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Date:

The Hon Simon Crean MP
Minister for Trade
Parliament House
CANBERRA ACT 2600

Dear Minister

On 27 July 2007, the then Prime Minister of Australia Mr John Howard and the Indonesian President Dr Susilo Bambang Yudhoyono announced that a joint feasibility study would be undertaken to examine the merits of a Australia -Indonesia free trade agreement (AIFTA).

As part of the feasibility study, views are being sought from you from interested parties on the potential implications of an AIFTA and to that end the attached South Australian Government submission has been prepared. In preparing its submission, the Government consulted widely with State industry associations, South Australian businesses and South Australian Government agencies with an interest in the Indonesian market.

Indonesia is an important trading partner for South Australia, with two way merchandise trade currently valued at \$327 million. Looking to the future, this trade is expected to grow with increasing opportunities for South Australian businesses in a market of over 220 million consumers whose consumption needs are expected to grow as Indonesian middleclass incomes rise. At present, the bilateral trading relationship is largely complementary as the bulk of South Australian exports to Indonesia comprise agricultural and mineral commodities used for further processing while Indonesian exports to the State also mainly comprise inputs in the form of petroleum, rubber and cocoa that add value to the State's economy.

A significant message from industry was that developing good personal relationships at government-to-government levels (political and the bureaucracy) was necessary in establishing a better climate for trade and investment, and in this respect the symbolic value of Australia having an FTA with Indonesia may be just as important as the actual text.

In assessing the impact of negotiating a free trade agreement with Indonesia, consideration should also be given to the impact that this will have on other FTAs Australia already has in place or is negotiating. The inclusion of Most Favoured Nation Clauses in FTAs means that the impact of a potential AIFTA is potential much broader than the bilateral trading relationship between Australia and Indonesia.

I welcome ongoing consultation between the Commonwealth Government and Australia's states and territories as the feasibility study process continues. As with other trade agreements that Australia has entered into, I believe that a national cooperative effort will do much to ensure a successful outcome, nationally and for South Australia.

Yours sincerely

Kevin Foley MP
DEPUTY PREMIER
TREASURER
MINISTER FOR INDUSTRY AND TRADE
MINISTER FOR FEDERAL/STATE RELATIONS

SOUTH AUSTRALIAN GOVERNMENT AND INDUSTRY COMMENTS ON THE AUSTRALIA-INDONESIA FREE TRADE AGREEMENT FEASIBILITY STUDY

South Australia's Trade and Economic Relations with Indonesia

As South Australia's 13th commodity export destination and 13th source of imported products in 2006-07, Indonesia is an important trading partner for South Australia. Adding more impetus to the State's trading relations with Indonesia is the fact that trade is mutually complementary; that is, South Australia's exports to Indonesia are primarily raw materials which are used for additional processing and Indonesia's exports to the State also comprise inputs used for further value add. This suggests that as both economies grow, bilateral trade will also grow.

As evidenced by South Australia's ambitious target to treble the value of exports to \$25 billion by 2014, international trade is a key priority for South Australia. South Australia is committed to increasing the value of commodity and service exports, increasing the number of exporters, and diversifying the State's export base.

In 2006-07, two-way merchandise trade between South Australia and Indonesia was valued at \$327 million, with the State recording a trade surplus of \$87 million. South Australia's merchandise exports to Indonesia in 2006-07 were worth \$207 million, reflecting a decrease of \$22 million from the previous year. South Australia's leading export items to Indonesia include wheat (\$79 million), refined copper (\$53 million) and scrap iron (\$12 million), malt (\$3.4 million), beef (\$3 million) and refined lead (\$2.2 million). Over the same period, South Australia imported \$120 million worth of goods from Indonesia, an increase of \$12 million on the previous year. The main imports to South Australia from Indonesia include petroleum (listed under confidential items) (\$50 million), rubber (\$7 million) and paper products (\$6 million). There is limited data available on trade in services between South Australia and Indonesia. Indonesia is presently a small market for South Australia's tourism exports. In 2006-07, South Australia welcomed over 4,500 visitors from Indonesia.

