Indonesia-Australia FTA Feasibility Study

Background Paper for Industry Consultations

17 October 2007

Overview

- Australia has a substantial trading relationship with Indonesia. In 2006-07, two way merchandise trade totalled $8.8 billion, making Indonesia our thirteenth largest merchandise trading partner.
- Merchandise exports to Indonesia reached $4.2 billion in 2006-07. Major exports include wheat; crude petroleum; live cattle; unwrought aluminium; cane sugar; alumina and cotton. Services exports were valued at almost $840 million in 2006, with education the single biggest item.
- Merchandise imports from Indonesia were valued at $4.6 billion in 2006-07. Substantial imports included crude petroleum; filtering equipment; gold; television receiving apparatus and other electronic equipment; wood and iron ore. Services imports were valued at $564 million in 2006, with personal travel services (other than education) the biggest single item.
- In 2006, Indonesia's average tariff was 9.5 per cent. However, some Australian exports to Indonesia, such as sugar and motor vehicles and parts, face much higher tariffs. In addition, Australian companies experience inconsistent rules and regulations in exporting goods to Indonesia.
- There are significant barriers to some categories of services exports to Indonesia. Indonesia ranks among the more restrictive ASEAN economies for legal services and accountancy. There remain impediments to financial services and telecommunications services which are of concern to Australian industry.
- Australia's tariffs on imports from Indonesia averaged just under 3.3 per cent in 2006. There are, however, higher tariffs in some areas, most notably textiles, clothing and footwear and passenger motor vehicles and parts, though Australia's tariff peaks are significantly lower than Indonesia's.
- Both countries support stronger investment links. Australian direct investment in Indonesia amounted to $1.5 billion at the end of 2006, well below investment in some other East Asian economies. Indonesian investment in Australia is quite limited.
- A free trade agreement (FTA) with Indonesia would need to address comprehensively impediments to trade in goods and services, as well as investment. It would also need to address other areas of importance to two-way trade and investment, including a range of non-tariff barriers.
- An FTA would need to include clear rules of origin (ROO). A product specific approach based primarily on Change of Tariff Classification (CTC) is used in three out of the four FTAs to which Australia belongs.

Background Paper
Australia's Trade and Investment Links with Indonesia

1. Introduction

Australia and Indonesia agreed in July 2007 to conduct a joint feasibility study on the merits of a bilateral FTA. The study is being jointly prepared by the Australian Department of Foreign Affairs and Trade and the Indonesian Ministry of Trade. Australia and Indonesia envisage that the study will be completed by mid-2008.

The Australian Government requires any FTAs to be consistent with WTO rules, specifically Article XXIV of the General Agreement on Tariffs and Trade (GATT) and Article V of the General Agreement on Trade in Services (GATS). Under GATT Article XXIV, any FTA must among other things provide for the elimination of duties and other restrictive regulations of commerce on substantially all trade in goods between the Parties. With respect to services, GATS Article V requires liberalisation that has substantial sectoral coverage and the absence or elimination of substantially all discrimination between the Parties through elimination of existing discriminatory measures and/or prohibition of new or more discriminatory measures.

Consultation with stakeholders will provide an important input into the feasibility study. This paper seeks to draw together some background information for those participating in the consultations. The first part of the paper looks briefly at the characteristics of the Indonesian economic and trade environment. Subsequent sections look at the trends in trade between the two economies, barriers to bilateral trade, the investment relationship and at other areas which might be addressed by a free trade agreement between the two economies.

2. The Indonesian Economic and Trade Environment

2.1 The Indonesian Economy

Indonesia is the largest economy in ASEAN and the world's fourth most populous nation. Measured at international exchange rates its economy is about half the size of Australia's – or slightly less than the economies of New South Wales and Queensland combined. At purchasing power parity (which largely adjusts for price distortions and price differences for non-tradeable goods and services), its economy is about 40 per cent larger than Australia's.

As Table 1 indicates, Indonesia's economic and social development process is ongoing. Over 50 per cent of the population lives in rural areas, and living standards are appreciably below those in OECD nations. However, Indonesia ranks highly as a potential growth market over the longer term. Economic growth is likely to be accompanied by a significant expansion in imports of goods and services, including those which Australia is able to supply competitively.

Table 1

Australia and Indonesia: 2006

	Australia	Indonesia
Compound Annual Growth, 2001-06, per cent	3.2	5.1
GDP, current prices, US$ billion	755.6	364.2
GDP at PPP, international dollars, billion (1)	680.2	959.8
GDP, per capita, current prices, US$	36,546	1640(e)
GDP, per capita, PPP, international dollars	32,938(e)	4323(e)
Structure of Output, per cent (latest available)		
Agriculture	3	13
Industry	27	46
of which manufacturing	12	28
Services	70	41
Population, milllion	20.7	222.1(e)
Surface Area, thousand sq km	7741	1905
Rural Population as per cent of total (2005)	11.8	51.9
Life Expectancy at Birth, years (2005)	81	68
Educational enrollment, per cent (latest available) (2)		
Tertiary	72	17
Exports, US$ billion		
Goods and services	157.9	118.4 (e)
Goods	124.8	103.5
Services	33.1	14.9(e)
Imports, US$ billion		
Goods and services	166.7	100.1(e)
Goods	134.4	73.9
Services	32.2	26.2(e)

Sources: IMF World Economic Outlook Database, April 2007; CEIC Database; Australian Bureau of Statistics, World Bank, World Development Indicators 2007, Department of Foreign Affairs and Trade, Economist Intelligence Unit.

Notes: (1) PPP, or purchasing power parity, measures GDP in a way which takes into account differences in price levels between countries. (2) Data on education measures enrolment as a percentage enrolled as a share of the age group that corresponds to that level. (e) denotes estimate.

Of the major economies badly affected by the East Asian financial crisis of 1997-98, Indonesia was the worst affected. However, the economy has grown at a respectable pace of around 5.1 per cent annually over the past five years, continuing a recovery from the crisis which began in 1999. By 2003, GDP had passed the level which had been reached in 1997 in real terms. It is now 22 per cent above the 1997 level. Growth is forecast by the International Monetary Fund to rise to 6.0 per cent in 2007 and 6.3 per cent in 2008, though achieving these rates is linked to continued strong world economic growth. The Indonesian Government projects growth at 6.3 per cent for 2007 and is aiming to lift this to 6.8 per cent in 2008.

