

## AUSTRALIA-INDONESIA BUSINESS OPPORTUNITIES

### KEY POINTS

- In the long term, Indonesia's ongoing trade liberalisation, complementary economy, growing population and disposable incomes create a very prospective market for Australian exporters. Despite the fall in Australian exports during the crisis, Australia's share of total Indonesian imports recovered to 5.2 per cent during 1999.
- Total two-way Australian-Indonesian goods and services trade was A\$6.9 billion in the year to June 2000, ranking Indonesia as Australia's tenth largest trading partner. Before the financial crisis, the balance of merchandise and service trade was heavily in Australia's favour, but since the crisis, strong Indonesian exports to Australia and lower imports have shifted the trade balance in Indonesia's favour.
- Significant export opportunities exist in manufactures especially with the relatively low value of the Australian dollar vis-a-vis the US dollar. Trade reforms are providing new opportunities in agricultural exports. Exports of services, including education and financial services, also are well placed to increase.
- A rapidly growing export sector, government asset sales through the economic reform program and a liberalised investment regime create new opportunities for Australian investment in Indonesia. This would deepen the the commercial relationship. However, adopting appropriate risk management strategies is important.

Despite Indonesia's financial crisis, Australia and Indonesia continue to enjoy a good commercial relationship. Trade is recovering from crisis induced falls, and with their complementary economies and ongoing trade liberalisation, this should continue. Further, new direct foreign investment opportunities in the strong export and small and medium enterprise sectors, and from Indonesian government asset sales could deepen commercial engagement between the two countries.

This chapter briefly describes the current bilateral trade and investment relationship, then explores emerging trade and investment opportunities for Australian business that Indonesia's ongoing economic reforms and recovery present.

## **AUSTRALIAN-INDONESIAN TRADE FLOWS**

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Australia and Indonesia enjoy a strong trading relationship.<sup>1</sup> Based on 1999 merchandise trade flows, Indonesia ranked as Australia's tenth largest trading partner. Before the financial crisis, the balance of merchandise and service trade was strongly in Australia's favour, with rapid growth and the relatively strong rupiah pushing up Indonesian import demand. However, with the crisis, Indonesian domestic demand contracted sharply and the rupiah depreciated, cutting Indonesian imports and boosting Indonesian exports to Australia. This shifted the trade balance strongly in Indonesia's favour (Figure 5.1). Increasing manufactures and services trade since the crisis indicates a more sophisticated trading relationship.

## **CRISIS' IMPACT ON TRADE**

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Following the crisis, Australia's exports to Indonesia fell by more than 15 per cent and imports rose by 8 per cent between 1997-98 and 1998-99 (Figure 5.1). By June 1999, Australia held a A\$780 million trade deficit with Indonesia, a significant turnaround from the 1996-97 surplus peak of A\$1.8 billion.

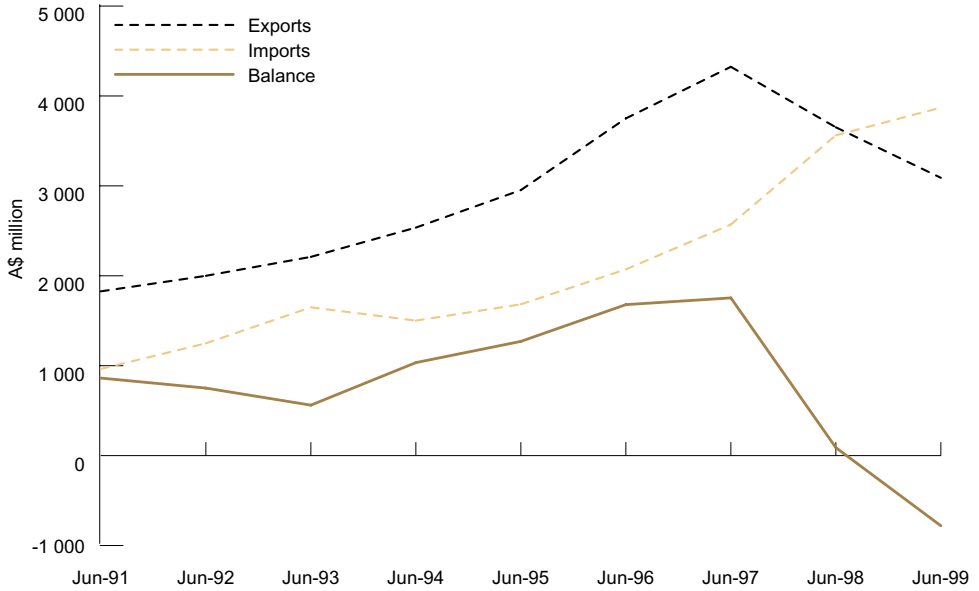
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<sup>1</sup> Total two-way trade in goods and services in the year to September 2000 was A\$6.9 billion.

Figure 5.1

**Indonesia Now Large Net Exporter to Australia**

**Australia's Goods and Services Trade with Indonesia**



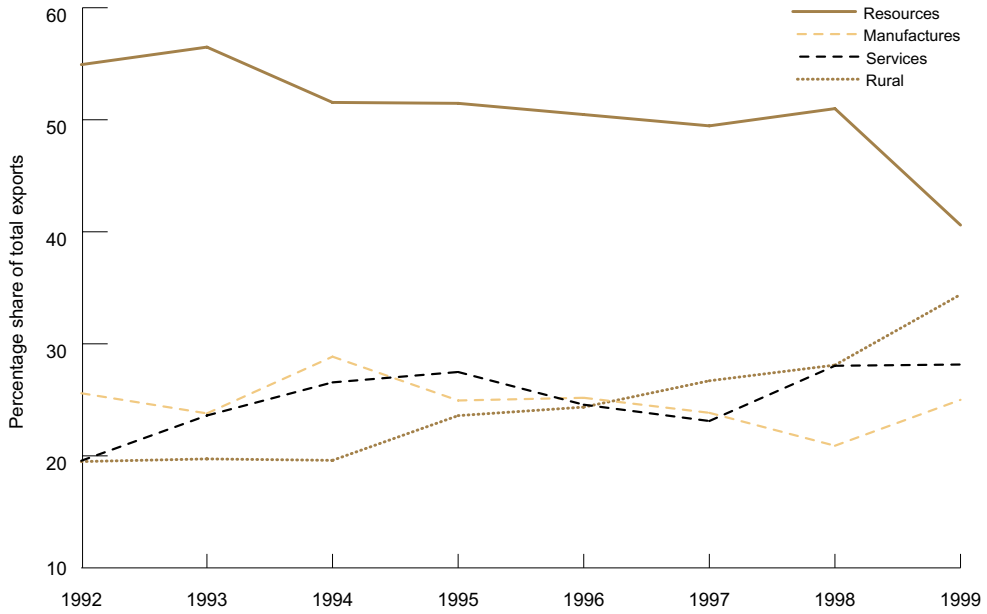
Source: Department of Foreign Affairs and Trade, 2000.

Trade composition also changed with the crisis, as rural exports like cotton and wheat held up strongly. Following the crisis, manufactures and services recovered as a share of Australian exports to Indonesia. Manufactures also rose as a share of Indonesian exports to Australia. However, it may be too soon to establish if these trends will continue. Over the decade, Australian service exports also grew strongly, increasing their share of total exports from 19.6 per cent in 1992 to 28.2 per cent in 1999 (Figure 5.2).

Figure 5.2

**Rural and Service Exports More Important after 1997**

**Shares of Major Categories in Australian Exports to Indonesia, Per cent**



Source: Department of Foreign Affairs and Trade, 2000.

Throughout the 1990s, Australia supplied about 5 per cent of Indonesia's imports, peaking at 5.6 per cent in 1996. Despite the absolute fall in Australian exports in 1998 and 1999, and the decline in market share in 1997 and 1998, Australia's market share recovered to 5.2 per cent during 1999 (Figure 5.3).

Figure 5.3

**Australia's Market Share Recovering**

**Australia's Share of Indonesia's Imports, Per cent**



Source: Department of Foreign Affairs and Trade, 2000; and Datastream, 2000.

**AUSTRALIAN EXPORTS TO INDONESIA**

In 1999, merchandise and service exports from Australia to Indonesia started to recover from sharp falls during the crisis, and continued to grow through 2000.