Indonesia is a small but significant education export partner for South Australia. In the twelve months to June 2007, 206 Indonesian students were enrolled in onshore education programs in South Australian tertiary institutions and schools. A majority of the students were enrolled in tertiary Masters' programs.

South Australia's Investment Relations with Indonesia

Though figures are not available, compared to other countries two-way investment between Indonesia and South Australia is not high and is restricted mainly to the resources and energy sectors. South Australia's mining giant Santos Ltd, is one of State's main investors in Indonesia. Santos has interests in several oil and gas fields in Java and could potentially invest significantly more in Indonesia in the next few years.

Given the substantial investment stake South Australia has in Indonesia (especially in its energy sector), the South Australian Government would welcome any moves in future FTA negotiations to create a more favourable environment for investment flows between Australia and Indonesia. The South Australian Government notes that Australia has in place a double taxation agreement with Indonesia and considers that arrangements like these add to bettering the overall investment climate. The AIFTA negotiators could also examine the present rules governing the investment regime in Indonesia to see if they could be made more investor-friendly. For example, rules governing equity and partnership shares by foreign investors in joint ventures would need to be closely examined to see that they were not overly restrictive.

An important message given to the South Australian Government, from industry, was that developing good personal relationships at government-to-government levels (political and the bureaucracy) was necessary in establishing a better climate for trade and specifically investment, and in this respect the symbolic value of Australia having an FTA with Indonesia

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may be just as important as the actual text. This is especially the case with regard to the mining and energy sectors where government plays a critically important role in facilitating trade and investment.

As the largest uranium producer in Australia, South Australia naturally has an interest in enhancing the investment and trade climate for minerals with Indonesia. The South Australian Government notes that the security agreement signed by Indonesia and Australia in November 2006 has provided a basis for Indonesia to buy uranium for a planned nuclear power plant, and considers that this agreement paves the way for a more substantial nuclear safeguards agreement to be negotiated between the Commonwealth Government and Indonesia. Though not specific to the AIFTA negotiations, the South Australian Government would expect that commencement of these negotiations would provide an impetus for negotiating a bilateral nuclear safeguards agreement.

Key South Australian Issues

The South Australian Government has undertaken extensive consultation within government and industry to identify specific issues for the AIFTA Feasibility Study to address, and these are reflected below.

Tariffs

As with any other FTA negotiation, the South Australian Government would expect that future FTA negotiations with Indonesia should lead to a reduction in Indonesian tariff rates beyond those agreed within the World Trade Organisation (WTO).

As Indonesian applied tariffs on imports of goods average a relative high 9.5 percent, it may be unrealistic to expect Indonesia to match Australia's traditional desire for zero tariff rates on every tariff line. One strategy worth considering in any future AIFTA negotiations would be to seek equivalent tariff concessions to those obtained by Indonesia's ASEAN trade partners (with whom it has a preferential trade agreement). The average tariff rate faced by ASEAN countries into the Indonesian market is 2.7%, which gives them a significant margin of preference in their exports to Indonesia.

As part of the comprehensive free trade agreement negotiations, DFAT negotiators should also obtain assurances from Indonesia that it would not raise its applied preferential tariff rates even if they are bound within the WTO at higher rates. Indonesia has raised its tariffs in this manner in the past (for example it recently raised its tariffs on a number of horticultural products within its tariff bindings). Though this is WTO-legal, it goes against the spirit of free trade and would be somewhat counter-productive if Indonesia were to continue with this practice in a post-AIFTA environment.

Non-tariff Barriers

In addition to tariff barriers, South Australian industries face a number of non-tariff barriers when entering Indonesia's market. These barriers include, but are not limited to, quantitative restrictions (such as quotas), restrictive licensing systems (for wine), procurement preferences and inconsistencies and lack of transparency in Indonesian Government decision making. The latter barrier is partly the result of Indonesia's decentralisation of government decisions into its regions, which started in 1999, which has, according to industry, apparently created uncertainty for South Australian businesses seeking to trade with Indonesia.

With regard to quotas where they exist, one strategy worth considering in a FTA negotiating context is seeking commitments from Indonesia that these be converted to appropriate tariff-equivalents as a first step, with future commitments made to reduce the subsequent tariffs over time. The South Australian Government considers that whilst tariffs are an impediment to trade, they are not as trade restrictive as quotas and they are much more transparent.

