

Nationalism as a Hindrance to Indonesia-Australia Economic Cooperation

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Abstract: Recent advances in economic relations between Indonesia and Australia have not been impressive. Despite the fact that the Indonesian and Australian governments promote multilateral and bilateral free trade agreements to facilitate information exchange, coordination of developmental policies, and to further regional market integration, structural impediments in the form of nationalistic trade and investment regimes remain in place to limit Australian businesses operating in Indonesia. This article examines how the nationalist roots of Indonesia's international relations, and recent developments in domestic and bilateral contexts, have hindered the essential components of ongoing economic collaboration with Australia. The argument is that since economic nationalism has been an inseparable element of Indonesia's foreign policy, it has conditioned the Indonesian government to take inward-looking position on external economic relations. Nationalist sentiment has gained traction because local elite political economic interests dominate the state's rulemaking. Protectionism leads to contradictions and disruptions within Indonesia-Australia economic cooperation, particularly with the FTA implementation.

1 INTRODUCTION

Recent advances in economic relations between Indonesia and Australia have not been impressive. Statistics of bilateral trade and investment illustrate that Australia is not ranked as one of Indonesia's major partners. Total trade volume between 2012 and 2016 indicates an annual decrease of 4.63 per cent (Indonesian Ministry of Trade 2017), whilst Indonesia is not among Australia's 10th largest trading partners, and its position is even below that of New Zealand and Malaysia (Australian Department of Foreign Affairs and Trade 2017). Australia's investments in Indonesia lag behind those of China, the United States, Japan, and Singapore, with the number of Australian companies operating in Indonesia decreasing from 250 in 2012 to less than 200 in 2016 (Coordinating Agency for Investment 2017). This is despite the fact of Indonesia and Australia's proximity to each other, which could potentially reduce transportation costs, and the relative complementarity of both countries' natural resources, as well as Indonesia's dynamic population and the potential of its growing middle-class markets for export of Australian products.

The Indonesian and Australian governments are trying to expand various initiatives in a free trade agreement (FTA) in order to eliminate barriers and strengthen economic cooperation. The ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA) was established in 2009, aimed to facilitate information exchange, coordination of developmental policies, and further regional market integration among Australia, New Zealand, and the ten ASEAN member states. It was followed by the commencement of negotiation rounds for Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA) in 2012, in which the two sides expected to accelerate bilateral achievements in line with the multilateral arrangements established by AANZFTA. However, the outcome of the liberalization processes has not been balanced. Australia shows more significant progress in opening its economy to Indonesian exporters and investors. On the other hand, structural impediments in the form of nationalistic trade and investment regimes remain in place to limit Australian businesses operating in Indonesia (Gleason and Springer 2014, 113-116).

2 HAMPERED BILATERAL ECONOMIC COOPERATION

Indonesia and Australia are trying to improve their economic cooperation through the multilateral framework of AANZFTA and the bilateral level approach of IA-CEPA. In many respects, however, Indonesia is sending contradictory messages to the spirit of liberalisation conceived in these free trade arrangements. In spite of realising tariff reduction programs, nontariff measures are retained to confine the flow of exports and imports. Regulation on investment is unwillingly adjusted to the global market demands. It is evident in the proliferation of conflicting national rules and procedures and the intergovernmental regulations governing foreign direct investments in the country. By and large, economic partnership between Indonesia and Australia is hampered by the former's continuing desire to protect itself.

3 CONTRADICTIONS WITHIN THE FTAs

AANZFTA is not Indonesia's first economic regionalism scheme, although it may be one which is most comprehensive regarding the scope of sectors being covered. The application of AANZFTA in Indonesia started in January 2012, meanwhile Australia had applied it two years before (*Kontan* 2012). In general, the ASEAN participants agreed to eliminate tariffs on 85 per cent to 100 per cent of products imported from Australia by 2025. Indonesia's commitment is 93 per cent by 2020. Australia has reciprocated with a more optimistic outcome that is it was able to reduce tariffs on 96 per cent to 100 per cent on ASEAN imported products after 2015 (ASEAN Secretariat 2009a). The standard agreements of the World Trade Organization (WTO) on deletion of tariff measures are referred to by AANZFTA (Australian Department of Foreign Affairs and Trade 2009). It is perhaps intended to avert potential increases in reciprocal tariffs beyond the negotiated terms.

