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Asleep at the Wheel? Australian Economic Engagement with Indonesia

I would like to start out by providing some perspectives on the opportunities and the risks for Australia and Indonesia. I will then talk a bit about Indonesia and our economic relationship and end by offering some thoughts on what we could be doing differently.

Australia has done tremendously well over the last 26 years exporting our bulk commodities to Asia. Our agricultural products and mineral resources have benefited from economic growth in the region and fed a rapidly growing middle class.

But how long will the good times last? When, exactly, will the 'lucky country' run out of luck? Some say it started with the end of the resources investment boom; others believe it began when productivity growth started to slow in the early 2000s.

What's not in dispute is that the last quarter of a century of sustained economic growth will not continue indefinitely. Last week's economic growth figures were a reminder of this.

As a nation, we face very real challenges in:

- finding new sources of growth that diversify our economic base
- create more and better paid jobs for our children; and
- provide for an ageing population.

If we don't, future generations will not enjoy the same lifestyles that we have grown accustomed to.

In less than a decade and a half, four of the world's five biggest economies in purchasing power parity terms will be in Asia: The People's Republic of China (PRC), India, Japan and Indonesia will lead a region that produces more than half of the world's economic output and will be home to two-thirds of the world's middle class.

As Asia, led by the PRC, rises US strategic influence will decline in relative terms. Australia could lose its place as a G20 economy.

In his new book, *The Future is Asian*, Parag Khanna makes the point that there are 5 billion Asian citizens, 3.5 billion of them are NOT Chinese.

A Brookings Institute report last year predicted that nearly 90% of the next 1 billion middle class consumers will be Asian.

The potential impact of that statistic alone on Australian living standards is hard to overstate.

Our region is at the epicentre of changes that will shape the world in which we live for decades to come. These changes are happening far quicker than most Australians appreciate or are prepared to confront.

Australia will have to change too. Our business and government leaders will need to be as comfortable engaging with the Beijing, New Delhi, Tokyo and Jakarta as we are today in Washington and London.

As a nation we are struggling to face up to the reality of this. We have yet to come to terms with it and I do not think that Governments or business leaders have articulated to our citizens what this actually means for Australians.

And we should not be under any illusions, the risks for Australia were already rising no matter what the results of the 2016 US Presidential election.

Around the world nationalist narratives and the politicisation of foreign policy for domestic audiences is threatening the stability of the global trading order - an order which remains central to our prosperity and security.

Strategic stability in Asia has been accompanied by perhaps the greatest period of prosperity in human history. This growth has brought with it shifts in relative economic and strategic power - rivalry in our region is on the rise.

Now the idea that economic power can be used in the pursuit of national interests is not a new one. But a more confident and assertive China is articulating its interests on the international stage. We are faced with a growing contest over the principles and values upon which power is based in our region.

Our friends - with whom we have shared common values - have been both rich and powerful. The UK and then the US made the rules and backed them with military power - and Australia prospered.

For the first time in our history though we do not share a security alliance with our major trading partner - and we have not come to terms with this as a nation. Our two-way trade with the PRC, valued at $174 billion, accounts for almost a quarter of our trade. It is more than two and a half times our trade with Japan and the US.

Australia has not had a trade relationship of this significance since the 1950s when the UK was our major trading partner.

Up to now, our economic relationships in the region have been largely separated from our security and geopolitical ones. Business gets on with doing business and our elected representatives and public servants deal with issues of national security and regional politics.

But tensions in the South China Sea, concerns about PRC influence on Australian society, a string of decisions to block foreign – notably PRC – investment and the more recent decision to ban Huawei and ZTE from participating in our 5G networks suggests that business and politics are not so neatly separated.

The growing forces of geo-economics and rising populism demands a new partnership between government and business.

Both must step up and engage our community in a discussion about our future.

In times of trouble, our business interests provide a vital ballast that we do not have in Indonesia, or for that matter anywhere in Asia today.

Many of you may be familiar with the report we published in 2014 titled ***Passing us by*** - this was the topic of my last visit here in July 2015 - which looked at the state of Australia's foreign direct investment in Asia (FDI). As the title of the report suggests, the level of our FDI is low by any measure. It is a truly woeful story.