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Manufacturing

Relative to the State's output, South Australia has a large manufacturing sector and therefore the South Australian Government seeks the best possible tariff access to the Indonesian market for manufactured goods.

For automotive and auto parts, the sectors of key importance to South Australia, it is apparent that bilateral trade in these items is practically one-way; that is Australia and South Australia export these items to Indonesia but do not import anything in return. Not surprisingly, industry does not see Indonesia as a threat and has not expressed a view about possible FTA negotiations.

That said, the South Australian Government's position is that the current automotive tariff structure, which will see tariff rates fall to 5% by 2010 and zero by 2015, should be preserved at the minimum for the purposes of the FTA negotiations with Indonesia. However, given the current trading environment for the automotive sector the South Australian Government supports the delay of future tariff reductions to 2015 and would seek flexibility within any agreement with Indonesia for this to occur.

Even though the Indonesian automotive industry does not pose an immediate threat to the State's interests, negotiating away our automotive tariffs could provide precedence to other countries seeking an FTA with Australia.

Mining and Resources

With the future expansion of the Olympic Dam deposit, mining and resources are becoming more and more important to South Australia's economy. Therefore, removing or reducing resource tariffs and any associated non-tariff barriers should be a priority in any future AIFTA negotiations with Indonesia. The South Australian Government notes that average MFN rates for mineral products and metals are 6.7% and 9.1% respectively, and that the preferential rates accorded to ASEAN countries are 3% and 2.1% respectively. Given the importance of the mining sector to South Australia and the fact that raw mineral and resource commodities would be used for further value add purposes in Indonesia, the AIFTA negotiators should press for zero tariffs, or at least seek tariff access equivalent to that accorded to Indonesia's other preferential trade partners. With the opening of new mines and expansion of existing ones, South Australia could potentially export more copper to Indonesia and lower tariffs would facilitate this trade. In addition, with lower metal tariffs, there may also be potential for increased exports of South Australian steel to Indonesia.

Wine

With the State exporting over half of all of Australia's wine, South Australia has a strong comparative advantage in wine production, and though exports to Indonesia are small, it has the potential to grow as Indonesia's middleclass grows and as its tourism sector expands. However, industry has informed us that it faces a number of barriers in the Indonesian market, the most prominent of which is the control the Indonesian government has over the importation of wine, notably in the form of high duties and taxes. Indonesian MFN duties on wine, partly the result of Islamic policies, range from 90% to 170%, and this together with a 10% VAT, makes it a prohibitive purchase for most Indonesian consumers. As part of a comprehensive AIFTA and as a very minimum, the negotiators should seek a significant lowering of these wine duties, at least to levels to those accorded to Indonesia's other FTA partners.

Seafood

South Australia is a net exporter of seafood. The Indonesian Government has apparently expressed interest in importing South Australian aquaculture expertise to develop the country's small aquaculture industry. More detailed information could be sought from the Indonesian

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government regarding this development, while at the same time, tariff and non-tariff barriers relating to Indonesian aquaculture should be addressed in the negotiations.

Agriculture

The South Australian Government views the inclusion of agriculture as essential to any successful Australia-Indonesia FTA negotiations. South Australia's agricultural export growth potential to Indonesia lies in lentils, grain, beef and dairy (milk powder) products. South Australia exports large quantities of grains, lentils, beef and dairy products, and therefore seeks enhanced tariff access to the Indonesian market, noting that current applied tariffs for all agricultural products average around 12% - a high figure for raw and/or semi-processed commodities. The South Australian Government notes that current applied preferential tariff rates on agriculture for Indonesia's other FTA partners still average a high 7.6%. South Australia acknowledges that while there may be some sensitivities associated with agricultural protection in Indonesia, the FTA negotiators should nevertheless seek commitments from Indonesia to significantly lower its tariff rates to those more comparable with other sectors.

