

**VICTORIAN GOVERNMENT SUBMISSION
TO THE JOINT FEASIBILITY STUDY ON A POSSIBLE AUSTRALIA-
INDONESIA FREE TRADE AGREEMENT**

1. Introduction

The Victorian Government welcomes the opportunity to provide input to the Department of Foreign Affairs and Trade (DFAT) on issues relevant to a possible Free Trade Agreement (FTA) between Australia and Indonesia. We acknowledge the importance of Australia's bilateral engagement with Indonesia, and look forward to developments in the relationship that are in the best interest of the Victorian economy.

The Victorian Government is committed to achieving a stronger economic and trade relationship with Indonesia, and regards Indonesia as a potentially very significant trade and investment partner. An FTA between Australia and Indonesia could have a significant impact in strengthening the business relationship between the two countries. Furthermore, Indonesia's business environment is still developing and an FTA could improve the ease of doing business for Victorian and Australian companies.

Victoria supports the Commonwealth Government commissioning rigorous independent economic modelling of the potential costs and benefits of an FTA with Indonesia. The Government should ensure that the methodology and assumptions underpinning the modelling are transparent and considerate of domestic political reality. The results should be made available to all stakeholders.

The Feasibility Study (the Study) should investigate all issues related to trade with Indonesia. In particular, the study should:

- identify all restrictions (tariffs, non-tariff barriers and regulatory arrangements) on trade between Australia and Indonesia;
- document the extent of these restrictions;
- determine how an FTA could address these restrictions;
- analyse the impact of removing these restrictions at both the national, state and industry levels;
- examine appropriate administrative, regulatory and enforcement mechanisms, giving consideration to the impact of decentralisation of authority in Indonesia and ensuring sub-national governments are subject to the disciplines of an FTA; and
- analyse a potential FTA between Australia and Indonesia within the broader context of intra- and inter-regional trade liberalisation.

2. Economic and cultural relations with Indonesia

2.1 Merchandise Trade

Victoria's two-way merchandise trade with Indonesia totalled \$1.5 billion in FY2007 and is Victoria's 15th largest trading partner. Indonesia is Victoria's 13th largest goods export destination, and is concentrated in the dairy, aluminium, refined petrol and

beef sectors. Indonesia's demand for agricultural commodities is expected to remain strong, presenting opportunities for Victorian exporters of agri-business particularly in large-scale corporate farming.

After a decline in exports of 27.9 per cent between FY2002 and FY2003 (from \$486m to \$350m), Victorian merchandise exports have increased each year to peak at \$523 million in FY2007. From FY2003 to FY2007, Victoria's exports to Indonesia grew by 49 per cent. Average annual growth in Victorian merchandise exports between FY2002 and FY2007 was 7.5 per cent.

Indonesia is Victoria's 15th largest source of imports, primarily in crude petroleum (\$438m) followed by confidential items, simply worked wood, natural rubber and televisions. From FY2002 to FY2007, imports from Indonesia have declined on average by 8.3 per cent per annum. After a decline of 24.4 per cent between FY2003 and FY2004 (from \$1058m to \$800m), imports increased by 23.5 per cent to \$988m in FY2005 and are currently \$1018m.

2.2 Services trade

While services exports data is not readily available, our consultations indicate that a growing number of Victorian companies are exporting services to Indonesia, with key sectors including banking, mining, legal, accounting, healthcare and transport and logistics. Additionally, the e-commerce sector offers a great opportunity for Victorian companies offering solutions in on-line services and value added services, especially online internet security.

Victoria's main services exports generally are education and tourism. Indonesia is an important source of foreign students (5th largest source) for Victoria. However, between 2002 and 2006, enrolments from Indonesia declined by 6,026 or 29 per cent. In 2006 there were 5,817 enrolments in Victoria which accounted for 39 per cent of all Indonesian enrolments across Australia, and was 5 per cent of the total number of international students in Victoria. For 2006 enrolments were mainly in the areas of higher education (63 per cent), Vocational Education and Training (19 per cent), and English language (7 per cent).

