

Connecting Australia and Indonesia

INSIGHTS

Asia Society Australia

25 May, 2015



Asia Society

Australia





*Front Cover Photograph
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About Asia Society Australia

Across the fields of arts, business, culture, education, and policy, Asia Society provides insight, generates ideas, and promotes collaboration to address present challenges and create a shared future.

Asia Society Australia is Australia's leading national centre for engagement with Indo-Pacific Asia, based in Sydney. Asia Society Australia is a non-profit, non-governmental and non-political organisation empowered by the membership of leading Australian and regional business, education and cultural institutions. Asia Society Australia promotes greater connectivity and deeper understanding between Australia and the Indo-Pacific in the areas of business, policy, culture and education and provides a high-level and innovative platform for Australian and Asian leaders and champions of engagement to connect, exchange ideas and develop meaningful relationships. Asia Society Australia was launched in 1997 by then Prime Minister John Howard to broaden interest and understanding in Australia of Asian countries and their politics, business and culture.

Asia Society is a global non-profit organisation and the leading force in forging closer ties between Asia and the West through arts, education, policy and business. Founded in 1956 by John D. Rockefeller 3rd, Asia Society is a nonpartisan, nonprofit institution with headquarters in New York, centers in Hong Kong, Houston, Los Angeles, Manila, Mumbai, San Francisco, Seoul, Shanghai, Sydney, and Washington, DC.

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Welcome



*The Hon Warwick Smith AM
Chairman, Asia Society Australia
Global Trustee, Asia Society*



*Philipp Ivanov
Chief Executive Officer,
Asia Society Australia*

Dear Asia Society Members,
Supporters and Friends,

2015 is an exciting year for Asia Society Australia. With the launch of our new strategic vision 'Asia Society Australia 2020' only a few weeks ago, we are taking the next step towards becoming Australia's most innovative centre for all-inclusive engagement with the Indo-Pacific region across business, policy, culture and education.

Asia Society Australia has been consistently recognised for the quality of its insights and the ability to connect Australian and the region's leaders, networks and communities in a dialogue on the critical issues in Australia-Asia engagement.

One of the most critical and complex issues facing Australia today is our relationship with Indonesia. It is fitting that the first edition of our new thought-leadership platform – Insights – is focused on Australia's relationship with Indonesia.

The Hon Warwick Smith AM
Chairman, Asia Society Australia
Global Trustee, Asia Society

It is a privilege to share with you two distinct viewpoints on the current state and prospects for the Australia-Indonesia relationship from two of Australia's leading Indonesia observers and practitioners – Richard Woolcott AC and Andrew Parker. Despite the different prisms through which our authors examine Indonesia, both come to the not entirely unexpected conclusion that Australia and Indonesia need to, and have always been able to, find a path to engagement and mutual trust – despite temporary setbacks and misunderstandings – and build a shared future in our region.

We are grateful for the ideas and perspectives that helped to shape this publication from across the Asia Society Australia family, particularly Andrew Parker and his team at PwC and Richard Woolcott, our members, the Board and Advisory Council. We look forward to your comments and connecting with you through our programs and events.

Philipp Ivanov
Chief Executive Officer,
Asia Society Australia

Australia-Indonesia: Shared Neighbourhood, Shared Future



RICHARD WOOLCOTT AC

Founding Director, Asia Society Australia

Former Ambassador to Indonesia (1975-78), Former Ambassador to the United Nations (1982-88)

Former Secretary of the Department of Foreign Affairs & Trade (1988-92), Chairman, Australian Indonesia Institute (1992-1998)

Australia and Indonesia in the Asia-Pacific neighbourhood

For Australia no bilateral relationship will be more important, complex and challenging in the future than that with Indonesia.

The relationship is, however, going through a difficult period at present, especially due to the reactions in Australia and Indonesia to the execution of two Australian citizens for heroin smuggling.

The necessary improvement in our relationship, given the level to which it has sunk, could take considerable time. It will require sensitive management by both Governments. Efforts of both countries in improving knowledge and reducing suspicion of each other in wider communities will be necessary.

Globally, Indonesia is of growing importance to major powers such as the United States, China, Japan, Russia, and India. This is because Indonesia, with a diverse population of some 250 million, spread over some 7,000 inhabited islands, is now the fourth most populous nation in the world. It is the largest Muslim country by population. Some 81% of its people are Muslim.

Despite a high degree of continuing poverty, it is a country with 94% literacy, an expanding middle class and a rate of economic growth of between 6% and 7% per annum. Indonesia is a member of the East

Asian Summit process, the G20 and the World Bank predicts it will have a larger economy than Australia within the next two or three years. Australia needs to acknowledge the reality that its relationship with Indonesia is asymmetrical. Indonesia is more important to us than Australia is to it. Suggestions by critics in Australia to cut or reduce aid to Indonesia will attract the response that this does not concern Indonesia, which no longer needs our aid.

Prime Minister Abbott has stated that Australia should pursue a "More Jakarta less Geneva" policy. This is a sound approach implying a priority for developing the relationship. In the context of the great changes underway in the Asia-Pacific region, Australia needs a fundamental change in our national psyche. We need to focus more on South East Asia, especially Indonesia, North Asia and the South West Pacific than we do on our long and well-established links with the United States, the United Kingdom and Western Europe. We need a continuous and sustained approach, rather than a spasmodic one, much more focused on the countries of Asia, especially Indonesia.