Indonesia's economic environment has improved considerably in recent years. Inflation is forecast by the Economist Intelligence Unit at 8.5 per cent in 2007 (down from an average 14.8 per cent in 2005).[1] Government debt has fallen from an estimated 67.5 per cent of GDP in 2002 to 38.6 per cent of GDP in 2006, with Indonesia repaying early its remaining obligations to the International Monetary Fund. The current account has remained in surplus, with the surplus rising to 2.7 per cent of GDP in 2006.

Currently, Indonesia is generally assessed on a number of measures to be a challenging environment in which to do business. Inadequate infrastructure is an important constraint on growth, as are labour skills, poor law enforcement and uncertainties in the legal and regulatory environment. Surveys suggest comparatively low levels of foreign investor confidence. Without further economic reform, it is unlikely that Indonesia will begin soon to sustain the kind of growth rate – estimated at around 7 per cent per annum – required to reduce quickly the large numbers of unemployed and underemployed.

2.2 Indonesia's Trade and Trade Policy

International trade is important to the Indonesian economy. Its exports and imports of goods and services together amounted to around 60 per cent of GDP in 2006. Exports of goods and services, at an estimated US$118 billion were almost 75 per cent of those of Australia and imports were around 60 per cent of Australia's in 2006.

Indonesia's major merchandise exports are energy commodities. Petroleum and hydrocarbon gases accounted for 10.1 per cent of exports in 2006, crude oil for 8.1 per cent and coal for 6.0 per cent. Other major exports include palm oil, copper ores and concentrates, and natural rubber. Important manufactured exports include automatic data processing and related equipment, plywood and veneer panels, paper and furniture. Although Indonesia has faced increasing competition from other developing economies in labour-intensive sectors, some types of footwear and clothing are still important and rank among its top 25 exports. Motor vehicle parts account for 0.9 per cent of all exports.[2] The top 25 exports are listed in Table 2. Japan is by far Indonesia's largest market, taking some 21.6 per cent of merchandise exports in 2006. The United States, Singapore, China and the Republic of Korea are other major markets. Australia was the eighth largest destination for Indonesia's merchandise exports in 2006, taking 2.8 per cent of the total.

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[1] Inflation is measured here by the GDP deflator.
[2] This covers only parts under HS 8708, as shown in Table 2.

Table 2

Indonesia: Top 25 Merchandise Exports, 2006

US$ million and percentage share

HS	Description	Value	Share
2711	Petroleum Gases & Other Gaseous Hydrocarbons	10,197	10.1
2709	Crude Oil From Petroleum And Bituminous Minerals	8,169	8.1
2701	Coal; Briquettes, Ovoids Etc. Mfr From Coal	6,082	6.0
1511	Palm Oil & Its Fractions, Not Chemically Modified	4,818	4.8
2603	Copper Ores And Concentrates	4,646	4.6
4001	Natural Rubber, Balata, Chicle Etc, Prim Form Etc	4,322	4.3
2710	Oil (Not Crude) From Petrol & Bitum Mineral Etc.	2,815	2.8
8471	Automatic Data Process Machines; Magn Reader Etc	1,786	1.8
4412	Plywood, Veneered Panels & Similar Laminated Wood	1,507	1.5
4802	Paper, Uncoat, For Writing Etc, Rolls; Hndmd Paper	1,392	1.4
9403	Furniture Nesoi And Parts Thereof	1,276	1.3
7501	Nickel Mattes, Nickle Oxide Sinters, Oth Int Prod	1,225	1.2
6403	Footwear, Outer Sole Rub, Plast Or Lea & Upper Lea	1,145	1.1
0306	Crustcns Lve Frsh Etc, Ckd Etc.; Flrs Mls H Cnsump	1,068	1.1
4703	Chemical Woodpulp, Soda Or Sulfate, Not Dissoly Gr	1,061	1.1
7403	Refined Copper & Alloys (No Mast Alloy), Unwrought	939	0.9
8001	Tin, Unwrought	913	0.9
8708	Parts & Access For Motor Vehicles (Head 8701-8705)	909	0.9
1513	Coconut, Palm Kernel Or Babassu Oil Etc, No Ch Mod	887	0.9
6204	Women's Or Girls' Suits, Ensemb Etc, Not Knit Etc	887	0.9
4011	New Pneumatic Tires, Of Rubber	772	0.8
8544	Insulated Wire, Cable Etc; Opt Sheath Fib Cables	742	0.7
8525	Trans Appar For Radiotele Etc; Tv Camera & Rec	702	0.7
7408	Copper Wire	634	0.6
4810	Paper & Paperboard, Coated With Kaolin Etc, Rl Etc	630	0.6

Source: GTIS World Trade Atlas online database.

Almost a third of Indonesia's merchandise imports consist of refined petroleum and crude oil (respectively 18.0 and 12.9 per cent of the total). Their value has increased appreciably in recent years, partly reflecting higher petroleum prices. Other imports are varied, but include a wide range of capital equipment and imported raw materials. Machinery (including electrical machinery) made up 17.2 per cent of merchandise imports in 2006, and iron and steel or iron and steel products 6.8 per cent. Organic chemicals, vehicles and plastics were other important imports. Table 3 lists the top 25 imports. Indonesia's merchandise imports are primarily sourced from Singapore (16.4 per cent of the total), China (9.4 per cent) and Japan (9.0 per cent), with the United States, Saudi Arabia and Malaysia other important suppliers. Australia ranked seventh as a supplier in 2006, providing 4.9 per cent of Indonesia's imports.