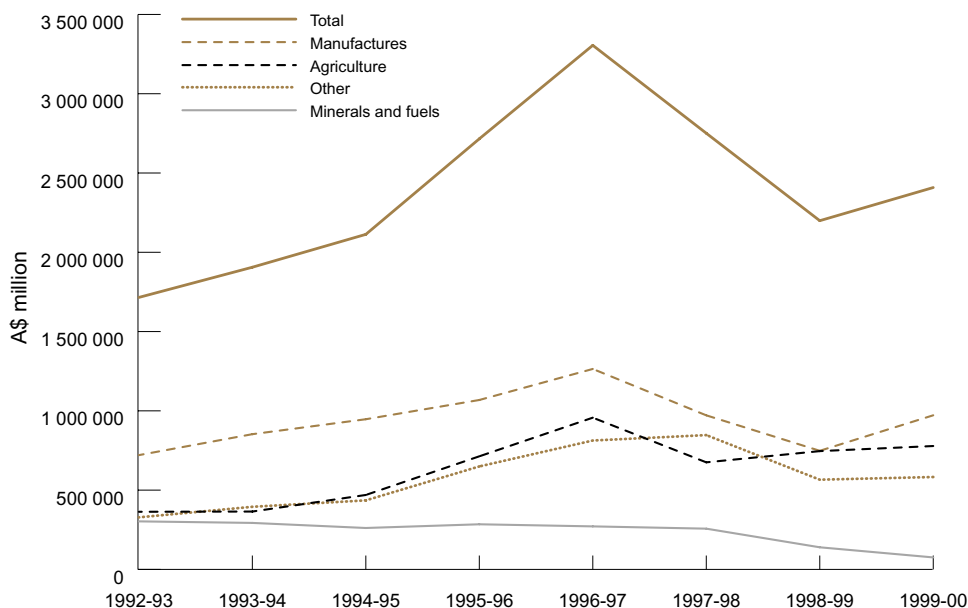
**Merchandise Exports**

After a decade of rapid growth, in 1998, the financial crisis and ensuing recession severely reduced Australia's merchandise exports to Indonesia. Between 1992 and 1997, Australia's merchandise exports to Indonesia rose at an average annual rate of almost 14 per cent. Rural, resource and manufactured exports to Indonesia all performed strongly, with annual growth rates averaging over 10 per cent. However, plummeting Indonesian demand following the crisis and a sharply depreciating rupiah cut Australian merchandise exports to Indonesia by over 30 per cent between 1996-97 and 1998-99, with resource, rural and manufactured exports all hit hard (Figure 5.4). All Australia's major merchandise exports to Indonesia, except cotton, experienced negative or zero growth during 1998. Merchandise exports to Indonesia fell from around 4.0 per cent of Australia's total merchandise exports at the end of 1997 to around 2.5 per cent by the end of 1999.

Figure 5.4

**Crisis Hit Exports Severely, Recovery Slow**

**Australian Merchandise Exports to Indonesia, Financial Year, 1992-2000**



Source: Department of Foreign Affairs and Trade, 2000.

In 1999, exports of live animals, meat, road vehicles, iron and steel, and non-ferrous metals led export growth. Cotton exports held up very well during the crisis and while they fell slightly through 1999, remained at historically high levels. However, Australian exports of petroleum products remained depressed throughout 1999, reflecting continuing low levels of economic activity in Indonesia. Throughout 2000, Australia’s merchandise exports to Indonesia recovered strongly, with annual merchandise exports growing by around 18 per cent in the year to September 2000.<sup>2</sup>

**Changing Composition of Merchandise Exports**

During 1996-99, Australian exports shifted from resources towards rural commodities and manufactures (Table 5.1 and Figures 5.2 and 5.4). Rural exports grew the fastest, led by cotton. In 1999, manufactures comprised six of the ten fastest growing exports; many had grown from very low bases, indicating new markets (Table 5.2). This may reflect the depreciation of the Australian dollar vis-a-vis the US dollar; the United States is Australia’s main competitor in the manufactures market. Whether this is an emerging trend is unclear at this stage. Nevertheless, the crisis may have provided an opportunity for Australian companies to penetrate new markets, providing a beachhead for future trade opportunities.

<sup>2</sup> Exports of coal briquettes, wheat, sugar, motor vehicles and furniture parts led export growth in 2000.

Table 5.1

**Rural Exports Growing Fastest**

**Sectoral Contributions to Growth of Australian Exports to Indonesia, 1996-99, Per cent<sup>a</sup>**

	1996	1997	1998	1999	Share of total exports 1996 (per cent)	Share of total exports 1999 (per cent)
<b>Rural</b>	<b>9.5</b>	<b>4.8</b>	<b>-10.6</b>	<b>6.3</b>	<b>26.3</b>	<b>34.5</b>
Live animals	3.0	0.0	-5.8	2.4	6.9	3.2
Meat	0.6	0.6	-1.8	1.6	1.8	2.1
Dairy products	0.9	0.3	-1.0	0.9	2.3	3.0
Sugar	1.0	0.5	-1.7	0.0	1.5	0.1
Textile materials	4.1	3.1	1.8	-0.7	10.3	21.5
Cereals	0.2	-0.1	0.0	1.0	0.4	1.3
Other rural	-0.1	0.4	-2.1	2.1	3.5	4.6
<b>Manufactures</b>	<b>5.4</b>	<b>2.8</b>	<b>-10.6</b>	<b>3.9</b>	<b>23.6</b>	<b>25.1</b>
Road vehicles	0.4	-0.2	-0.5	2.9	1.3	3.7
Other transport	0.5	2.0	-2.0	0.4	0.7	1.1
Electric machinery	0.1	-0.6	-1.5	-0.7	3.2	0.7
General machinery	1.9	-0.8	-0.9	0.3	3.0	2.1
Other manufactures	2.5	2.4	-5.7	1.0	15.4	17.6
<b>Resources</b>	<b>-0.7</b>	<b>1.8</b>	<b>-11.2</b>	<b>1.1</b>	<b>23.3</b>	<b>19.4</b>
Iron and steel	-1.4	1.6	-2.9	1.3	2.8	3.0
Non-ferrous metals	1.9	-0.6	-3.7	1.8	11.0	10.9
Petroleum	-1.4	0.7	-3.8	-3.6	8.2	3.1
Natural gas	0.0	0.0	0.0	0.9	0.0	0.9
Other resources	0.1	0.1	-0.8	0.8	1.2	1.5
<b>Other (including confidential)</b>	<b>14.7</b>	<b>0.5</b>	<b>-4.1</b>	<b>-11.7</b>	<b>26.8</b>	<b>21.0</b>
<b>Total</b>	<b>28.9</b>	<b>9.9</b>	<b>-36.5</b>	<b>-0.3</b>	<b>100.0</b>	<b>100.0</b>

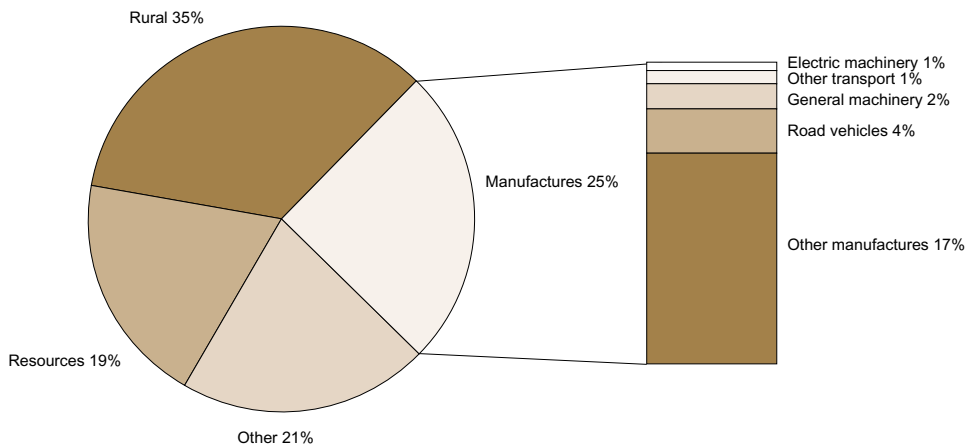
Note: <sup>a</sup> Contribution to growth is calculated as the percentage change in the item's exports multiplied by its share in total exports.

Source: Department of Foreign Affairs and Trade, 2000.