Perhaps more worrying was the fact that a staggering two thirds of Australian businesses we surveyed said they had no intention of changing their stance on Asia in the coming 3 years. I have not seen any real evidence that that view has changed.

Our economic relationships in the region are still built around our exports of bulk commodities. While 6 of our top 10 trading partners are in Asia, Australian businesses have invested more in New Zealand ($62 billion in 2017) than they have in all of the 10 ASEAN countries ($40 billion) – and even if you add China ($13 billion), Japan ($0.8 billion), India ($1.8 billion) and Korea ($0.9 billion) you don't get to $60 billion (combined $57 billion).

We trade with Asia but we are not in Asia.

And while trade in goods and our "export services" of education and tourism will remain important elements of the Australian economy and our relationship with Asia, the biggest opportunity lays in tapping into the domestic markets in the region.

As Parag Khanna pointed out, one quarter of ASEAN trade was with other ASEAN countries, in total more than 60% was with other Asian countries. Since 2001, more than half of the $US 500 billion of FDI that has come into Asian countries originated in another Asian country.

AsiaLink, PwC and ANZ released a report in 2015 that highlights that Australian services exports to Asia are relatively low compared to exports to traditional trading partners.

In fact Services made up 34 per cent of Australia's 'value-added' exports to Asia compared to 54 per cent to the rest of world.

Much of this differential can be attributed to the fact that the rest of the world is currently more developed than Asia.

But this is changing. Asia is quickly becoming home to many ‘service intensive’ markets. And this is good for Australia because it is an area we have real competitive advantage.

If the last 25 years has been about shipping our bulk commodities to Asia, the next 25 will be a story of consumption and services.

And to be part of those markets, Australian firms will have to be where the consumers are – and that is increasingly in Asia.

Paul Keating once said “no country is more important to Australia than Indonesia”. As the world’s third largest democracy, the fourth most populous country and the largest Muslim population, Keating’s assessment of our largest near neighbour seems pretty fair.

But our relationship with Indonesia has been a difficult one. Australia’s role in East Timor’s independence; asylum seekers; death sentences and imprisonment for Australian drug smugglers; disputes over live cattle exports; revelations that the personal mobile phones of former President Susilo Bambang Yudhoyono and his wife were wiretapped by Australian intelligence and more recently Prime Minister Scott Morrison’s announcement that Australia would recognise West Jerusalem as the capital of Israel threatened to derail the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA).

Three years ago one of Australia’s foremost Indonesian analysts, Ken Ward, published an essay titled *Condemned to crisis?* There is a question mark in that title….but Ward argued that the Australia-Indonesia relationship has been, and probably will always be, punctuated by varying degrees of crisis.

In Ward’s view, governments need to better understand Indonesia's point of view - policy settings and the political narrative can then be managed with those sensitivities in mind, rather than responding to a media and/or opposition driven narrative.

That advice is sensible enough, particularly if we are happy with the status quo and simply want to manage the current relationship more effectively.

But should we even be happy with how the relationship is today? I would argue we should not. In fact our relationship is a long way short of where it ought to be in today's environment, let alone where we should aspire to taking it.

In September last year Prime Minister Scott Morrison stood beside President Joko Widodo and announced the upgrading of diplomatic relationships to a Comprehensive Strategic Partnership. This included an announcement that the parties had reached an agreement on the Indonesia-Australia Comprehensive Economic Partnership - an agreement that was 8 years in the making.

That agreement was signed in Jakarta last week. And while domestic politics and the usual hand-wringing over who the winners and losers are will probably continue through the ratification process - we should be celebrating the symbolic significance of having any agreement at all.

Like any trade deal, governments can open the door but it is up to business to find the courage to walk through it.

And we would be wise to make the most of it - we may not get another invitation as good as this one.

Since the Asian Financial Crisis left the economy in ruins in the late 1990s, Indonesia's economic performance has been impressive. GDP growth is among the highest of the large emerging markets, consistently over 5 percent, with only a slight fall during the global financial crisis.

In 1998 Indonesia's GDP was $US 95 billion. Today it is around three quarters of the Australian economy. Indonesia recently became just the 5th Asian member of the $US 1 trillion club.

Already the world's 8th largest economy in purchasing power parity terms, Indonesia is expected to rise to 5th place by 2030 according to our economic modelling.