Table 3
Indonesia: Top 25 Merchandise Imports, 2006
US$ million and percentage share

HS	Description	Value	Share
2710	Oil (Not Crude) From Petrol & Bitum Mineral Etc.	10,963	18.0
2709	Crude Oil From Petroleum And Bituminous Minerals	7,853	12.9
2902	Cyclic Hydrocarbons	1,029	1.7
8901	Vessels For The Transport Of Persons Or Goods	1,017	1.7
8708	Parts & Access For Motor Vehicles (Head 8701-8705)	904	1.5
8802	Aircraft, Pow ered; Spacecraft & Launch Vehicles	903	1.5
1001	Wheat And Meslin	816	1.3
7207	Semifinished Products Of Iron Or Nonalloy Steel	798	1.3
8525	Trans Appar For Radiotele Etc; Tv Camera & Rec	733	1.2
5201	Cotton, Not Carded Or Combed	620	1.0
1701	Cane Or Beet Sugar & Chem Pure Sucrose, Solid Form	577	1.0
2901	Acyclic Hydrocarbons	519	0.9
8704	Motor Vehicles For Transport Of Goods	507	0.8
8409	Parts For Engines Of Heading 8407 Or 8408	498	0.8
2304	Soybean Oilcake & Oth Solid Residue, Wh/Not Ground	493	0.8
8431	Parts For Machinery Of Headings 8425 To 8430	476	0.8
8703	Motor Cars & Vehicles For Transporting Persons	455	0.8
8471	Automatic Data Process Machines; Magn Reader Etc	451	0.7
8429	Self-Propelled Bulldozers, Graders, Scrapers Etc	408	0.7
0402	Milk And Cream, Concentrated Or Sw eetened	402	0.7
2905	Acyclic Alcohols & Halogenat, Sulfonatd Etc Derivs	402	0.7
7601	Aluminum, Unw rought	397	0.7
7208	Fl-Rl Iron & Na Steel Nun600Mm Wd Hot-Rl, Not Clad	385	0.6
8483	Transmission Shafts, Bearings, Gears Etc; Parts	378	0.6
3901	Polymers Of Ethylene, In Primary Forms	357	0.6

Source: GTIS World Trade Atlas online database. Total imports as recorded in this source are significantly different from those recorded in Table 1. This appears to reflect the treatment of goods for processing.

Indonesia's services exports are relatively limited at US$12.9 billion in 2005 (see Table 4), with modest credits for travel services accounting for about one third (US$ 4.5 billion). Exports of "other business services" were valued at US$2.9 billion in 2005 and transportation services at US$2.8 billion. These values have remained fairly consistent over the past few years. Services imports are appreciably larger. They were valued at around US$23.7 billion in 2005. Of these, transportation services were valued at US$7.0 billion and included US$5.6 billion in freight services. Travel services imports were valued at US$3.6 billion. Notably "other services" were valued at US$13.1 billion and included imports of "other" business services (US$9.1 billion), financial and insurance services, communication services and construction.

Table 4
Indonesia: Services Trade
US$ million

	2004	2005
Services exports	12,045	12,926
Transportation services	2,279	2,841
Passenger	428	570
Freight	1,288	1,733
Other transportation	563	538
Travel services	4,798	4,522
Business travel	1,439	1,357
Personal travel	3,358	3,165
Other services	4,969	5,563
Communication	835	998
Construction	463	484
Insurance	8	15
Financial	297	367
Computer and information	138	147
Royalties & licence fees	221	263
Other business services	2,669	2,876
Personal, cultural & recreational	47	57
Government services n.i.e.	291	355
Services imports	20,856	23,728
Transportation services	5,474	7,030
Passenger	1,062	1,157
Freight	4,213	5,643
Other transportation	199	230
Travel services	3,507	3,584
Business travel	1,069	1,076
Personal travel	2,438	2,509
Other services	11,876	13,114
Communication	359	495
Construction	708	726
Insurance	353	338
Financial	594	539
Computer and information	468	561
Royalties & licence fees	990	961
Other business services	7,984	9,116
Personal, cultural & recreational	184	166
Government services n.i.e.	236	212

Source: International Monetary Fund. At the time of writing, detailed services data were not available for 2006.

Indonesia is a member of the World Trade Organization (WTO) and it is a supporter of a strong multilateral trading system. It has participated actively in the WTO Doha Round, including as a member of the G20 developing country grouping and the Cairns Group. Its priorities in the Round reflect its position as a developing economy, including on agriculture where its focus is on the problems faced by subsistence farmers. For non-agricultural goods, it emphasises the reduction and elimination of tariffs which affect developing economies. On services it favours a cautious approach to liberalisation that reflects its view that development considerations should take priority.

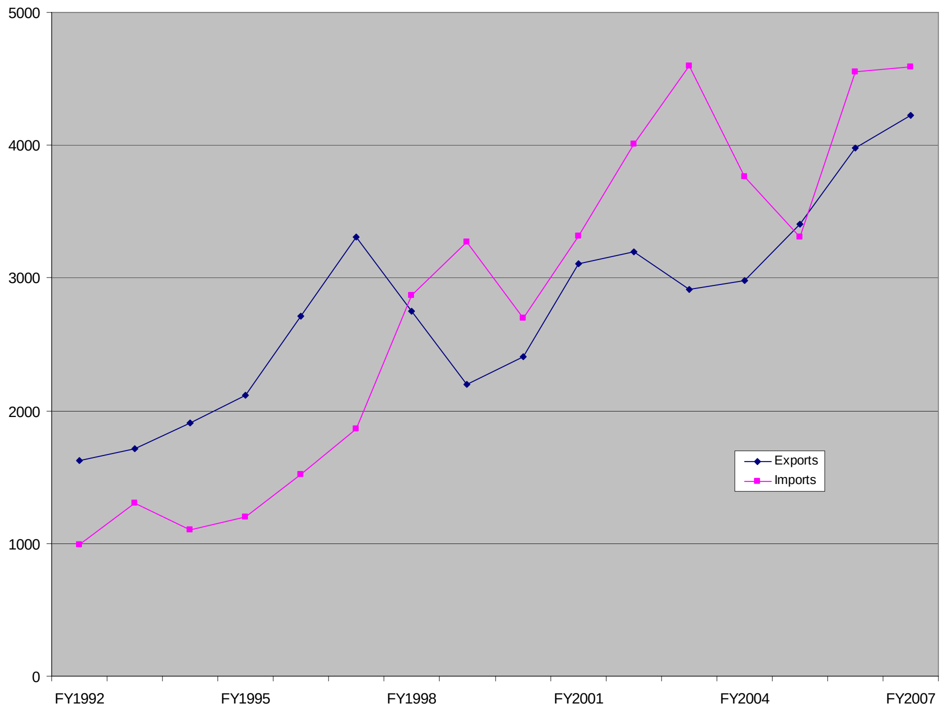
Through its membership of ASEAN, Indonesia is a party to the ASEAN Free Trade Area (AFTA). AFTA provides for the elimination of import duties on the Inclusion Lists of the original six ASEAN economies (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand) by no later than 1 January 2010. However, sensitive and highly sensitive products are not included in this commitment. Indonesia is also a party to the ASEAN Framework Agreement on Services (AFAS), the Agreement on the ASEAN Investment Area (AIA) and a Framework Agreement on Intellectual Property Cooperation.