Sanitary and Phytosanitary Measures (SPS)

As evidenced by the State's active protection of its borders from interstate pest and diseases, such as fruit fly, the South Australian Government takes SPS issues very seriously. Both the South Australian Government and South Australian industry are concerned that unless Australia reaffirms and maintains its strict science-based SPS policies, Indonesian agricultural diseases could potentially pose a significant threat to the State's industry.

The South Australian Government asks that there be no dilution to the Australia's current SPS regime, despite possible pressure from the Indonesian side for a relaxation of standards as under no circumstances should the health of Australia's agricultural industry be jeopardised.

Wheat

The estimated value of South Australian wheat exports to Indonesia in 2006-07 is \$80 million, lower than in previous years because of the drought but still making wheat South Australia's number one export commodity to the country. Most of the wheat shipped to Indonesia is refined in Indonesian flour mills. The Australian Wheat Board (AWB) and Toepfer International export South Australian wheat to Indonesia. Toepfer International's exports are limited to shipping wheat in bulk container loads. Given the critical importance of the wheat trade to the State's economic interests, coupled with the fact that this wheat is further processed in Indonesia, the South Australian Government seeks zero tariffs for unprocessed wheat in any AFTA negotiations.

Beef

The South Australian Government acknowledges that for religious reasons, Indonesia prefers to import live bovine animals from Australia for Halal culling in Indonesia. At the same time, the South Australian Government would ask the AFTA negotiators to remind Indonesian interlocutors that all South Australian export accredited abattoirs are Halal compliant, and can therefore ship halal beef directly and efficiently into Indonesia. An FTA would present an opportunity to grow the beef market for the State's producers since better access would encourage a greater focus on this market.

The growth opportunities for South Australian producers are also in high-end processed beef products, which are sold to Indonesian hotels and restaurants. There is approximately only four days sailing required to ship meat from Darwin to Indonesia, which South Australian business can access through the Adelaide-Darwin Rail Link, making the high-end produced even more competitive in Indonesia

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Government Procurement

The South Australian Government has a liberalised, flexible and open tendering process, where value for money and equity are paramount considerations. The South Australian Government seeks assurances that Australia will seek similar tendering processes from Indonesia in an FTA. The government procurement chapters in this agreement should be similar to the Australia-United States FTA, so not to create any unnecessary administrative burden.

On that note, the South Australian Government would like to remain engaged in any discussions impacting upon current government procurement practices, both throughout this FTA negotiation and other trade liberalisation avenues. Furthermore, it is important that the future FTA explanatory documents provide a clear statement on the opportunities for Australian businesses in Indonesia's government procurement market, so that South Australian companies could bid for contracts.

Defence

The South Australian Government is interested in any defence trade opportunities that this FTA presents. South Australia has world class capabilities in defence research, design, production and operations for many defence operations. An opportunity for South Australian defence exports to Indonesia lies in South Australia's state-of-the-art military training facilities. Potentially, Indonesian troops could be involved in joint or single training in land combat through South Australia's defence land warfare facilities. However, this would be subject to Australian Defence Force approval.

Education and Training

Indonesia is a developing focus market for educational institutions in South Australia. In particular, Flinders University, the University of Adelaide and the University of South Australia capture around 200 tertiary post-graduate students from Indonesia each year. South Australian tertiary facilities have significant relationships with equivalent institutions in Indonesia.

Industry has suggested that one way to improve relations between Indonesia and Australia is to increase the number of AusAID scholarships available to Indonesians. Past Indonesian students in South Australia, are slowly rising to the higher levels of government and industry in Indonesia and can therefore be in a position to exert influence. Their Australian experience bodes well for a deepening of bilateral relations. As part of the FTA negotiations, Indonesia may well be seeking additional AusAID scholarships and the South Australian Government asks that due consideration be given to requests of this nature.

Horticultural Products

Given the proximity to the market and the greater ease of establishing supply chains with the Adelaide to Darwin rail link, South Australian horticultural product sales to Indonesia have been a focus for South Australian farmers. At present, sales of horticultural products to Indonesia are believed to be dominated by New Zealand. South Australian farmers have attempted to break into this market with limited success. The recent raising of horticultural tariffs by Indonesia (though legal as it was within its WTO bindings) has dismayed the State's horticultural industry as it sees Indonesia as a natural market for products like citrus, temperate climate vegetables and stone fruit. The South Australian Government asks that, for a future FTA, that Indonesia lower its horticultural tariffs at least to levels granted to ASEAN FTA countries and that it provides assurances that it would not raise them to MFN or bound levels in the future.