All of this happened while Australian businesses were asleep.

Not only is Indonesia's 260 million-strong population growing, it's becoming better educated, more urban and more employed. With an average age of 29 years, Indonesia's population is also young. An emerging and affluent middle class is expected grow to 140 million by the end of the decade.

Indonesians are now more digitally connected than ever before and are among the world's highest users of social media. Today, Indonesia is the fastest growing internet market in the world. Some 30 million Indonesians already shop online, three quarters using a mobile device.

Incredibly, with bilateral trade worth just A$16.8 billion in 2017, Indonesia isn't one of Australia's top 10 trading partners. Australian direct investment in Indonesia stands at an embarrassing $10.7 billion, just over half the investment in PNG and not even 1 percent of the total stock of our outward direct investment.

Part of the problem may be due to some profound misunderstandings about one of our nearest neighbours.

It is hard to think of another region in the world where two near neighbours are more different.

Research by the Australia Indonesia Centre in 2016 found that there are almost twice as many Indonesians (87%) who view Australia favourably than there are Australians who view Indonesia favourably (43%).

The word Australians most associate with Indonesia (68%) is "religious". True enough but it is not necessarily the first thing you would think of if you were doing business with someone.

And when Australians were asked about their understanding and willingness to do business in Indonesia only 18% of Australians agreed

(34% disagree) that Indonesia has a "strong economy", 14% agreed (49% disagree) that Indonesians are "fair", and 13% agreed (44% disagree) that Indonesians are "trustworthy".

70 years after Indonesia achieved independence from Dutch rule, we still don't really understand one of our closest neighbours.

This was no more apparent than in last year's Lowy Poll where just 27 percent of Australians agreed that 'Indonesia is a democracy'. Worryingly, the poll results are going from bad to worse with 34 percent agreeing with the same statement three years ago.

In fact, Indonesia has held 4 free elections since President Soeharto stepped down nearly 20 years ago. The 2014 Presidential elections saw the largest single day of voting anywhere in the world – a remarkable but little celebrated achievement. And one that will be bettered next month when Indonesians head to the polls again to elect their president.

This is not the kind of place a near neighbour should occupy in our national psyche. Even more so when you consider the economics.

And what better way to get to know each other than tourism.

Ross Taylor, the President of the Indonesia Institute has been pointing out for some time now that Indonesia's rapidly expanding middle class saw more than 9 million (up from 8.4 million in 2016) citizens travel abroad in 2017.

We have only recently decided to allow Indonesian citizens to apply for a visa online – something that nationals from Japan, Malaysia, and Singapore have been able to do for years. Our Japanese, Singaporean and Malaysia visitors can travel here on an Electronic Travel Authority which costs $20 and is issued with 24 hours. People from other countries including Indonesia, Vietnam and Thailand have to fill in a long form, pay $140 and wait up to a month - sometimes longer!

Now you will hear that we are getting encouraging growth in the inbound market from Indonesia (up 15.4% in 2017), but this is from a hopelessly low base and it also includes business and student travel.

To put that into context, both Singapore and Malaysia, with populations of around 6 million and 31 million respectively, each sent us plus or minus about 250,000 tourists last year. Indonesia with its population of 260 million sent us barely 100,000.

No doubt the argument will be advanced that Australia needs to be sure about who is visiting our country and to weed out those who will do us harm - and we do. But bad people with intent don't only come from Indonesia and they most certainly won't be deterred by a $140 fee and month long wait. Unfortunately the good people are being deterred - and it would seem in considerable numbers.

As Mr Taylor points out, perhaps a good starting point in sending a more consistent and neighbourly message would be to introduce a far cheaper and simpler visa process for Indonesian tourists wanting to visit; just like the 1.1 million Australians who holiday in Bali every year enjoy.

Indonesia of course has its challenges, ranking 73rd on the World Bank's Ease of Doing Business Index but that is a significant improvement from 117th four years ago.

Building strength and capability in the Indonesian bureaucracy will take time. Corruption issues, along with the tussle between Jakarta and provincial authorities, makes for a complex environment for business to navigate. Australia should absolutely be Indonesia's preferred partner to help solve these challenges. But we are not.