Through its membership of ASEAN, Indonesia has been involved in negotiations for free trade agreements with a number of other economies. It is thus a member of agreements already concluded with China and the Republic of Korea, and is participating in negotiations for agreements between ASEAN and Japan, Australia and New Zealand, and India. As a member of the East Asia Summit, Indonesia has also been involved in a study of a possible Comprehensive Economic Partnership in East Asia (CEPEA).

Figure 1

Australian Exports to and Imports from Indonesia

A$ millions



Source: DFAT STARS Database

Indonesia has been less active than some other ASEAN economies (notably Singapore, Thailand and Malaysia) in negotiations for bilateral free trade agreements. It has preferred until recently to work through ASEAN on free trade agreements. However, it has recently signed a bilateral Economic Partnership Agreement with Japan – its first such agreement outside of ASEAN. Indonesia is also studying a possible FTA with India. Agreements with Pakistan and EFTA have also been foreshadowed or proposed.

3. Australia-Indonesia Bilateral Trade

Australia has a substantial trading relationship with Indonesia. In 2006-07, two way merchandise trade totalled $8.8 billion, making Indonesia our thirteenth largest merchandise trading partner and the fourth largest in ASEAN. Indonesia accounted for some 2.5 per cent of Australia's two-way merchandise trade in that year. Two-way trade in services is also substantial, valued at $1.4 billion in 2006. Indonesia is the fifteenth largest trading partner for services for those economies for which our services trade is identified separately.

Table 5

Australia's Principal Merchandise Exports to Indonesia

$A million

Code	Description	FY2006	FY2007
9999	Confidential items, items not classified	1064.5	1054.0
2709	Crude oil from petroleum and bituminous minerals	455.4	635.6
0102	Live bovine animals	220.5	303.0
7601	Aluminium, unwrought	281.0	276.7
5201	Cotton, not carded or combed	249.9	211.2
7403	Refined copper and copper alloys, unwrought	195.4	155.9
0402	Milk and cream, concentrated or sweetened	133.3	107.5
7204	Ferrous waste and scrap; remelting scrap ingots or iron or steel	68.8	80.6
7901	Unwrought zinc	30.5	76.2
7326	Articles of iron or steel nes	76.7	70.8
1101	Wheat or meslin flour	66.5	70.0
0202	Meat of bovine animals, frozen	31.0	60.3
8431	Parts suitable for use mainly in lifting, loading, grading, etc machinery	46.6	53.7
7606	Aluminium plates, sheets, etc., thicker than 0.2 mm	46.8	48.8
2301	Flours, meals and pellets, unfit for human consumption; greaves	21.0	44.2
2710	Oil (not crude) from petrol & bitum mineral etc	45.7	37.1
8413	Pumps for liquids; liquid elevators	28.0	35.7
8708	Parts and accessories of motor vehicles	31.3	34.2
8474	Machinery for sorting, screening, grinding, shaping, etc.	37.1	28.8
0406	Cheese and curd	24.4	28.6
4707	Waste and scrap of paper or paperboard	29.6	27.1
3102	Mineral or chemical fertilisers, nitrogenous	26.1	26.3
0404	Whey; products consisting of natural milk constituents, nes	16.8	26.3
0206	Edible offal of bovine and other animals, fresh, chilled or frozen	17.5	24.4
3004	Medicaments for therapeutic or prophylactic uses, measured/ retail	18.4	18.1
	Total merchandise exports	3981.7	4227.1

Source: ABS data from DFAT STARS Database. Descriptions of the HS codes above have been abbreviated in a number of cases and should be employed with caution.

3.1 Merchandise Trade

Australia's merchandise exports to Indonesia were seriously affected by Indonesia's prolonged downturn as a result of the East Asian financial crisis. As Figure 1 indicates, merchandise exports did not exceed the 1996-97 level until 2004-05. However, merchandise exports have recovered quite strongly in recent years. Between 2001-02 and 2006-07, they grew by some 32 per cent. Recovery has been led by exports of primary products, particularly fuels. In 2006-07, Australia's merchandise exports to Indonesia reached $4.2 billion, making Indonesia our eleventh largest export market overall and the third largest in ASEAN.

Table 5 identifies the top 25 merchandise exports to Indonesia. As the table shows, confidential items head the list (indicating that items for which export values are not divulged by the Australian Bureau of Statistics make up the largest single entry). Wheat is an important confidential export, with the value of exports estimated at over $650 million in 2006. Other confidential commodities include cane sugar, where exports were valued at $250 million in 2006,[3] and alumina with exports estimated from Indonesia's trade statistics at $250 million in 2006. Of those items for which data are separately identified in 2006-07, the most important is petroleum. Other important merchandise exports include live beef cattle, unwrought aluminium and cotton. Growth in petroleum exports was the single biggest factor explaining the growth in merchandise exports in 2006-07.

Australia's merchandise imports from Indonesia were valued at $4.6 billion in 2006-07, with Indonesia our twelfth largest source. Imports have fluctuated in recent years, and had not by 2006-07 passed the level recorded in 2002-03. The single biggest import in 2006-07 was petroleum, which accounted for some 38 per cent of all merchandise imports from Indonesia. Other substantial imports included centrifuges and filtering equipment[4], gold, television receiving apparatus and video equipment, wood and iron ore (Table 6).

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[3] The value of wheat exports can be estimated from quantity data and the average bulk wheat unit value. Cane sugar exports are released by the ABS after a six month lag.