Figure 5.5

**Rural Exports Still Dominate, Manufactures Significant**

**Composition of Australian Merchandise Exports to Indonesia, 1999**



Source: Department of Foreign Affairs and Trade, 2000.

Table 5.2

**Manufactures Dominate Fastest Growing Export Lines**

**Ten Fastest Growing Australian Exports to Indonesia, 1999**

Export	Share of total merchandise exports (per cent)	Sector	Growth (per cent)
Liquefied propane and butane	0.89	Manufactures	132 879
Road vehicles	0.02	Manufactures	53 000
Steam and other vapour turbines	0.01	Manufactures	3 025
Men's or boys' clothing (knitted)	0.00 <sup>a</sup>	Manufactures	2 600
Heavy transport vehicles	1.50	Manufactures	2 517
Other cereal flours	0.00 <sup>a</sup>	Rural	1 550
Other non-ferrous base metals	0.01	Resources	1 393
Flour	1.00	Rural	1 177
Jewellery	0.01	Manufactures	995
Confectionery	0.02	Rural	922

Note: <sup>a</sup> Means rounded down to zero.

Source: Department of Foreign Affairs and Trade, 2000.

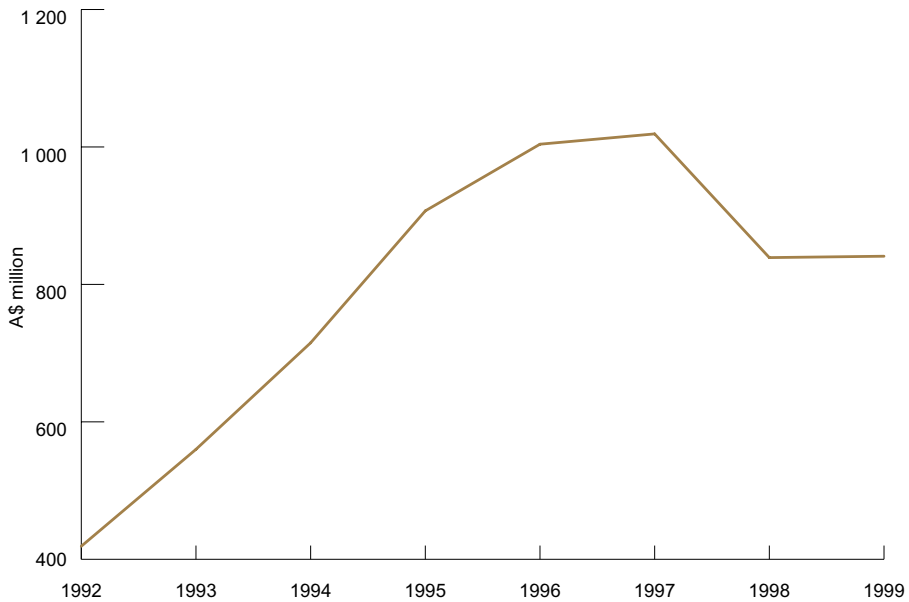
## Service Exports

Australian service exports to Indonesia grew at an annual average rate of over 20 per cent between 1991-92 and 1996-97, well above merchandise trade growth. Exports of education, tourism, financial and banking services, insurance, IT services and technology transfers were particularly strong (KPMG, 2000). During the crisis, service exports fell, but by less than merchandise exports, declining 10.5 per cent in 1997-98 (Figure 5.6).

Figure 5.6

### Service Exports Stable after Crisis, Stronger before

#### Australian Service Exports to Indonesia, Financial Year, A\$ million



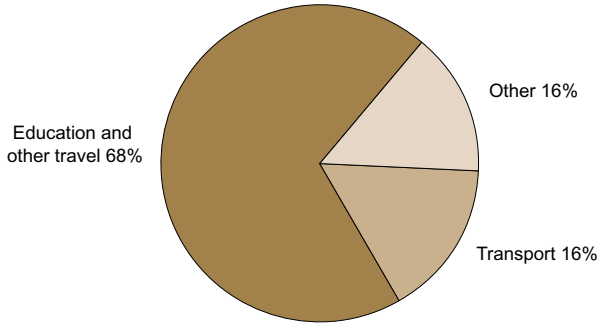
Source: Australian Bureau of Statistics, 1992-99.

Education services, and to a lesser extent, other travel, dominate Australian service exports to Indonesia, with 68 per cent of total service exports in 1999. Transport services comprised 16 per cent of service exports by value, and all other services including financial and business services, comprising 16 per cent, were the other major service export successes (Figure 5.7).

Figure 5.7

**Education Dominates Service Exports**

**Australian Service Exports to Indonesia, Financial Year, A\$ million**



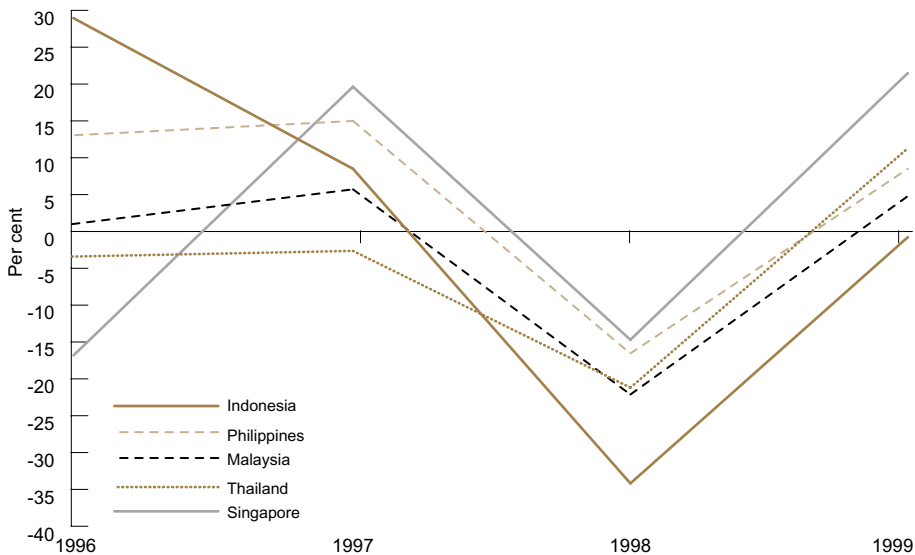
Source: Australian Bureau of Statistics, 2000b.

Indonesia's more severe crisis caused Australia's exports to Indonesia to fall more than exports to other ASEAN economies (Figure 5.8). In the three years before the crisis, Australia's exports to Indonesia grew by around 30 per cent annually, exceeding the growth in exports to Thailand, Malaysia, Philippines and Singapore. However, during the crisis, exports to Indonesia fell more sharply than those to its ASEAN neighbours.

Figure 5.8

**Indonesian Trade Has Been Volatile**

**Growth in Australian Exports to Selected ASEAN Economies, 1996-99**



Source: Department of Foreign Affairs and Trade, 2000.

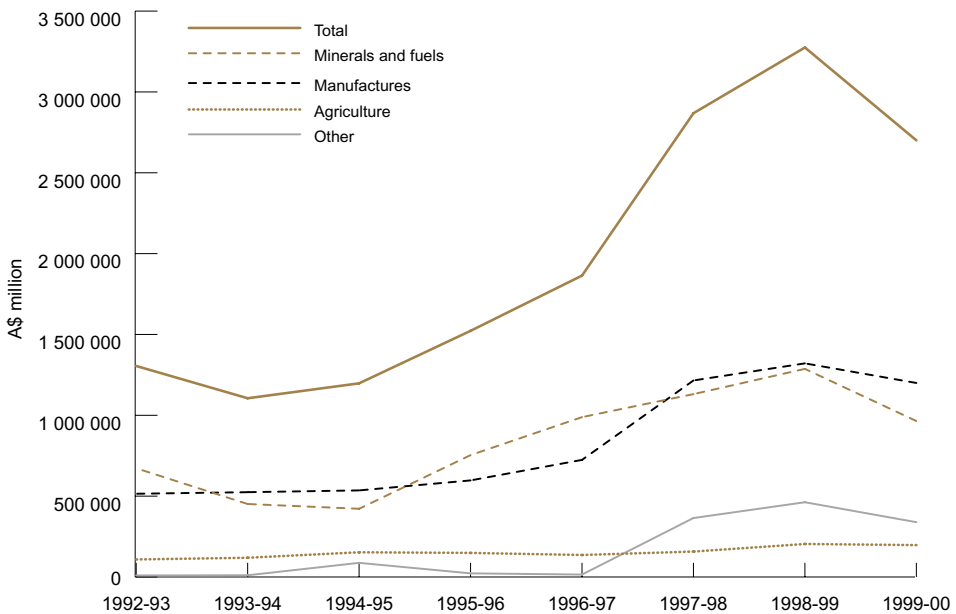
## AUSTRALIAN IMPORTS FROM INDONESIA

Weaker oil prices contributed to the lacklustre performance of Australian merchandise imports from Indonesia in the early 1990s; they fell by around 17 per cent between 1992 and 1994. However, they grew annually by an average of around 30 per cent between 1994 and 1997, again largely due to oil prices (Figure 5.9).