In attempts to smooth regional circulation of goods, AANZFTA has approved the implementation of flexible rules of origin. Essentially, there is no prohibition on member countries trading products listed in AANZFTA for which the material ingredients are supplied by non-member producers (ASEAN Secretariat 2009b). Nevertheless, Indonesia is not enthusiastic about this system. It employs the

more domestic oriented policies to bolster local industrial linkages. The government encourages and facilitates a particular domestic sector to use input from another domestic sector, or output from a domestic sector is used to add more value to another domestic sector. When linkages are formed and further enhanced, domestic economic sectors can reap benefits from the increased value of the product (Patunru and Rahardja 2015, 6). This policy vision and action are clearly stated in the document of *Masterplan Percepatan dan Perluasan Pemangungan Ekonomi Indonesia* (Master Plan for Acceleration and Expansion of Indonesian Economic Development/MP3EI) promulgated by the Yudhoyono government. MP3EI projects which were begun in 2011 preceding Indonesia's AANZFTA commencement are quite nationalistic in nature.

Jokowi sustains the nationalism of MP3EI. He indeed directs domestic industrialisation in ways which conform to greater intent to foster internal connections. It can be found in Jokowi's middle range national development planning for 2015-19. Jokowi's economic trajectory is certainly in contrast to the core thinking of liberal economics, to which trade interdependence among states should be advanced to create common prosperity. The nationalist leadership expects that intensified local linkages can bring about efficiency, stable prices, and even economic growth throughout the Indonesian archipelago. This has been translated into the national maritime connectivity development called *tol laut*. The essence of the *tol laut* development is building robust and modern water transportation as well as logistic systems serving major port cities and the surrounding islands to speed up goods and services inflows from industrial sites in Java to isolated areas throughout the country. It looks like a complex web of local interisland connections which is centralised in several points. As a consequence, international trade cannot pass through any sea routes within the *tol laut*. It is gradually concentrated to go through gates in five major port cities. For example, imports from Australia and the Pacific region can only enter Indonesia from one point that is harbour built in Sorong Papua. Clearly, the *tol laut* development is being undertaken without considering the wider regional economic integration agendas, including AANZFTA.

Decentralised governance poses another challenge to AANZFTA's preferences. The problems are derived from conflicting legal products and interests between Jakarta and the local governments. The central government is authorized to make laws on international trade agreements, and apply them across the country. However, under the

decentralization regime the local governments can make and implement their own regulations to control trade of goods within local jurisdictions. There are provinces, for instance Central Java, East Java, and Bali, which impose more permit requirements, taxes, and cross-bureaucracy procedures to export and import activities. The treatment is stricter to foreigners owned business.

Beside this, significant issues also challenge AANZFTA's dialogue process on trade in services. Three central areas are being discussed without satisfactory conclusions. The first issue is related to the level of market openness for essential service sectors, such as education, finance, infrastructure, mining logistics, and telecommunications. Indeed, among ASEAN members, Indonesia is the most recalcitrant trade partner due to its largest non-tariff measures. Up to 2015, there have been 199 nontariff measures issued by 14 different government agencies regulating 6,466 products (Munadi 2016, 67), which potentially affect all its trading partners within AANZFTA. The other two areas are associated with investment services and protection of foreign ownership. Likewise in RCEP disagreements revolve around ISDS rights of foreign companies to bring lawsuits against the host countries. Indonesia has consistently opposed the legalization of such rights, arguing that the state's territorial rights, especially domestic law establishment, must be enforced on foreign business entities. It portrays Jokowi's inconsistent investment policies, at international forum inviting investments but at home trying to restrict them. In his presidential campaign Jokowi had emphasised the need to impose the state's laws on foreign economic activities (*Kompas.com* 2014). The trend so far has indicated that foreign investors prefer to file lawsuits through the international adjudication mechanisms. In the international arbitration tribunals, it has been noted that there are no fewer than 50 cases involving ASEAN states and their Asia Pacific partners, and which amount to US\$ 31 billion (Das 2017, 4).