[4] This was in practice parts of filtering and purifying apparatus, and as noted below is treated in the Australian tariff as equipment for passenger motor vehicles with a 10 per cent tariff.

Table 6

Principal Australian Merchandise Imports from Indonesia

$A million

Code	Description	FY2006	FY2007
2709	Crude oil from petroleum and bituminous minerals	2107.7	1722.7
8421	Centrifuges; filtering or purifying machinery	9.5	513.2
9988	Confidential items, items not classified	207.6	239.0
7108	Gold unwrought or in semi-manufactured forms, or powder form	610.5	214.8
8528	Reception apparatus for television; video monitors and video projectors	37.9	114.9
4409	Wood continuously shaped, sanded or finger-joint	63.0	96.1
2601	Iron ores and concentrates, including roasted iron pyrites	22.5	76.0
8544	Insulated wire, cable, etc.; opt sheath fib cables	33.5	67.0
9403	Furniture nesoi and parts thereof	59.4	58.0
8521	Video recording or reproducing apparatus	76.8	56.5
4407	Wood sawn or chipped lengthwise, sliced or peeled, thicker than 6 mm	38.3	54.7
4802	Paper, uncoat, for writing etc., rolls or sheets; hand-made paper	65.9	51.7
8419	Machinery, etc. for treating mat. by temp.change; storage water heaters non-e	16.0	45.4
4803	Tissue stock, towel or napkin stock and similar paper, in rolls or sheets	19.3	42.1
4001	Natural rubber, balata, chicle etc, primary forms, etc.	33.0	40.1
4412	Plywood, veneered panels and similar laminated wood	30.8	39.9
1804	Cocoa butter, fat and oil	34.1	35.3
4418	Builders' joinery, carpentry of wood	33.3	33.1
7308	Structures and parts of structures, incl. plates, rods, etc, of iron or steel	17.3	31.3
8471	Automatic data process machines; magn readers, etc	56.8	30.6
9401	Seats (other than medical, surgical or barbers') and parts thereof	24.8	27.4
8525	Trans appar for radiotel etc, TV camera, still image video cameras	19.6	23.1
8426	Ships' derricks; cranes; mobile lifting frames, etc		22.7
4011	New pneumatic tyres, of rubber	16.7	22.5
6403	Footwear, with uppers of leather	14.7	21.0
	Total Merchandise Imports	4553.3	4586.7

Source: ABS data from DFAT STARS Database. Descriptions of the HS codes above have been abbreviated in a number of cases and should be employed with caution.

3.2 Services Trade

Australia's services exports to Indonesia totalled $838 million in 2006, making Indonesia the twelfth largest destination among countries separately identified. As Table 7 indicates, the single largest item in services exports was education-related travel services. This made up some 57 per cent of services exports to Indonesia in 2006, reflecting the significance of Australia as a destination for Indonesian students. Personal travel services made up another 18 per cent of services exports.

Services exports have fallen by 23 per cent since 2001. The decline has been caused by a fall in several categories of services exports, including transportation services; education-related travel services; personal travel services (other than those related to education); and personal, cultural and recreational services. Of these, the single biggest fall (from $162 million to $53 million) was in transportation services. In the case of education, Indonesia has fallen from the third largest source of student enrolments in 2002 to the eighth largest source, as student numbers from Indonesia have declined and numbers from other countries have grown rapidly.

Table 7
Australia's Services Exports to Indonesia
$A million

	2001	2002	2003	2004	2005	2006
Transportation services	162	151	112	84	69	53
Travel services	765	695	702	675	624	664
Business	*27*	*32*	*25*	*25*	*25*	*34*
Personal	*738*	*663*	*677*	*651*	*599*	*631*
Education related	*565*	*522*	*512*	*500*	*476*	*480*
Other	*173*	*141*	*165*	*150*	*123*	*150*
Communication services	14	4	1	2	np	6
Construction services	np	9	np	np	np	0
Insurance services	0	0	0	0	0	0
Financial services	0	0	0	0	0	0
Computer & information services	11	13	np	11	10	7
Royalties & license fees	np	20	15	np	17	5
Other business services	50	60	51	49	47	46
Personal, cultural & recreational services	29	33	23	12	np	12
Government services	41	44	44	47	47	46
Services exports	**1,086**	**1,028**	**961**	**897**	**832**	**838**

Source: ABS. np = not published. Data for financial years for services were not available at the time of writing.

Australia's services imports from Indonesia totalled $564 million in 2006, making Indonesia our seventeenth largest source among countries for which data are separately identified. The largest component of services imports is personal travel services (other than education). Transportation services are also a significant import. Services imports declined appreciably in both 2005 and 2006. The biggest single factor in the decline was a fall in personal travel services (other than education), from $642 million in 2004 to $297 million in 2006. The number of Australian residents travelling abroad and listing Indonesia as their main destination fell from around 335,000 in 2004 to 195,000 in 2006.

4. Barriers to Bilateral Trade

4.1 Barriers to Australian Merchandise Exports

The average applied tariff for Indonesia in 2006 was 9.5 per cent and some 59.1 per cent of tariff lines were in the range 0-5 per cent. There are however, significantly higher tariffs in some product areas. In 2006, 10.6 per cent of applied tariffs exceeded 15 per cent and 5.4 per cent of applied tariffs were higher than 20 per cent. Average applied tariffs on imports from ASEAN, at 2.7 per cent, are appreciably lower than the MFN rate, giving ASEAN economies a significant margin of preference in exports to Indonesia.[5]

[5] See WTO Secretariat, *Trade Policy Review: Indonesia: Report by the Secretariat*, Geneva, WT/TPR/S/184, 23 May 2007, pp.39-46.

Table 8 breaks down the 2006 tariff by sectors, drawing on work carried out by the WTO Secretariat. As the Table shows, average applied tariffs on agricultural products (as defined in the WTO) were 11.8 per cent, while those on non-agricultural products (including fish, but excluding petroleum) were somewhat lower at 9.2 per cent. By sector, tariffs are particularly high for beverages and spirits (reflecting very high rates for alcoholic beverages), transport equipment and grains (reflecting high specific rate tariffs for rice). Tariffs can be much higher than averages shown. In the case of transport equipment, for example, tariffs range up to 80 per cent for certain automobiles.