Figure 5.9

### Imports Grew Strongly after Crisis

#### Value of Australian Merchandise Imports from Indonesia, Financial Year, 1992-2000



Source: Australian Bureau of Statistics, 1992-99.

The rupiah's sharp depreciation during the crisis increased the competitiveness of Indonesian merchandise exports. Consequently, Australia's imports from Indonesia rose by around 75 per cent, between 1996-97 and 1998-99 led by an 82 per cent growth in manufactures (Figure 5.9). However, during 1999-2000, as the rupiah appreciated and Indonesian domestic demand recovered, Australian merchandise imports from Indonesia fell by over 17 per cent from 1998-99 (Bank Indonesia, 2000). A more stable rupiah saw annual merchandise imports from Indonesia grow by a modest 2.7 per cent over the year to September 2000 (CEIC, 2000).

## Changing Composition of Merchandise Imports

Australia's post crisis imports from Indonesia comprise more manufactures and other imports, including confidential and non-monetary gold, than before the crisis. Paper imports drive the increase in manufactures. However, it is too soon to determine whether this trend is likely to continue. Resource imports, mainly petroleum, remain the largest component of imports. By 1999, resources and manufactured imports accounted for around 80 per cent of Australia's merchandise imports from Indonesia (Table 5.3 and Figure 5.10).

Table 5.3

### Manufactured Imports Increasing in Importance Contributions to Growth of Australian Imports from Indonesia, 1996-99

	1996	1997	1998	1999	Share of total imports 1996 (per cent)	Share of total imports 1999 (per cent)
<b>Rural</b>	<b>-1.6</b>	<b>0.7</b>	<b>1.3</b>	<b>0.3</b>	<b>8.0</b>	<b>6.8</b>
Rubber	-1.0	-0.4	-0.3	0.0	2.0	0.7
Paper	0.1	0.1	0.5	0.5	0.2	1.2
Wood	-0.4	0.1	0.0	-0.1	1.6	1.0
Coffee	-0.3	0.2	0.8	-0.3	1.8	1.5
Other rural	0.1	0.6	0.3	0.3	2.4	2.4
<b>Manufactures</b>	<b>5.9</b>	<b>10.0</b>	<b>29.0</b>	<b>-9.1</b>	<b>37.2</b>	<b>41.0</b>
Paper manufactures	2.7	1.8	3.1	1.8	4.4	8.6
Furniture	0.3	1.0	0.4	0.1	3.0	2.9
Explosives	0.1	1.0	1.6	-0.3	0.3	1.7
Other manufactures	2.7	6.3	23.9	-10.6	29.4	27.9
<b>Resources</b>	<b>27.5</b>	<b>16.0</b>	<b>3.5</b>	<b>-3.4</b>	<b>54.0</b>	<b>41.5</b>
Petroleum	28.1	13.5	4.5	-3.3	51.8	39.6
Other resources	-0.7	2.5	-1.0	-0.1	2.2	1.9
<b>Other (including confidential)</b>	<b>-4.5</b>	<b>6.0</b>	<b>23.0</b>	<b>-9.6</b>	<b>0.8</b>	<b>10.7</b>
<b>Total</b>	<b>27.3</b>	<b>32.6</b>	<b>56.9</b>	<b>-21.7</b>	<b>100.0</b>	<b>100.0</b>

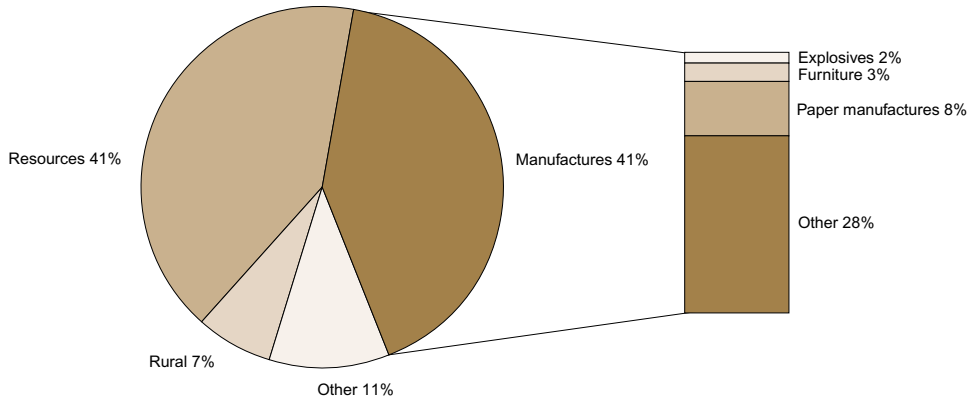
Note: Contribution to growth is calculated as the percentage change in the item's exports multiplied by its share in total exports.

Source: Department of Foreign Affairs and Trade, 2000.

Figure 5.10

**Oil Dominates Imports from Indonesia**

**Composition of Australian Merchandise Imports from Indonesia, 1999**



Source: Department of Foreign Affairs and Trade, 2000.

**Service Imports**

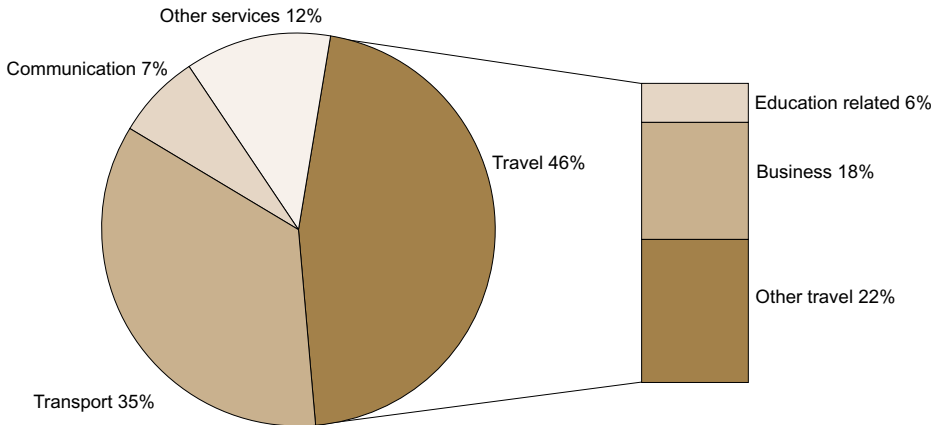
Until the crisis, service imports from Indonesia also grew at an average annual rate of around 20 per cent, albeit from a lower base, with strongest growth in travel and transport imports. In contrast to merchandise imports, service imports fell by around 15 per cent in 1998-99, reflecting less Australian travel to Indonesia.

In 1999, Australian service imports from Indonesia comprised mainly travel (around 45 per cent) and transport (around 35 per cent). Almost 40 per cent of Australian travel to Indonesia was for business (Figure 5.11).

Figure 5.11

**Travel and Transport Dominate Service Imports**

**Composition of Australian Service Imports from Indonesia, 1999**



Source: Department of Foreign Affairs and Trade, 2000.

**AUSTRALIA-INDONESIA DEVELOPMENT AREA, AIDA**

The Australia-Indonesia Development Area, AIDA, was launched on 24 April 1997 by Australian Foreign Minister, Mr Downer and Indonesian Coordinating Minister for Production and Distribution, Mr Hartarto. AIDA aims to develop closer economic relations between Australia and the eastern provinces of Indonesia, and improve the environment for private sector trade and investment in the region. AIDA covers Australia and the Indonesian provinces of West Kalimantan, Central Kalimantan, East Kalimantan, South Kalimantan, Bali, North Sulawesi, Central Sulawesi, South Sulawesi, South-East Sulawesi, West Nusa Tenggara, East Nusa Tenggara, Maluku and Irian Jaya.