Any projections of Indonesian economic success are also not without risk. The reform process has not all been plain sailing. President Widodo is still pushing up against powerful protectionist and nationalist forces that come and go in Indonesian politics - something our political leaders should keep in mind when we get around to thinking about ratification of IA-CEPA.

Indonesia requires immense investment in infrastructure and improvements to its political, economic, legal and social institutions.

Local institutions don't have the capacity to deliver the infrastructure needed to support President Widodo's growth aspirations. So Indonesia needs foreign investment – and quite a lot of it – to reach its economic potential.

So protectionism will need to be balanced with pragmatism.

A healthy and vibrant Indonesia is, most importantly, good for Indonesians. It is also good for Australia: good in economic terms and good for our shared security interests.

As one of only a few developed economies in the region, Australia is well positioned to help Indonesia. With one of the world's largest pools of pension funds, our capabilities in technology, innovative ideas, and our concentration of talented people - we can contribute to all of the key drivers of economic growth for Indonesia.

To be sure, the operating environment is not straight-forward, and the opportunities are not risk-free. But then growth is never a risk free proposition.

Despite our obvious competitive advantages, there is mounting evidence to suggest that as a business community we are alarmingly under-prepared for the world that we live in.

A report from last year titled *Match Fit* that AsiaLink, PwC and the Institute of Managers and Leaders produced was the latest report card to say this. The report found that a staggering 9 out of 10 ASX200 companies were not "Asia capable" – by any measure, an epic fail for corporate Australia.

Australians have low, and falling, Asian language capabilities. Five times as many students studied Italian than did Indonesian in the 2018 NSW HSC (564 vs 106). Barely 100 final year students in NSW studied the language of our nearest neighbour and a country expected to be the world’s fifth largest economy in PPP terms in 2030.

Language is a window to culture and we need to invest far more in developing our cultural understanding of Indonesia.

And it may well be that it will be the younger generations who take us there. By the end of 2020, the New Colombo Plan alumni will have grown to around 40,000 young Australians with experience of living, studying and undertaking work experience in the Indo-Pacific. Indonesia is one of the top 5 destinations selected by the NCP students.

As I mentioned earlier, the PRC’s influence in our region is growing, both economically and on a geo-political front. Australian and indeed Indonesian policy makers and diplomats will be faced with a very delicate balance in managing PRC’s increasingly clear challenges to 70 years of US primacy in the region.

Our two countries share a common economic interest in our engagement with China, the US, Japan and India to ensure a peaceful and stable environment is maintained in the Indo-Pacific. Terrorism is also a very real and present concern to both of our nations.

Any ideas though that Indonesians get up in the morning and look south for guidance are wrong - they do not. They look north, as we do.

If we want to be more than just bystanders we will have to seriously rethink our engagement model. This will require courage and a healthy measure of leadership.

Like Ken Ward's essay, there is a question mark in the title of my topic this evening although there is no doubt in my mind that Australia has been asleep at the wheel when it comes to our economic engagement with Indonesia.

But it doesn't have to be that way. In fact there is plenty of room for Australia in Indonesia but we have to be more ambitious in how we think about the relationship.

Future generations are unlikely to thank us if we choose to continue down a path punctuated by the recurring crises that Ken Ward so expertly documented.

I have three **recommendations** for what we need to do if we are going to turn the economic opportunity of Indonesia - and indeed the broader Indo-Pacific region into a reality:

1. We need a narrative about the future of our nation. Our strategic interests, both economic and security, need to be understood in the context of a bi-partisan, long-term vision for our place in the region. The Foreign Policy White Paper provides a good foundation for that conversation but the vision needs to be explained to the people

2. There has to be a deeper partnership between the economic and security arms of government and the business community - we need each other more than we know in this complex and changing world
3. We have to get to know our region, that starts at school, it extends to tourism and it means knowing our counterparts - business and government - in Jakarta in the same way as we know our counterparts in New York and London

It is unlikely that we will waltz on through the next quarter of a century as comfortably as we have done the last quarter of a century.

The next 25 years could be spectacular for our country. And while we must be clear eyed about the risks, they should not blind us to the extraordinary opportunity on our doorstep.

How we respond will determine how well Australia does in the coming decades.

Thank you….