Table 8

Indonesia's Tariffs by Sector: 2006

Simple average, applied rates

	MFN	CEPT
All Products	9.5	2.7
Agricultural Products	11.8	7.6
Live animals	4.5	0.2
Dairy products	5.6	0.0
Coffee, tea, cocoa, sugar, etc.	11.3	7.5
Cut flowers and plants	6.4	0.0
Fruit and vegetables	5.2	0.5
Grains	17.7	16.3
Oil Seeds, fats, oil and products	4.7	0.3
Beverages and spirits	87.4	84.1
Tobacco	10.5	3.8
Other agricultural products, n.e.s.	4.3	1.6
Non-agricultural Products (excl. petroleum)	9.2	2.1
Fish and fishery products	5.4	0.5
Mineral products, precious stones	6.7	3.0
Metals	9.1	2.1
Chemicals and photographic supplies	6.6	2.4
Leather, rubber, footwear, travel goods	10.3	3.9
Wood, pulp, paper, furniture	4.2	2.2
Textiles and clothing	10.9	1.6
Transport equipment	25.6	4.1
Non-electric machinery	2.7	0.6
Electric machinery	5.6	1.4
Non-agricultural products, n.e.s.	7.0	1.4
Petroleum	1.6	0.5

Source: WTO Secretariat. The CEPT rate applies to ASEAN economies.
Data include estimated ad valorem equivalents of specific rate tariffs.

Indonesia has bound some 93.2 per cent of its tariffs in the WTO. However, the average bound tariff, at 37.5 per cent, is much higher than the average applied rate. This is a potential source of uncertainty for exporters, since there is no legal impediment to Indonesia were it to wish to appreciably raise its tariffs to the level of the binding. AFTA and other free trade agreements that Indonesia is either party to or negotiating also mean that Australian exports could face increased competition in sectors where tariffs are, or are being reduced to, levels below the MFN rate.

Table 9 looks more closely at the tariffs which apply to the principal products which Australia exports to Indonesia. As the Table indicates, many of the most important exports enter at low or zero tariffs, but there are important exceptions. Moreover, even where tariffs are low, there is usually a margin of preference for other ASEAN economies, which places Australia at a competitive disadvantage. Areas where there are relatively high tariffs include cane sugar (where the specific rate tariff is estimated by the WTO as equivalent to an ad valorem tariff of 30 per cent) and motor vehicle parts and accessories (where the most favoured nation tariff is 15 per cent, but products from ASEAN economies can enter at 5 per cent).

Table 9

Tariffs on Key Australian Exports to Indonesia

Per cent unless otherwise indicated

Code	Description	MFN	CEPT
9999	Confidential items, items not classified, of which		
	wheat	0	0
	cane sugar	Rp 550/kg	-
	alumina	0	0
2709	Crude oil from petroleum and bituminous minerals	0	0
0102	Live bovine animals	0-5	0
7601	Aluminium, unwrought	0	0
5201	Cotton, not carded or combed	0	0
7403	Refined copper and copper alloys, unwrought	0-5	0
0402	Milk and cream, concentrated or sweetened	5	0
7204	Ferrous waste and scrap; remelting scrap ingots or iron or steel	0	0
7901	Unwrought zinc	0-5	0
7326	Articles of iron or steel nes	5-20	0-5
1101	Wheat or meslin flour	5	0
0202	Meat of bovine animals, frozen	5	0
8431	Parts suitable for use mainly in lifting, loading, grading etc machinery.	0-10	0
7606	Aluminium plates, sheets, etc., thicker than 0.2 mm	5-20	0-5
2301	Flours, meals and pellets, unfit for human consumption; greaves	0	0
2710	Oil (not crude) from petrol & bitum mineral etc	0-30	0-5
8413	Pumps for liquids; liquid elevators	0-10	0-5
8708	Parts and accessories of motor vehicles	15	5
8474	Machinery for sorting, screening, grinding, shaping, etc.	0-5	0-5
0406	Cheese and curd	5	0
4707	Waste and scrap of paper or paperboard	0-15	0
3102	Mineral or chemical fertilisers, nitrogenous	0	0
0404	Whey; products consisting of natural milk constituents, nes	5	0
0206	Edible offal of bovine and other animals, fresh, chilled or frozen	5	0
3004	Medicaments for therapeutic or prophylactic uses, measured/ retail	5	0-5

Source: Indonesia 2006 tariff. Note that the list of key Australian exports is based on the HS 2007 classification, whereas the Indonesia 2006 tariff is based on HS 2002.

Non-tariff barriers are important for some products. According to the WTO Secretariat, import licensing restrictions apply to 141 tariff lines, including alcoholic beverages, explosives and certain dangerous chemical compounds. Rice imports are prohibited during the peak harvest period and are subject to close control at other times with a state trading enterprise (Bulog) operating with the aim of supporting domestic producers and stabilising prices. Salt imports are banned in the second half of each year. Sugar imports are closely regulated to protect domestic farmers and importers must utilise three quarters of the cane produced by small farmers.[6] A number of anti-dumping actions have been taken by Indonesia, with 15 investigations between 2002 and the end of June 2006 leading to anti-dumping duties. Poor transparency of regulations and administration in Indonesia also has an impact on prospects for developing trade and is an important non-tariff barrier.

4.2 Barriers to Services Exports

Barriers to services trade with Indonesia are significant in many sectors. In the WTO, Indonesia has retained very extensive reservations in its market access and national treatment commitments, including limits on foreign equity and nationality requirements. Its overall Uruguay Round commitments and Doha Round offers cover only 34 per cent of all services sectors. There have, however, been some improvements in Mode 4 (movement of natural persons), and sectors such as legal services, architectural services, education and financial services, in its Doha Round offer. Brief comments on selected services sectors, are as follows:[7]

Education: An important impediment to Australia's exports of educational services to Indonesia is the fact that the Indonesian Department of National Education (DNE) does not recognise the Australian three-year bachelor degree as equivalent to the Indonesian Sarjana (SI). The SI requires a minimum of four years of study, and apparently on this basis, the DNE considers it to be superior to the Australian three-year degree. This issue has created significant problems for Indonesian students with Australian three-year bachelor degrees, particularly in terms of government employment. Other important impediments arise from regulatory or other barriers to the establishment in Indonesia of branch campuses of Australian education institutions. Indonesia made no Uruguay Round WTO commitments in education. We have welcomed Indonesia's cross-border offer to permit distance education, but remain concerned that its (Mode 3) commercial presence limitations (forms of legal entity, geographic limitations) would severely constrain market access opportunities for Australian education providers.