The private sector is the key player in AIDA projects, and organises special working groups for implementing projects on a sectoral basis. These groups identify and explore sectoral trade and investment opportunities in the AIDA region. This collaborative work has identified several priority areas and established working groups in mining, agriculture and fisheries, tourism, education and transport. These working groups report their findings to meetings of government officials.

Source: Australia-Indonesia Business Council, 2000.

## POTENTIAL EXPORT GROWTH SECTORS

Recent trends in Australian exports to Indonesia indicate an emerging comparative advantage in manufactures and service exports. At the same time, Indonesia has liberalised domestic agricultural markets, dramatically improving access and opportunities for Australian agricultural exporters.

### Manufactured Exports

Manufactures were the fastest growing Australian merchandise exports to Indonesia in 1999, reflecting in part increased competitiveness from the depreciated Australian dollar. Rising domestic demand and a recovering rupiah boosted Australia's manufactured exports to Indonesia by 19 per cent in 1999, to A\$538 million. Indonesia's manufacturing sector also is recovering from the crisis, recording growth of 2.2 per cent in 1999, raising its share of GDP to around 26 per cent (KPMG, 2000).

### Vehicle related exports

After the Government lifted tight controls on vehicle imports, they increased five fold in 1999, boosting Australia's manufactured exports to Indonesia (Table 5.4). The June 1999 automotive deregulation package allows Indonesia to import completely built up vehicles, providing a major opportunity for Australian car manufacturers. By the end of 2000, preferential tariff rates for manufacturers using a high percentage of local parts also will be phased out, further benefiting Australian exporters.<sup>3</sup>

Indonesian demand for cars is expected to rise by 10 per cent per year between 2000 and 2005, well above the projected average for ASEAN economies (Tables 5.4 and 5.5).

Table 5.4

### Car Exports to Indonesia Boom in 1999

#### Australian Exports of Road Vehicles to Indonesia, Numbers of Vehicles

Export sub-category	1998	1999	Growth in 1999 (per cent)
Passenger motor vehicles	6 587	22 947	248
Heavy transport vehicles	1 211	31 697	2 517
Other road motor vehicles	1	531	53 000
Motor vehicle parts	7 038	19 917	182
Motor cycles	85	364	328
Trailers and semi-trailers	795	3 086	288
Total	15 717	78 542	400

Source: Economist Intelligence Unit, 2000.

<sup>3</sup> These policies complemented the June 1999 abolition of the national car program and local content scheme for automotive products.

Table 5.5

**Good Prospects for Indonesian Demand for Cars**  
**Forecasted ASEAN Vehicle Sales, 2000-05, in Thousands**

Export sub-category	2000	2005	Average annual growth (per cent)
Malaysia	348	493	7
Thailand	273	472	11
Indonesia	167	271	10
Philippines	86	147	11
Singapore	71	49	-7

Source: Economist Intelligence Unit, 2000.

**Pharmaceutical products and medical equipment**

Although pharmaceutical and medical products account for only 0.4 per cent of Australian merchandise exports to Indonesia, the share of these exports grew by around 50 per cent in 1999; this is significant in a market Japanese and US suppliers dominate.<sup>4</sup> Indonesia’s large population and rising incomes should continue to expand demand for these products. The Government uses most of the medical equipment and supplies (KPMG, 2000).

**PHARMACIA AND UPJOHN PERTH**

Pharmacia and Upjohn, P&U, Perth, export pharmaceutical products to Indonesia, concentrating on products used to treat cancer. Before becoming part of the merged Pharmacia and Upjohn company in 1995, Pharmacia and Upjohn Perth used the services of a local agent to promote and distribute their products in Indonesia. They believe identifying and grooming an appropriate local agent is critical to succeeding in Indonesia.

Geographic proximity, the presence of numerous other Australian companies and promotion by the Western Australian Government of Indonesia’s market opportunities encouraged P&U Perth to enter the Indonesian market. P&U Perth believes the key to succeeding in Indonesia is to choose an appropriate local agent. The highly price sensitive market and weak rupiah also make competitive pricing critical to success.

P&U Perth acknowledge economic and political instability since the crisis have damaged business. Also, increasing price sensitivity and new strict product standards have reduced profit margins. Consequently, P&U Perth sees the scope to expand in Indonesia as minimal, at least in the short term.

Source: KPMG, 2000.

<sup>4</sup> During the crisis, imports of medical equipment fell by more than 50 per cent in US dollar terms.

### Consumer ready food products

Australia gained considerable market share in consumer ready food products after the crisis, reflecting lower prices than major competitors such as the United States offered (KPMG, 2000). In 1999, Australian exporters recorded excellent sales growth in meat (around 300 per cent), fruit (80 per cent), and vegetable and dairy markets (50 per cent), mainly to the middle classes. Providing Australia maintains its relative exchange rate advantage over competitors, continues to produce at competitive prices and Indonesian incomes improve, growth in this export sector should continue.

### Security and safety equipment

The Indonesian security and safety equipment market continues to offer good potential for Australian exporters. According to 1998 estimates, Australia dominates the foreign players in Indonesia's security and safety equipment sector, holding around 30 per cent of the import market.<sup>5</sup>

Industrial, commercial, oil/gas and mining sector demand for this type of equipment is forecast to increase over the next five years (KPMG, 2000). Particularly active sectors include equipment relating to personal security, fire fighting and building protection.

## Agricultural

During the crisis, Indonesia's agricultural imports were relatively durable, resisting the recession, increasing their interest to Australian business (Australia-Indonesia Business Council, 1999c). Significantly reduced barriers to agricultural imports are part of the post crisis economic reform program, further supporting opportunities.

### Grains

In November 1997, the Government removed import licensing requirements on commodities the national logistic agency, BULOG, previously controlled; consequently, private imports of wheat, wheat flour and soy beans, and the sale and distribution of flour, now are allowed, with obvious benefits for Australian exporters. To smooth the transition to a fully open market, tariffs have replaced import licences; a tariff of 20 per cent applies to soy beans and 10 per cent to wheat flour. These tariffs should drop to 5 per cent or less by 2003.

In late 1998, the Government opened rice imports to competition, but applied a temporary import duty of Rp. 430 per kilogram. As a regional exporter of rice, Australia is well positioned to take advantage of this liberalisation. (See Chapter 10 - *Agriculture*.)

Australia remains Indonesia's major supplier of wheat. Wheat-flour based industries, particularly millers and downstream manufacturers of pasta, noodles, bread and biscuits, have considerable potential; Australian producers are well placed to invest in these sectors (KPMG, 2000).

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<sup>5</sup> This is well above the market shares of Australia's major competitors such as the United States (with 17 per cent), France (with 11 per cent) and Singapore (with 10 per cent).

### **Cotton**

With a large textiles industry and negligible domestic cotton production, Indonesia remains the world's largest cotton importer (KPMG, 2000). Despite Australian exports of cotton falling slightly in 1999, they have performed particularly well in the past few years, with annual growth averaging around 20 per cent since 1995, and particularly strong growth in 1997 and 1998. With the depreciated rupiah, the export-oriented textiles sector will continue its high demand for cotton.

### **Fishing vessels, handling and processing**

Deregulation has lifted bans on importing fishing vessels, and fishing industry liberalisation is ongoing; both moves provide significant opportunities for Australia. Demand for new fishing vessels should grow considerably over coming years and fishing sector liberalisation provides excellent opportunities for Australians to provide post-catch handling facilities such as refrigeration (Australia-Indonesia Business Council, 1999d).

### **Sugar**

A 25 per cent tariff on sugar is set to drop to 5 per cent or less by 2003. Australia, with a highly efficient sugar industry, is well placed to take advantage of this opportunity. Australian sugar and wheat exports to Indonesia are classified as confidential because of the small numbers of exporters involved.

### **Dairy and other sectors**

In January 1998, the Indonesian Government dismantled controls on dairy product imports and wood panel exports and shipment, industries in which Australia has considerable comparative advantage. Local content requirements for dairy products were phased out in February 1998, well ahead of Indonesia's Uruguay Round commitment. These developments offer significant opportunities to Australian exporters.