While Indonesia is not a current target market for Victoria, Tourism Victoria statistics show that there were 22,475 Indonesian visitors to Victoria in 2006, which is a 2.1 per cent increase over the previous year and represents 30 per cent of Australian market share. While Indonesian visitation to Victoria has decreased by an average rate of 1.2 per cent per annum since 1999, the number of visitor nights spent in Victoria by Indonesian visitors has grown by an average of 2.9 per cent per annum since 1999. In 2006 the number of visitor nights spent in Victoria by Indonesian visitors was approximately 1.1 million visitor nights.

2.3 Investment with Indonesia

Recent Indonesian FDI in- and outflows have been impressive. In 2006, outflows from Indonesia were at USD \$3418 million, up significantly from 2005 outward FDI levels of \$3065 million. From 2003 to now, outward levels of Indonesian FDI have grown considerably by 1505 percent. Such strong growth rates highlight the outward

looking nature of the Indonesian economy. FDI inflows to Indonesia are also strong, growing at 1031 percent from 2003 to date.

Despite the strong inward and outward FDI rates for Indonesia, Australia (and Victoria) has received very little of this investment. Notably, from 2002-03 to present, the Victorian Department of Innovation, Industry and Regional Development (DIIRD) has only facilitated 1 investment from Indonesia in the food sector. Major Indonesian investment in Victoria includes the Halim group, which purchased the Windsor Hotel with a local property developer; and the Stuart Co., an Australian company established by an Indonesian family, which has invested in two wineries in regional Victoria.

2.4 Cultural ties

The latest Census in 2006 recorded 12,604 Indonesia-born persons in Victoria. 91,800 Victorian Government School students learn Bahasa Indonesian as a Language Other Than English subject, making Bahasa the 2nd most popular language taught in schools. About twenty Victorian Government schools have a sister school relationship with a school in Indonesia.

Cultural activities between Victoria and Indonesia include Asia Link's Australia-Indonesia Arts and Community Program; a number of exchange projects, many of which involve both AusAID and the Indonesian Ministry of Education; and, since 2005, the Consul General of the Republic of Indonesia in Melbourne and Festival Indonesia Inc. have organised Festival Indonesia, which promotes cultural and business opportunities. There is a range of other celebrations held in Melbourne throughout the year and the Australia-Indonesia Business Council has an active Victorian chapter.

3. Key issues to be addressed by the Feasibility Study

The Victorian Government has identified a range of issues that it considers should be included in the scope of the Feasibility Study:

3.1 Removal of tariff barriers

As the World Trade Organisation's Trade Policy Review of Indonesia states, the average applied most-favoured-nation (MFN) tariff is 9.5 per cent. While more than 75 per cent of tariff rates are currently within zero to 10 per cent, high tariffs remain on motor vehicles. A lower 5 per cent tariff remains on key exports such as dairy, meat and horticultural products; although some products such as yoghurt and mandarins receive higher tariffs (10 per cent and 25 per cent respectively).

Our consultations suggest a degree of volatility with tariff rates which may be attributed to the divergence between the average bound and applied rates. For example, the bound tariff on concentrated milk and cream is 210 per cent and the applied tariff is 5 per cent. Furthermore, Victorian agribusiness exports to Indonesia continue to move towards premium products, making any tariff escalation a potential issue. The Study should examine these issues as well as the impact of a further reduction in the ASEAN Common Effective Preferential Tariff (CEPT) rate as intra-ASEAN trade continues to develop.

3.2 Removal of non-tariff barriers

It is important that issues relating to non-tariff barriers to trade are addressed as part of the Study into a possible FTA with Indonesia. Consultations indicate the main problems are associated with transparency and consistency in customs administration, import licensing and quarantine arrangements. Some sectors such as retail, wine and food, have expressed concern about lack of transparency and lengthy timeframes for registering products, as well as problems associated the tariff classification process and consistent entry into Indonesia.