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Services

An Australian FTA with Indonesia should include liberalisation in the services sector. The approach for services liberalisation followed in the Australia-United States Free Trade Agreement is South Australia's preferred starting point. At the same time, the Australian Services Roundtable asked the Australian Government to raise the profile of services in WTO and FTA negotiations. With services exports like tourism and education growing in importance to the State's economy, the South Australian Government fully supports this position.

Medical Services

According to the state chapter of the Indonesia-Australia Business Council, the medical sector has expressed an interest in providing in-country surgical services to the Indonesian market but has apparently encountered barriers relating to non-Indonesians not being allowed to practice. This is potentially a non-tariff barrier that is preventing South Australian companies from establishing health operations in Indonesia using Australian surgeons. The South Australian government requests that the AIFTA negotiators obtain more information from their Indonesian counterparts, particularly the criteria for establishing health and surgical operations in Indonesia and, where possible, seek to establish within an AIFTA fair and equitable access in the area of providing medical services to Indonesia.

Government services

Industry has advised that training in government services, may be an export opportunity for South Australia in Indonesia. Due to the decentralisation of government decisions and infrastructure, there is a view that Indonesia may benefit from high-level exchanges in this area. This presents a good capacity building opportunity for South Australia and Australia in the FTA negotiations.

Delivering Aid

South Australia has been engaging in delivering aid to Indonesia for sometime, initially through SAGRIC, previously a South Australian government organisation until 1999, which was later on sold to Coffey International, which has significant South Australian and International operations. Coffey International was a major Australian partner in the Tsunami reconstruction efforts in Banda Aceh. The company employs around 150 teaching staff in Indonesia. The South Australian Government would like to state that in the broader interests of bilateral relations, it is important that Australia further increases its tied and untied aid as well as capacity building projects to Indonesia, as a means of assisting Indonesia to reduce poverty and build the buying power of consumers. This approach makes good sense in that increased aid to Indonesia will ultimately lead to increased trade and investment opportunities.

Protection of Indigenous, Cultural and Other Rights

As with any FTA Australia enters into, the South Australian Government would like to maintain the ability to protect the environment, indigenous people and their culture, law and order, consumer protection, public health, land use and development.

The South Australian Government would also expect to maintain its capacity to deliver social and cultural policy objectives under any final agreement. The South Australian Government would want to maintain its ability to retain or adapt existing measures, or introduce new measures, designed to support and foster our cultural industries. For example, an 'Australian voice' in film, television and multimedia enables the expression of our regional, ethnic and historical diversity.

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Legal

There are considerable cultural, structural and legal differences between Australia and Indonesia which would tend to limit the amount of trade in legal services. In the interests of furthering the cross-border supply of legal services, the FTA negotiations may present Australia with an opportunity to gain better market access for Australian legal service providers seeking access to Indonesia's legal market.

Intellectual Property

As with all trade proposals that Australia undertakes, the South Australian Government would like the protection of intellectual property to remain a primary consideration in any final agreement. Intellectual property laws should remain consistent with and reinforce Australia's existing and continuing commitments to related international agreements.

Movement of People

The South Australian Government would like a future FTA with Indonesia to help improve the bilateral flows of people between both countries. Businesses, particularly from the rapidly growing mining sector, have expressed an interest in sponsoring skilled migrants from Indonesia. In this context, the South Australian government would welcome initiatives that improve the accessibility each country extends to visitors and potential settlers.

Other Issues

The State would like any potential trade liberalisation resulting from a future FTA with Indonesia to reduce any technical barriers to trade between Australia and Indonesia. Technical regulations and standards across a range of industries and product categories should be reviewed and, where appropriate, harmonised through compliance, mutual recognition agreements and conformity assessment procedures. In particular, product packaging and labelling requirements, testing procedures and import documentation should be considered in the negotiations.