### **Mining**

Indonesia is Australia's most important market for mining equipment and services, absorbing exports of A\$300 million annually (Australia-Indonesia Business Council, 1999a). The presence of a strong Australian mining network provides a foundation to expand Australian mining technology, service and equipment exports (*Indonesia-Australia Business Council News*, May 2000, p. 1). The mining sector accounts for around 10 per cent of Indonesia's GDP and, after contracting by only 1.5 per cent in 1999, should rebound strongly in 2000.<sup>6</sup> Austmine, comprising several leading Australian mining equipment exporters, supports industry exports. However, ongoing security issues may constrain mining sector growth. (See Chapter 9 - *Mining*.)

### **Services**

As the Indonesian economy continues its reform process, the trend of strong growth in Australian service exports should continue.

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<sup>6</sup> Mining activity declined by 2.8 per cent in 1998 (CEIC, 1998).

### Financial services

Australia's financial service professionals, with considerable expertise in risk management and regulatory compliance, are well placed to assist in the reform of Indonesia's financial sector. Demand is strong for corporate finance professionals who can help Indonesia attract new partners and strategic alliances (Colley, 1999). Several Australian financial service providers are pursuing merger and acquisition opportunities in Indonesia.

For example, in November 1999, ANZ increased its 4.9 per cent share in Bank Panin to 10 per cent (with an option to increase its share to 28 per cent). ANZ also has a technical service agreement supporting Bank Panin in developing human resources, information technology, trade and risk management (*Asia Pulse*, 19 November 1999).

### Legal, accounting and consulting services

Indonesia's demand for legal and accounting services presents significant opportunities for professional firms in Australia. Major opportunities exist in corporate debt restructuring, particularly providing corporate recovery and due diligence services. Australian firms are at the forefront of debtor/creditor negotiations and use Australian personnel to provide these services. Australia's legal and accounting professionals also can contribute to developing Indonesia's judicial and corporate governance systems.

As debt restructuring concludes over the medium term, demand will increase for consultants assisting in implementing new accounting and risk management systems, establishing business plans and preparing feasibility studies (Colley, 1999).

### Environmental services

New regulations rating manufacturers by their compliance with environmental standards offer opportunities for Australian operators in this field.<sup>7</sup> Rising demand by Indonesian firms to control pollution presents an opportunity for Australian exporters, especially in construction, waste water treatment, water supply and solid waste disposal facilities. For example, the South Australian Water Corporation provided technology and expertise to the West Java Government to help it develop and manage water resources, water supply and waste water treatment (Australia-Indonesia Business Council, 1999b).

### IT services

The number of Internet users in Indonesia is expected to increase from 1 million in 1999 to 1.5 million in 2000 (KPMG, 2000). Although it still is in its infancy, Indonesia's e-commerce industry should increase nearly ten fold between 2000 and 2003 (KPMG, 2000). The Government recently allowed IT start-up companies to raise capital on the Jakarta Stock Exchange. Australia possesses the technological capabilities and human capital necessary to contribute to this expansion.

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<sup>7</sup> The Government publicises these ratings. Around 300 firms participate in this program, but the Government aims to raise this to 750 firms by the end of 2000 (KPMG, 2000).

## **SURPAC SOFTWARE INTERNATIONAL**

Perth based Surpac Software International produces, markets and sells mining software in Indonesia, via an agency which Australians and Indonesians staff. Indonesia is a critical market, with a sizeable proportion of South East Asia's modern mines. The Surpac brand is well known in Indonesia, especially among Australian mining companies, and Surpac's Perth headquarters ensures relatively easy access to the Indonesian export market.

Surpac provides regular upgrades and product support for its main software to its Indonesian clients, and sales demonstrations to prospective clients. Perth based sales and support staff regularly visit Indonesia. Surpac also trains its technical staff.

Surpac started to export to Indonesia in the mid 1980s. Initially, it undertook all marketing and support services from Perth, making frequent visits to Indonesia to learn about the market. Then it combined marketing trips with local staff training, to cover travelling costs. However, to market its technical products, Surpac realised it needed more permanent local support. After deciding against establishing a joint venture with a local firm, it tried to establish a joint office with another Australian company, but this option proved untenable as the financial crisis progressed. Finally, an established Australian surveying contractor, PT Globecon, familiar with Surpac's product, agreed to assist with marketing. The marketing agent receives a commission for seeking out new clients, and Surpac provides quotations and sales support, including sales presentations.

Surpac believes flexibility is critical to succeeding in Indonesia, particularly in marketing strategies. Technical aspects of the product were adapted to Bahasa Indonesian. Commitment to client service and after sales service were important, and local Indonesian support was vital to understand the subtleties of doing business in Indonesia.

Political instability remains a concern. Civil unrest disrupts marketing and sales trips, especially in regions where the mining sector is concentrated. The weak rupiah makes Surpac's products, invoiced in Australian dollars, much more expensive than before the crisis. Lack of language training and poor English amongst Indonesians can be a problem. Nevertheless, Surpac generally is comfortable with the prospects for its current Indonesian operations.

Source: KPMG, 2000.

## **Education services**

Australian educational institutions' good reputation, effective marketing strategies and relatively low tuition fees mean Australia attracts around 40 per cent of all Indonesian students pursuing overseas studies; this proportion is higher than any other education provider achieves (Table 5.6). In one innovative approach, Monash University and University of New South Wales in conjunction with an Indonesian company, have opened pre-university classes in Jakarta, guaranteeing placements for graduates at either institution.

Table 5.6

**Australia Is Main Exporter of Education Services**  
**Exports of Education to Indonesia in 1998**

Exporter	Estimated number of students	Market share in terms of number of students (per cent)
Australia	17 462	43
United States	13 282	32
Germany	3 400	8
United Kingdom	2 000	5
Other	4 856	12
Total	41 000	100

Source: KPMG, 2000.

Prospects for exporting education services from Australia remain excellent, given Australia’s geographic proximity and established reputation within the region.

**TRENDS IN DIRECT INVESTMENT**

Opportunities stemming from the financial crisis should boost traditionally small investment flows between Australia and Indonesia. Sales of assets to repair Indonesia’s bank and corporate sectors provide opportunities to increase significantly Australian direct investment in Indonesia. Australian investment in Indonesia drives bilateral investment flows, with overall investment around A\$1.2 billion in 1997-98; close to A\$800 million of this was direct investment. Around 400 Australian companies have a permanent presence in Indonesia, including BHP, Rio Tinto, ANZ, Commonwealth Bank, Amcor and Telstra.

**AUSTRALIAN DIRECT INVESTMENT IN INDONESIA**

Indonesia’s population (the fourth largest in the world) and market size, relatively low cost labour, abundance of natural resources and geographical proximity traditionally have attracted Australian investment. Although Indonesia ranks twenty second as a destination for Australian investment, accounting for only 4 per cent of total foreign investment, it attracts more Australian investment than any other ASEAN economy except Singapore (Directory of Australian Business in Indonesia, 1999).<sup>8</sup> In April 2000, Australia ranked as Indonesia’s ninth largest source of accumulated direct investment (KPMG, 2000).<sup>9</sup> This is concentrated in mining, utilities and chemicals (Table 5.7).

<sup>8</sup> Compared to other ASEAN economies, Indonesia (at 22) ranks ahead of Malaysia (at 23), Thailand (at 26) and Philippines (at 31). It also ranks ahead of Taiwan (at 29). See Australian Bureau of Statistics (2000) for more details.

<sup>9</sup> Although Australian investment in Indonesia mostly comprises direct investment in companies, total foreign investment also includes portfolio and other investment.

Table 5.7

**Mining Investment Dominates Australian Foreign Investment**

Cumulative Approvals of Australian Direct Investment in Indonesia, 1967 to 31 May 2000<sup>a</sup>

Sector	Per cent share
Mining	34
Utilities	26
Chemical industry	20
Construction	4
Other services	4
Other sectors	12
Total	100

Note: <sup>a</sup> Data are approvals only and do not include oil and gas, and financial and insurance sectors.

Source: KPMG, 2000.