In bilateral forums, the Indonesian delegates to trade negotiations with Australia have committed to work together in parallel to AANZFTA to gradually remove tariffs on Australian imported goods from 78 per cent to 92 per cent in 2015, to 94 per cent in 2025. These deregulation packages would allow Australia's main agricultural commodities, except for wine, sugar, and live cattle, to gain wider markets in Indonesia. For Australia's pharmaceuticals, manufacturing, and minerals tariffs will be organised so that they do not exceed limits permitted by the WTO (Australian Department of Foreign Affairs and

Trade 2012). Alongside the tendency within AANZFTA, service sectors are not yet open widely. For example, permits for foreign institutions to invest in the education sector have been very limited. Proposals for revision to this regulation were objected to by the Yudhoyono government on account of protection against commercialisation (*Kontan* 2013). Equity limitation is applied to foreign construction firms which undertake government and private projects (*Okezone.com* 2014). There are strict rules on foreign lawyers who can work in Indonesia (*Hukumonline.com* 2014). Others are entailed in the lists of negative investments issued between 2013 and 2014.

In dealing with these problems, IC-CEPA was initiated with the primary objective of discovering alternatives to speed up changes in policies and governmental structures considered to be impeding progress. Indonesia and Australia have arrived at the assumption that bilateral talks can be more efficient in achieving common goals. Nevertheless, there is a different view between Jakarta and Canberra about IA-CEPA. The former believes IA-CEPA should be consulted with reference to the conduct of other ASEAN-driven economic cooperation. This position is also visible in Indonesia's free trade scheme with Japan, South Korea, and Pakistan. ASEAN's economic institutionalisation is used to ground the extended bilateral free trade dialogue. Of course, it is more comfortable for Jakarta to rely on ASEAN's framework of interstate interactions which guarantee no political intervention in its internal affairs. Against the Indonesian stance, Australia wishes that IA-CEPA could be promoted like the model of Australia's free trade agreements with Singapore and Thailand in which there have been existing equal state-to-state commitments made to proceed with trade liberalisation on both sides, directed at the same pace. Such a difference in the ways Indonesia and Australia project their respective interests made IA-CEPA discussions less productive and they were suspended in 2013. The Jokowi government resumed IA-CEPA meetings in 2016, yet the erstwhile contending positions have remained to hinder their progress.

4 THE POLITICS OF FREE TRADE INITIATIVES

Economic nationalism plays an influential role in conditioning the Indonesian government to take protective actions within AANZFTA and IA-CEPA,

thus affecting the ongoing Indonesia-Australia economic cooperation. Firstly, the fact that Australia is not Indonesia's favourite trading and investment partner means that Australia cannot leverage economic diplomacy to set imperatives for Indonesia to follow in the free trade regulatory bodies wholly and completely. He (2008) argued that Indonesia's external actions during the Reform era have been constructed by the mixture of political legitimacy and international pressure. Yudhoyono and Jokowi had no problems with their respective political legitimacy because they were directly elected by the majority voters in democratic presidential elections. Hence, the consecutive leaderships which are established are able to anticipate possible political costs which may be caused by policies denoting rejections of full scale liberalisation. In addition, the public in general have usually supported the government's protectionist decisions. Subsequently, AANZFTA and IA-CEPA only create various processes of mutual understandings about the need for liberal trade mechanisms, yet offer little real achievement in respect to common interests.

Secondly, high tariffs on Australia's agricultural exports and non-tariff regulations issued to restrict Australia's services can be linked to the politics of domestic actors, especially the oligarchs, whose interests have been disadvantaged by the free trade arrangements in question. In the post-Suharto unconsolidated democracy, the messages of protection of people's interests and the safeguarding of national sovereignty are easily hijacked by the oligarchic elites to serve their rent-seeking objectives. The extension of this political culture to foreign relations is observable in the state's behaviour within regional and bilateral institutions which are developed with unbalanced contributions in economic affairs. Drawing on Keohane's variance of intergovernmental cooperation and state power relations (1989), the free trade agreement between Indonesia and Australia exemplifies the case of low degree of compliance and high transactional costs. The reason behind the negotiation is determined by the dominant political economic players.