Legal services: Indonesia has been ranked in a recent study as being among the more restrictive ASEAN economies in terms of access for legal services.[8] Foreign legal firms cannot operate directly, and instead must seek a relationship with a local firm. A degree from an Indonesian legal facility or other recognised institution and Indonesian citizenship are required to practise as a lawyer, though foreign lawyers can operate as consultants. There are limits on the number (five) and the percentage (20) of foreign lawyers who can work in Indonesian law firms. Indonesia has made no binding WTO offer for Mode 3 (commercial presence), but has made an offer on

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[6] See WTO Secretariat, *op. cit.*, pp.46-48.

[7] Summaries on barriers draw heavily on points in United States Trade Representative (USTR), *2007 National Trade Estimate Report on Foreign Trade Barriers*, 2007 at www.ustr.gov; *Expanding Trade in Business Services in ASEAN*, Regional Economic Policy Support Facility Project 05/006, June 2007; WTO Secretariat, *op.cit.*, and Indonesia's APEC Individual Action Plan for 2005, available at www.apec-iap.org/

[8] *Expanding Trade in Business Services in ASEAN, op.cit.* This source is also the basis for estimates of the restrictiveness of accountancy and architectural services noted below.

Mode 1 (cross border supply), Mode 2 (consumption abroad) and Mode 4 (presence of natural persons). The last would allow foreign lawyers to work or take part in Indonesian law firms as employees or experts in international law.

Accountancy: Indonesia also ranks as among the more restrictive ASEAN economies in this sector. Foreign firms can operate in Indonesia only through a cooperation agreement with a local public accountancy firm and cannot practise under their own names. Indonesian citizenship is necessary to become a licensed accountant. Foreign agents and auditors can only operate as consultants. Indonesia has made no WTO commitments for access to its accounting services market.

Architectural Services: Indonesia is among the more restrictive ASEAN economies, although the market is in practice competitive. Foreign architectural firms must form a joint operation with a local partner with foreign ownership not more than 49 per cent (or 55 per cent for ASEAN). Foreign construction firms can only sub-contract or advise local firms where the Government considers that the work cannot be carried out by a local firm. However, in contrast to some other professional services, Indonesia does not apply nationality and residency requirements for architectural services. Indonesia has made no commitments under Mode 1 and its Mode 3 commitment has a joint operation and venture limitation.

Financial services: Foreign ownership of up to 99 per cent is allowed in the banking sector and 80 per cent for insurance companies. State banks control a substantial proportion of banking sector assets. However, foreign participation is also strong, with foreign banks estimated to own 40 per cent of Indonesia's banking assets at the end of 2005. There nevertheless remain a number of restrictions on foreign bank lending and operations which are of concern to Australian industry. Indonesia has made no commitment in a number of sectors under Modes 1 and 2, and its Mode 3 Doha Round offer includes restrictions on branch numbers.

Telecommunications: While there have been gradual reforms in the telecommunications sector in recent years, resulting in greater competition, the two principal carriers, PT Telkom and PT Indosat, continue to dominate fixed phone line and international services. There is stronger competition in the mobile phone sector, with Telkomsel (jointly owned by PT Telkom and Singtel) the largest supplier. The new investment regime published in June 2007 introduced tighter foreign investment restrictions for certain telecommunications sectors. For example, foreign investors are now permitted to own only up to 65 per cent of mobile telephone companies. Foreign investment in fixed line networks is permitted up to 49 per cent. Indonesia has made WTO commitments on various telecommunications services, including commitments on pro-competitive regulatory disciplines. However, these commitments are subject to significant market access and national treatment limitations, including foreign investment limitations of only 35 per cent.

Computer and related services: Foreign firms can operate with 100 per cent foreign ownership. As with other sectors, foreign consultants must comply with labour and immigration laws. Indonesia's Mode 3 commitment is limited to partnerships.

Management consulting: Foreign firms can operate with 100 per cent foreign ownership. As with other sectors, foreign consultants must comply with labour and immigration laws. Indonesia has made no WTO commitments for these services.

Mining, Energy and Environmental Services: Given Indonesia's substantial mineral and energy reserves, and recent privatisation of production and exploration in these sectors, there are significant opportunities for Australian mining, energy and environmental service providers. However, the Indonesian Government retains exclusive authorisation rights for all stages of mining activity, from survey, exploration, exploitation, production, refining, transport and marketing. Consequently, state enterprises are dominant in this sector. Where there is private involvement, the Government imposes foreign investment restrictions and employment of nationals. Indonesia has relatively few WTO commitments in energy-related services sectors. Indonesia currently has not made an offer in mining and environmental services.

Construction: As USTR has noted, foreign construction firms are "only permitted to be subcontractors or advisors to local firms in areas where the Government believes that a local firm is unable to do the work. In addition, for government-financed projects, foreign companies must form joint ventures with local firms."[9] Indonesia has made a limited WTO offer in this sector, with commercial presence only permitted through a joint operation or joint venture with maximum 55 per cent foreign ownership.

4.3 Barriers to Indonesian Exports

Australia's applied tariffs on imports of goods from Indonesia are already low. Some 86 per cent of Australian tariffs are at 5 per cent or lower and over 47 per cent of tariff lines are duty free. The simple average applied tariff as at January 2006 was 3.53 per cent. However, because Australia offers Indonesia developing country preferences (the DCS rate) on certain lines, the simple average tariff for Indonesia was somewhat lower at 3.29 per cent.

In two sectors – the textiles, clothing and footwear (TCF) and passenger motor vehicle (PMV) sectors – tariffs currently exceed 5 per cent. MFN tariffs in the PMV sector, which are currently 10 per cent, are scheduled to fall to 5 per cent in 2010. Tariffs in the TCF sector, which currently range up to 17.5 per cent will be reduced to 5 per cent in 2010, with the exception of tariffs for apparel and certain finished textile goods, where tariffs are expected to be reduced to 10 per cent in 2010 and then to 5 per cent in 2015.

