between the Australian Federal Police (AFP) and POLRI. Speaking at Edith Cowan University on 10 April 2018, Tito Karnavian, Police Chief of the Indonesian National Police, praised the relationship between his organisation and the AFP, adding that it is POLRI's strongest relationship in the region that is committed to combatting terrorism. According to a paper released by the [Australian Strategic Policy Institute](#), the closeness of the AFP-POLRI relationship is a rare achievement among security forces and can be seen as a success story in the wider bilateral relationship.

The partnership has clear benefits for both countries, allowing the police forces to better disrupt and prevent transnational crime and terrorism. Although the police-to-police relationship can be vulnerable to the ups-and-downs of the bilateral relationship, it has made a positive contribution to the broader relationship through [fostering a 'habit of co-operation'](#). In the longer-term, it can be expected that both governments will continue to invest in this essential component of the bilateral relationship.

### **Conclusion**

From an economic standpoint, it appears that Australia will become less relevant to Indonesia as the Indonesian economy grows. Australia's small population in comparison to the countries of South-East Asia means that bilateral trade will reflect that decline as Indonesia looks elsewhere to expand its export markets. While IA-CEPA will help to boost bilateral trade, it is unlikely to shift Indonesian priorities away from larger, faster growing, markets.

The defence relationship, on the other hand, is a different story. With Australia operating one of the most capable navies in the Asia-Pacific, maritime co-operation with Canberra is a valuable resource for Jakarta in its struggle to maintain the security of its vast expanse of archipelagic waters. While there are opportunities for closer ties through defence exports,

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<sup>3</sup> Chow, J.T., 'ASEAN Counterterrorism Co-operation Since 9/11', *Asian Survey*, Vol. 45, No 2, p. 304.

the strongest linkages lie in police-to-police co-operation aimed at tackling terrorism in the region. Over time, those linkages will hopefully become even stronger and set a precedent for closer ties in other aspects of the bilateral relationship.

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