Standards and technical regulations

The Feasibility Study should consider the extent to which an FTA could address the mutual recognition of qualifications, and the appropriate occupational registration and accreditation arrangements. This is particularly the case for sectors such as education, legal and other professional services. Also, issues have been raised about inconsistent quarantine measures for products such as meat, and fruit and vegetables; and the implementation of Halal laws for Victorian food exports.

Investment

The new Indonesian investment laws passed in mid-2007 promoting equal treatment for foreign and domestic investors are welcome. Increased investment by Australian firms in Indonesia is likely to lead to increased trade and benefits to Australian industry and as such the Study should thoroughly examine restrictions on inward investment into Indonesia. Consultations suggest that there are issues with how quickly and efficiently a company can invest in Indonesia. The Study should consider the impact of factors generally associated with the ease of doing business (e.g. contract enforcement) that may currently deter investment into Indonesia.

3.3 Ease of doing business in Indonesia

A key factor that has been highlighted during consultations relates to the difficulty in setting up a business in Indonesia. The Study should examine the cultural and regulatory barriers to the establishment of business presences in Indonesia by Australian firms, including, for example, any investment restrictions, restrictive licensing provisions, and administrative and bureaucratic complexities. To this end, the Study should consider appropriate capacity building programs and initiatives that would improve the ease of doing business in Indonesia.

Rules of Origin

The Feasibility Study should analyse and provide an assessment of a range of rules of origin systems that could be adopted under an FTA, such as local value adding or the change in tariff classification (CTC) system. The assessment should take into account issues such as ease of administration, enforcement and review procedures.

Protection of intellectual property

An FTA with Indonesia could provide export opportunities for Australia's knowledge-based industries in areas such as design, architecture, healthcare and agribusiness. As the result, it is important that the Feasibility Study assess Indonesia's current level of intellectual property protection and the extent to which these laws are

enforced. The Australian Government and industry need to be satisfied that there is vigorous enforcement of these laws.

Government procurement

The inclusion of government procurement in an FTA could present significant opportunities for Australian businesses to tender for government work in Indonesia. The Feasibility Study should consider whether government procurement could be included in an FTA, and analyse how government procurement regimes operate in Indonesia. For example, to what extent is procurement devolved from the central to regional/provincial levels of government in Indonesia and to what extent is local industry given preference in procurement activities?

Business mobility and movement of natural persons

The Study should consider the effect of current visa and immigration requirements, and the impact of any changes to these requirements. The Victorian Government understands that Indonesia will seek improved access for skilled labour in Australia in a range of sectors such as nurses, construction and hospitality. The Study should consider the implications of this.

Investor State dispute resolution

With the development of an FTA, it is likely that Australian FDI into Indonesia would increase in future years, as more Australian companies looking to set up a presence in the Indonesian market. The Study should therefore consider whether an FTA should include an Investor State Dispute Settlement clause, as an incentive to encourage two-way investment. This would involve analysing Indonesia's legal system and its methods for dealing with investor disputes and determining whether this would represent a barrier or disincentive for Australian companies to invest in Indonesia.

DFAT Travel Advice

The impact of the Australian Government's approach to other aspects of the relationship was raised during consultations. For example, the decrease in Indonesian student enrolments is attributed in part to DFAT's travel advice which discourages some institutions from marketing in Indonesia. However, it should be noted that the University of Melbourne has a recruitment office in Jakarta, and RMIT and Swinburne regularly attend recruitment events in Indonesia. Furthermore, this aspect of the relationship has implications for the Victorian Government's trade fairs and missions program. The Study should consider the economic implications of continued security concerns.

4. Conclusion

Victoria supports the examination of the benefits of an FTA with Indonesia, and therefore welcomes the current DFAT Feasibility Study. There are commercial opportunities for Victorian exporters and investors from increasing market access to this regional market through trade liberalisation in both tariff and non-tariff measures.

Further detail on the issues raised in this submission and stakeholder feedback is available on request. The Victorian Government looks forward to further communication and cooperation with DFAT on completion of the Study.