Thirdly, the nationalistic features of Jakarta's international affairs connect functional and technical matters with those which are actually the domain of high politics. Likewise other multilateral commitments made by Indonesia, which also encompass Australia, such as ASEAN Regional Forum (ARF), ASEAN RCEP, and Asia Pacific Economic Cooperation (APEC), the viability and feasibility of AANZFTA will be much dependent on Jakarta's perception about noneconomic issues, such

as defence and security, in state-to-state interactions. Laksmana (2017) notices that the 1999 East Timor crisis and the 2006 Lombok Treaty prove the importance of Jakarta's and Canberra's strategic assessment on the dynamic developments of wide-ranging Indonesia-Australia relations. In this context, the nationalists in Jakarta, both executive and legislative, still view Australia as an untrusted partner. Consequently, although not every single economic initiative from Australia is rebuffed for historical politico-security reasons, Jakarta always carefully calculates the impact on national security.

Jakarta prudently witnessed Canberra's changing foreign policy approach from favouring Paul Keating's multilateralism to adhering to a new type of bilateralism of preferential trade agreements under John Howard. This change was not entirely related to the Howard government's self-endorsed preference for relations with Australia's Asian neighbours, but the contagious effects of the Asian financial crisis which was unresolved by the two major regional institutions of the East Asia, APEC and ASEAN, which pushed Australia to find a different way to conduct its immediate external relations. Washington's success, which was acquiesced by Canberra, to promote IMF as opposed to APEC as the crisis funding helper body for Indonesia, South Korea, and Thailand at a time American-Australian links were strengthening alerted Southeast Asians about the cross-regional powers' interests outside the existing economic multilateral institutions. Indonesia and others crisis affected states fully understood about Australian regional ambition following the ill consequences of the IMF's controlled liberalisation programs. Howard's confidence of bilateralism heightened in the Australian-led INTERFET mission in East Timor (Lee 2015, 152-53). Jakarta was upset, and ties with Canberra touched the lowest ebb since Australia stood by the establishment of Malaysia in early the 1960s.

Holding distrustful views about Australian intentions towards its neighbouring Asians, Indonesia and Malaysia rejected the initiative proposed by the Howard government to relate ASEAN free trade (AFTA) and Australia-New Zealand Closer Economic and Trade Agreement (CER), although Canberra had contributed to providing economic rehabilitation assistance in the IMF's reform packages. Yet, Australia moved forward with bilateral free trade talks with other ASEAN countries, and made good impressions on Singapore and Thailand, which had initially been appealed to (Lee 2015, 153-54). These evolving events can explain why Indonesia did not warmly welcome the later

proposal for AANZFTA. Jakarta's lack of interests in Australia's regional proposal persisted when Kevin Rudd's idea for an Asia Pacific Community was launched in 2008 (Morini 2010). Diplomatic clashes caused by Australian navy intrusions into Indonesia's territorial waters for turning back illegal migrants again disrupted dialogue for economic cooperation. The IA-CEPA rounds were put on hold.

Jokowi is trying to repair fractures in the relationship with Australia. On his visit to Australia in February 2017, the president emphasised the importance of economic cooperation between the two countries. IA-CEPA discussions should be completed by end of the year. However, two issues remain to act as obstacles to free trade advancement. The first issue is related to Indonesia's resource exploitation by Australian companies still threatens the prospects for a more open investment atmosphere. The second issue is the unfinished perception gap between elites that Indonesia and Australia have divergent economic and security priorities, for example development in the South China Sea. Australia's main concern is its shipping, and therefore a bilateral solution with China must be made. Whilst, Indonesia focuses more on its economic sovereignty over Natuna, and regards the multilateral framework of the South China Sea code of conduct as the best option to stabilize the seas (Suryadinata and Izzuddin 2017). The influence of such mismatched expectations on how Jakarta and Canberra deal with bilateral economic cooperation cannot be underestimated.

5 CONCLUSION

This study concludes that economic nationalism is an important factor in the current Indonesia-Australia cooperation in trade and investment. The impact on economic cooperation with Australia is explainable through this nationalist feature. Agreements on tariff elimination are successfully achieved. However, nontariff measures are mushrooming, and consequently impede the inflow of trade and investment with Australia. The nationalist inconsistency characterises Indonesia's engagement in AANZFTA and IA-CEPA, allowing them to proceed, but with little real effect. In addition, the evolving politics of free trade, which is affected by Indonesia's negative perception about Australia's regional roles, remains to act as a hindrance to the advancement of Indonesia-Australia economic cooperation.

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