Australia's imports of TCF from Indonesia amounted to $144 million in 2006-07, only approximately 1.8 per cent of the total. The simple average tariff for Indonesia at the DCS rate for textiles and clothing was 9.13 per cent in 2006 (marginally below the corresponding MFN rate of 9.14 per cent). Imports of automotive equipment from Indonesia jumped sharply in 2006-07 because of substantial imports of parts of filtering and purifying apparatus, valued at $504 million. Imports of motor vehicle wiring harness ($41 million) were also significant. In all, imports of automotive

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9 USTR, *op.cit.*, p.293.

equipment (including vehicles and parts) totalled $605 million in 2006-07, or about 2.3 per cent of total imports.

Australia has made specific commitments covering a broad range of services under the General Agreement on Trade in Services (GATS), including for business and professional services; telecommunications; construction and engineering; distribution; education; financial; recreational, cultural and sporting; tourism and transport, as well as commitments in our FTAs with the United States, New Zealand, Singapore and Thailand.

5. The Investment Relationship

5.1 Australian Investment in Indonesia

Australia has significant investment interests in Indonesia, though both countries acknowledge that links could be stronger. At the end of 2006, Australia's total investment in Indonesia (including portfolio investment) was $3.1 billion, making Indonesia our nineteenth largest destination. Australian direct investment in Indonesia amounted to almost $1.5 billion at the end of 2006. As Table 10 indicates, this was well below investment in some other regional economies. Direct investment in Indonesia was 15 per cent of Australia's direct investment in ASEAN.

The flow of new Australian investment to Indonesia has been limited in recent years, averaging only $72 million per annum in the three years ending 2006 according to the ABS. Australia is nevertheless an important source of investment from Indonesia's perspective. According to data on realised foreign direct investment published by Indonesia's Investment Coordinating Board (BKPM), Australia ranked fifth as a source of investment (after the United Kingdom, Taiwan, Singapore and Japan) in the first five months of 2007, with total realised investment of US$186.5 million.[10] This represented some 5 per cent of all realised direct investment for this period. Areas in which Australian business has investments in Indonesia include the mining and energy sectors, as well as agribusiness, finance, health and education.

There are a number of impediments to greater Australian investment in Indonesia. These include business regulation; uncertainties regarding responsibilities between central and provincial or local authorities; labour and bankruptcy regulations; and infrastructure limitations. The challenges of doing business in Indonesia are reflected in its relatively low ranking in various indicators of competitiveness and the business environment. The IMD *World Competitiveness Yearbook 2007* thus ranked Indonesia 54th out of 55 countries (compared with 23rd for Malaysia and 33rd for Thailand). The World Economic Forum's Global Competitiveness Index ranked Indonesia 50th of 125 countries in 2006 (compared to 26 for Malaysia and 35 for Thailand). The World Bank recently ranked Indonesia 123rd out of 178 countries in terms of ease of doing business (while noting positive reforms).[11]

The Indonesian Government has sought to introduce a number of reforms to improve the investment environment. These steps have included new investment legislation

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[10] These data are based on approval permits, rather than balance of payments data.

[11] *Doing Business 2008: Comparing Regulation in 178 Economies*, September 2007, at www.doingbusiness.org

that was passed by the Parliament in March 2007 and the release in July of a negative investment list that liberalises equity requirements in a number of sectors (but imposes more restrictions in others). Reforms have also sought to address such issues as infrastructure and the financial sector. However, there is a substantial reform agenda which remains to be addressed.

Table 10
Level of Australian Direct Investment Abroad
Selected East Asian and Pacific Economies
$ million, end of year

	2001	2006	% Share 2006
Hong Kong	4943	6751	2.3
Singapore	2135	4395	1.5
Papua New Guinea	1315	2743	1.0
Indonesia	519	1470	0.5
Fiji	241	639	0.2
Thailand	54	508	0.2
Malaysia	370	385	0.1
Japan	n.p.	142	0.0

Source: ABS. n.p. = not published.

5.2 Indonesian Investment in Australia

Indonesian investment in Australia is limited. The stock of inward investment (including portfolio investment) totalled $487 million at the end of 2006. Inflows of all investment from Indonesia have averaged slightly in excess of $50 million in the past three years. There are no recent ABS data on the stock of Indonesian direct investment in Australia, but the total is likely to be small. There were no inflows of direct investment recorded from Indonesia in 2006.

6. Other Possible Areas for Strengthening Cooperation and Liberalisation

As already indicated, from Australia's perspective, to ensure maximum benefits for both countries, an FTA with Indonesia would need to address comprehensively barriers to trade in goods and services, as well as investment. However, there are a range of other issues which would need to be addressed to enhance trade and investment opportunities. The following is an indicative, not exhaustive, selection.

Customs procedures	Competition policy
Technical barriers to trade, standards	Intellectual property
Economic cooperation	Government procurement

7. Rules of Origin

An FTA would also need to include clear rules of origin. Australia is now using in three FTAs product-specific rules (PSR) based largely on change of tariff classification (CTC). Under this approach, where the rule relies solely on CTC, the final product has to have a tariff classification sufficiently different from that of the imports used to demonstrate substantial transformation. In a small proportion of cases, where substantial transformation cannot be demonstrated through a change of tariff classification alone, the CTC rules are supported by a regional value content test.[12]

8. ASEAN-Australia-New Zealand FTA

Australia and Indonesia are both involved in region-level negotiations towards an ASEAN-Australia-New Zealand FTA (AANZFTA). An important issue for the feasibility study on the merits of a bilateral FTA with Indonesia will be to identify the way in which any such bilateral FTA could build upon any of the commitments made under an AANZFTA (when concluded). For example, there might be opportunities for enhanced market access or additional commitments in a range of areas important to the trade and investment interests of Australia and Indonesia.

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[12] Further information on the issue of rules of origin is included in a paper titled "Rules of Origin and Australia's Free Trade Agreement Negotiations: a background paper on issues for consideration", at http://www.dfat.gov.au/trade/050921_roos_background.html