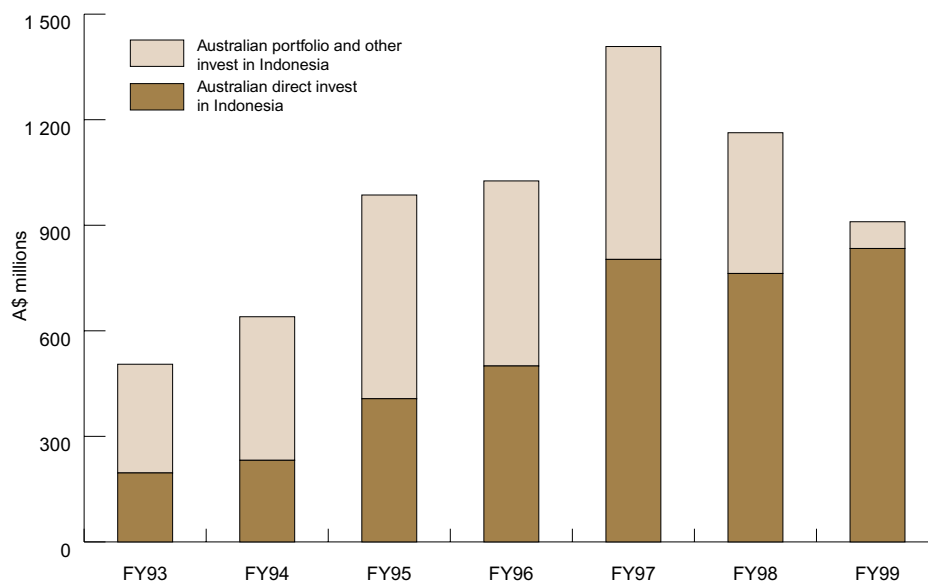
**Direct Investment in the Pre-crisis Period**

Between 1991-92 and 1996-97, the level of Australian direct investment in Indonesia increased more than eight fold (Figure 5.12). Most was concentrated in the resources and construction sectors.

Figure 5.12

**Australian Direct Investment Has Fallen Slightly since the Crisis**

**Australia's Flow of Foreign Investment in Indonesia, 1992-98**



Source: Australian Bureau of Statistics, 1999.

Mining companies BHP and Rio Tinto are particularly active in Indonesia. They established large scale operations for mining coal, gold and tin; BHP alone employed around 4 000 people in Indonesia by 1996 (BHP, 2000a).<sup>10</sup> Indonesia's extensive infrastructure requirements also generated significant investment opportunities for Australian infrastructure and construction companies during this period. As tariffs decline, clothing, footwear and textile manufacturing enterprises, increasingly attract Australian investment.

### **BHP'S INDONESIAN COAL OPERATIONS**

BHP has a significant coal mining presence in Indonesia. In Kalimantan, PT Arutmin Indonesia (80 per cent BHP, 20 per cent PT Bakrie and Brothers) operates the Senakin and Satui mines, and North Pulau Laut coal terminal. PT Kendilo Coal (80 per cent BHP, 20 per cent Mitsui Mining Company) manages the Petang mine, also in Kalimantan.

BHP's Indonesian mines exported 6.8 million tonnes of coal in 1999, up 15.7 per cent on the tonnage exported in 1998. The Satui mine was constructed in 1989 and the Senakin mine, constructed in 1991, was expanded in 1994 to increase its capacity to 4 million tonnes per year. The Petang deposit, developed in 1994, produces 1 million tonnes per year.

Source: BHP, 2000b.

### **MANUFACTURER XYZ<sup>11</sup>**

Manufacturing firm XYZ, a prominent Australian company, has maintained a direct investment presence in Indonesia since the mid 1970s, producing both for the local market and export. Manufacturer XYZ is a joint venture with two local partners; it holds a majority, but not a controlling interest. Since the financial crisis, XYZ's profit has increased. This is because the depreciated rupiah increased export competitiveness, and the company's access to foreign currency funding during the financial system collapse gave it a significant competitive advantage. Access to capital allowed the company to guarantee clients of product supply, a priority when doing business in Indonesia. Manufacturer XYZ maintains close relationships with business partners and the local community who highly regard the Australian manager. Manufacturer XYZ has learned to deal effectively with intra-firm politics.

Manufacturer XYZ points out companies now entering Indonesia may face legal uncertainty and difficulties in obtaining finance, even from foreign institutions. It also considers slowing economic reforms a concern.

Source: KPMG, 2000.

<sup>10</sup> Other Australian companies with substantial investments in Indonesia in mineral exploration and production include Aberfoyle Ltd (copper and gold), Aurora Gold Ltd (gold), Laverton Gold (gold), Meekatharra Minerals (gold and silver), Newcrest Mining Ltd (gold and silver), Pelsart (gold), Placer Pacific (gold and base metals), Wesfarmers Coal Pty Ltd (coal), North Ltd (gold) and WMC (coal). (See Australia-Indonesia Business Council web site, OzIndo Online).

<sup>11</sup> This firm's name was suppressed at the request of the company for commercial-in-confidence reasons.

Several financial institutions, including ANZ and Colonial have established banking and insurance joint ventures.

### **COLONIAL ACTIVE IN INDONESIA'S INSURANCE SECTOR**

With the life insurance market's strong recovery from the financial crisis, Astra CMG Life, a joint venture between Australia's Colonial Mutual Group and the Astra Group, saw income from premiums jump 55 per cent in 1998. By the end of 1998, the company had 315 000 customers and 1 500 employees. In 1999, to respond to strong growth, Astra CMG Life opened five new branches, adding to the existing branch network of 20 offices.

The low coverage of the national pension scheme and a growing middle class generate considerable growth opportunities for insurance companies in Indonesia that now can be 100 per cent foreign owned. Life insurance requires a long term strategic commitment; Colonial Mutual Group's commitment is based on market potential. The current penetration of life insurance is less than 3 per cent of the Indonesian population; in other Asian neighbours, the penetration rate is more than 20 per cent. Indonesia's population is large; the economy is improving; and consumers' disposable income is increasing. Therefore, the life insurance industry should flourish. Consumer awareness of the value of creating wealth for retirement and family protection is increasing rapidly; this also strengthens confidence that the growth potential for the life insurance industry in Indonesia is strong.

Astra CMG Life, a 50:50 joint venture of the Colonial Group (Australia) and Astra International (Indonesia), was established in October 1992, after a two year market appraisal. As the life insurance market matured, Astra CMG Life expanded, and developed new products and services to meet the changing needs of the Indonesian market, providing savings, investment, health and traditional risk products. The joint venture offers the strong branding, consumer awareness and success of a large local partner that survived the financial crisis and Colonial's financial strength. Colonial contributes growth via shareholder capital injections and its international experience, allowing transfers of state-of-the-art products, systems and services to Indonesia.

Despite the financial crisis, Astra CMG Life grew by more than 20 per cent per year, and recorded profits in both 1998 and 1999. Unlike in other Asian economies, the insurance industry does not suffer excessive legal and regulatory restrictions. However, the rupiah continues to be volatile, and tools such as currency swaps and options to hedge against currency fluctuations are limited.

Consumers and businesses overwhelmingly support foreign financial service companies which offer secure investments. Therefore, Astra CMG Life believes growth opportunities in this market are equal to or better than those elsewhere. From the Indonesian Government's perspective, foreign financial service companies help retain savings in Indonesia.

Source: KPMG, 2000.

## Direct Investment since the Financial Crisis

With increased perceptions of risk, Australians divested A\$40 million from Indonesia in 1997-98, reducing the level of Australian direct investment by around 5 per cent (Figure 5.12).

In 1999, programs reforming the financial and corporate sectors bolstered investor confidence, although sensitivity to slippage in implementation remains. A low exchange rate and assets sales encouraged Australian investors to return to Indonesia. In 1999, Australian companies gained approval for 54 new investment projects and expansions on existing investment valued at US\$2.5 billion, placing Australia second in terms of the value of approvals.<sup>12</sup> In October 1999, P&O Ports (Australia) invested US\$170 million acquiring a 49 per cent share in the Surabaya Tanjung Perak port container (Buchanan, 2000). Australian firms continue to pursue new investments in 2000, with approvals for 34 new projects worth a total of US\$32 million given between January and July 2000. In July 2000, BHP announced it had reached agreement with Falconbridge Limited to form a joint venture which may develop the Gag Island nickel laterite project (BHP, 2000c).<sup>13</sup>

Foreign investor confidence appears to be increasing; Indonesian balance of payments show foreign direct investment approvals during the third quarter of 1999 exceeded all 1998 approvals. Foreign interest was concentrated in the chemicals, electricity, gas, water and paper sectors; these traditionally have attracted strong interest. (See Chapter 3 - *Foreign Investment*, particularly Table 3.1.)

## INDONESIAN DIRECT INVESTMENT IN AUSTRALIA

Official data indicate Indonesia's direct investment presence in Australia was A\$55 million in 1997-98 and has risen somewhat since the crisis (Figure 5.13). Low investment levels partly reflect Indonesian investor preference for Australian portfolio and other financial assets. Also, some Indonesian investment may arrive via Singapore, and be included in Singaporean data.

## INDONESIAN DIRECT INVESTMENT OUTLOOK AND OPPORTUNITIES

The Economist Intelligence Unit forecasts foreign direct investment in Indonesia will grow by 20 per cent per year between 2001 and 2003 (Buchanan, 2000). A dynamic and competitive export sector provides an ideal environment for start-up investment. Ongoing sales of corporate and financial assets also promise new opportunities for Australian investment in Indonesia. Australia is well placed to consolidate its commercial presence in the mining sector, as well as increase its presence in the infrastructure, manufacturing and financial sectors. However, doubts over economic, political and social stability, and an underdeveloped legal system could dampen new direct investment prospects. (See Chapter 3 - *Foreign Investment*.)

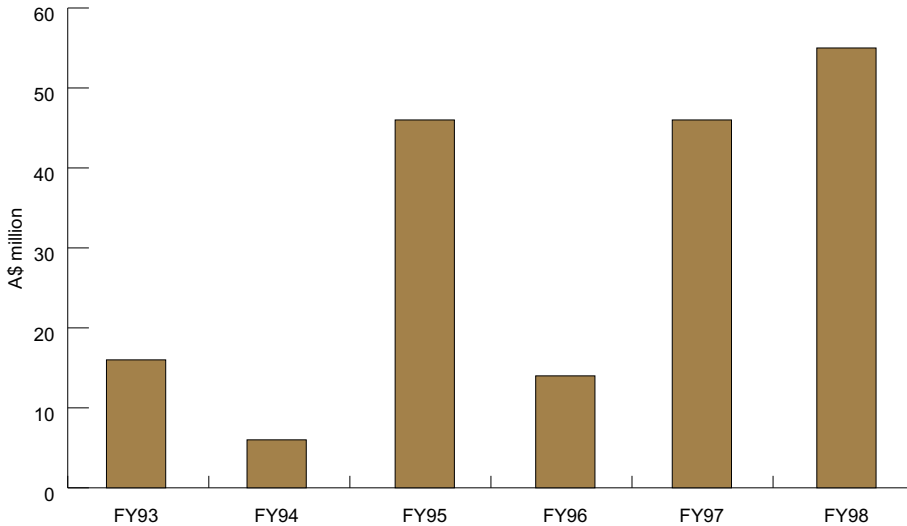
<sup>12</sup> However, approval for a large waste water project in Riau province, worth US\$2.2 billion, was the main reason for this very sharp increase.

<sup>13</sup> At this stage, the basis of the agreement is that Falconbridge would spend US\$75 million to gain a 37.5 per cent interest in the Gag Island project, with BHP and PT Aneka Tambang holding 37.5 per cent and PT Aneka Tambang holding 25 per cent interests in the project. Currently, BHP holds a 75 per cent interest in the project and PT Aneka Tambang holds the remaining 25 per cent.

Figure 5.13

**Indonesian Investment up since the Crisis**

**Indonesian Direct Investment in Australia, A\$ million**



Source: Australian Bureau of Statistics, 1992-99.

**FACTORS BOOSTING FOREIGN INVESTMENT**

The rupiah's low value and trade reform are stimulating export sector activity, providing Australian business with a potentially attractive manufacturing base from which to serve the Asian market. The Government's ongoing asset sales also should encourage Australian companies to consider investing in Indonesia. Survey evidence suggests Australians established in Indonesia anticipate their operations will expand, although levels of risk remain moderate to high.

**Investing in the Export Sector**

Indonesia's competitive exchange rate and the recovery in its trading partners' economies is creating a dynamic export sector. Liberalised foreign direct investment laws have made this sector more accessible to foreign firms, which increasingly are locating to large export-oriented industrial estates across Java and elsewhere in Indonesia. Access to foreign funds reduces these firms' reliance on the domestic banking sector (World Bank, 2000).

### Asset Sales

The Indonesian Bank Restructuring Authority, IBRA, currently holds Rp. 564 trillion (US\$65 billion) of the economy’s productive assets. While some will be returned to previous owners through debt workouts, many eventually should be sold through share market floats, open tenders, auctions, liquidations and sales to strategic buyers. IBRA sales target foreign investors with marketing skills and technological knowledge (KPMG, 2000). When IBRA lists assets for sale, it provides an information memorandum, detailing the assets and relevant financial information. This allows all potential purchasers to conduct thorough due diligence assessments on assets.

Further, many Indonesian firms not attached to IBRA also seek partners to inject equity, provide access to new markets and increase efficiency (Allan, 1999).

### Increasing Australian Investor Confidence

Over 80 per cent of recently surveyed Australian businesses in Indonesia plan to expand their operations, even though over 90 per cent consider risks moderate to high (Table 5.8).<sup>14</sup> Many observers remain optimistic about the prospects for Australian investment in Indonesia.<sup>15</sup>

Table 5.8

#### Australian Businesses Plan Expansion Investor Confidence and Risk

My firm’s future business operations in Indonesia will:			The level of risk associated with Indonesia is:		
Expand	Contract	Not change	High	Moderate	Negligible
80 per cent	0 per cent	20 per cent	40 per cent	52.5 per cent	7.5 per cent

Source: Australia-Indonesia Business Council and KPMG, 2000.

### Improving Corporate Governance

New government reforms offer a more transparent corporate and financial sector. Improved accounting systems and disclosure requirements eventually should ensure more information is available on prospective investments, reducing the level of risk. Government reforms of the legal system and tighter supervision of capital markets also should help improve corporate governance. New foreign investment is likely to disperse the level of industrial concentration, increase competition and improve the quality of resource allocation, strengthening the operating environment for new firms.

<sup>14</sup> This survey was conducted in May 2000 by KPMG Chartered Accountants on behalf of Australia-Indonesia Business Council. All 45 survey respondents were council members. Council members represent a cross-section of Australian organisations directly involved with Indonesia; therefore, their knowledge of Indonesian conditions and opportunities is extensive.

<sup>15</sup> Managing director of the Australian Trade Commission, Austrade, Charles Jamieson believes 'there could hardly be a better time than now to reinforce our commitment to this market and our bilateral relationship' (*Indonesia-Australia Business Council News*, May 2000, p. 1).

## INVESTOR ISSUES TO EVALUATE

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However, Indonesia's rapidly changing environment introduces uncertainties that may weigh on foreign investment flows. These include decentralisation and the possibility of higher taxes.

### Decentralisation of the Approval Process

Regional devolution is shifting responsibility for reviewing foreign investment applications to regional foreign investment boards, raising the risk that new taxes and charges may be introduced, making the application process more complex. (See Chapter 2 - *Political Developments*.)

### Fiscal Uncertainty

The need to reduce government debt incurred to refinance the banking sector may lead to higher corporate tax rates in the medium term, possibly deterring foreign direct investment. However, higher oil revenue in 2000 and 2001 should help the fiscal situation.

### Weaknesses in the Legal System

While recent commercial court developments have been encouraging, the Government's reform of the legal system will take time, and some foreign investors may defer investments until the new system is functioning fully.

## AUSTRALIAN BUSINESS LINKS WITH INDONESIA

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The Australia-Indonesia Business Council is the main industry group promoting business relationships between the two countries, and comprises more than 700 members including large corporations, medium and small enterprises. The council aims to represent the interests of members in bilateral commercial and trade matters relating to Indonesia, and foster friendship and cultural understanding between the business communities and people of Australia and Indonesia.

Each year, the council and the Indonesia-Australia Business Chamber of Commerce, based in Indonesia, hold a joint business conference, alternating between venues in Australia and Indonesia. Business people from both countries and officials from both governments attend this conference. Contact details of the Australia-Indonesia Business Council are at the end of the report.

## IMPLICATIONS

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Australia's proximity and complementarity to Indonesia's economy suggest significant potential for further developing the already healthy commercial relationship. A flourishing export and small and medium enterprise sector provide new opportunities for Australian investment. New laws further opening the Indonesian economy to trade and foreign investment, coupled with the program of asset sales, provide a unique opportunity for the Australian business community to increase its engagement with Indonesia. A growing middle class points to new opportunities for a range of Australian producers and service providers. Appropriate risk management strategies continue to be important.

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