The rise of Asia is closely linked to the unprecedented transfer of wealth from the West to the East, from the Atlantic to the Pacific, which seems likely to continue into the foreseeable future. This seismic shift is driven by the spectacular growth of China,

in particular, but also by the rise of India and the established economic strengths of Japan and South Korea, in addition to the growing potential of Indonesia itself and Vietnam. This constitutes a historic global turning point to which Australia must respond, if we are not to find ourselves left behind.

We need a continuous and sustained approach, rather than a spasmodic one, much more focused on the countries of Asia, especially Indonesia.

It follows that the Australian Government will need to craft a more appropriate and updated balance in our relations with the United States and China, as the emerging superpower, and also with Japan. We should not take sides in territorial disputes between Japan and China. We should reinforce the Government's rhetoric about our role in the Asia Pacific region with action, balance, and adequate funding.

In what is widely referred to as the Asian Century, Australia should maintain an unambiguous policy to the Australian public, as well as to the United States and Chinese Governments, that, while we are in a long-standing alliance relationship with the United States and while we have



some different values and a different political system from China, we welcome the rise of China and oppose policies directed at the “containment” of China.

A rising China could, if mismanaged, lead to instability and frustrate progress towards Asia-Pacific regional co-operation. All countries in the region need continued peace and stability if economic growth is to be maintained and to deal with competition within the region for resources, including food and water.

Dialogue with Indonesia

Turning back to the Australia - Indonesia relationship, when the widespread reactions to the executions are behind us, we need to resume regular and improved consultations on a wide range of policy issues. Australia should consult Indonesia at Head of Government, Ministerial and Senior Official level, on all major global and regional issues, especially those involving the current complexities in the Middle East. On our continuing involvement in Afghanistan and our most recent additional involvement in Iraq we should have consulted Indonesia especially as it is by population the largest Muslim country in the world.

We have tended to consult mainly the United States, the United Kingdom and, on some occasions, Canada,

New Zealand and some European countries on issues such as the second invasion of Iraq in 2003.

In 1989 the Hawke Government consulted Indonesia and other South East Asian countries with Muslim majorities, like Malaysia, or substantial minorities like Singapore and the Philippines on our participation in operation “Desert Storm” in Iraq. Since 1996, however, we may have notified Indonesia of our major foreign and security policy decisions but I understand that the high-level regular consultations I am recommending have not taken place, as distinct from notification.

Australian Prime Minister Tony Abbott and Indonesian Prime Minister Joko Widodo's first meeting in Jakarta in October 2014. Photograph by Eka Nickmatulhuda / AAP



Photograph by Azrul Azli / Flickr

Joko Widodo on the cover of TIME Magazine in October 2014. Photograph by Adam Ferguson / TIME



We need to resume regular and improved consultations on a wide range of policy issues

A recent example of our failure to consult Indonesia in advance on policy issues which could affect that country was the hasty decision of the Gillard Government, subsequently rescinded, to ban live cattle exports to Indonesia. Another was - and still is - the handling of the refugee / asylum seekers issue in the region, an issue which is less of a priority for Indonesia than it is for Australia. Indonesia, which is a transit country rather than a destination for refugees, sees Australian policy of turning back boat people to Indonesia as harsh, contrary to international expectations and, on occasions, violating Indonesian territorial waters.

Another decision which was not fully canvassed in advance at a Head of Government level with Indonesia was the decision, announced by President Obama during his visit to Australia in November 2011, to rotate 2,500 US marines through Darwin. Such decisions should be announced by our Prime Minister in the Australian Parliament.

A group from the NSW branch of the Australian Institute of International Affairs, which toured Indonesia after President Obama's announcement, said that one of the main impressions the group had formed was that

Indonesia would like to see Australia follow a more independent foreign policy, not based on either compliance with American wishes, or a fear of China. Former Prime Minister Rudd put this well when he said that "compliance did not equate to alliance" in respect of the United States; similarly, "understanding did not equate to agreement" in respect of China's policies.

It is obvious that Australians and Indonesians need to know much more about each other. It is regrettable that many Australians still regard Indonesia mainly as a mysterious and corrupt country in which the rule of law is weak. According to the Lowy Institute's polls many Australians still see Indonesia as a potential security threat. This is largely because of historical fears, its size, its proximity, its assumed political instability and the situation in West Papua.

The great majority of Indonesians are largely ignorant about Australia. Those who do know Australia still tend to see it as part of the "Anglosphere". In the context of Indonesian, especially Javanese, cultures many see Australia as uncouth, sometime arrogant and still harbouring undertones of racism and religious intolerance. These suspicions go back to the days of the White Australia policy and more recently to public statements of politicians, such as Pauline Hanson, which are considered in Asia to be racist.

The fact that Australia's Head of State is still the Queen of England also reinforces our association with the United Kingdom and the "Anglosphere", which detracts from a more distinctive international and regional Australian identity.

Many Indonesians I have encountered still express uncertainty about the depth and sincerity of our commitment to our Asian and South West Pacific neighbourhood. While Indonesia, like Australia, welcomes a constructive and continuing United States involvement in the Asia Pacific region there is some concern in both countries about what the "pivot to Asia" - now referred to as "rebalancing" - really involves. What is expected of Australia? Will Indonesia be consulted about US expectations?

Indonesia remains a moderate secular state. That it is so is of fundamental importance to Australia and other countries in the region.

In the wider context of global Islam and the dangerously unstable and deteriorating situation in the Middle East, Indonesia is the most tolerant of all Islamic countries. Historically, it is mainly Sunni, but Islam in Indonesia has been tempered and softened by Hinduism and Buddhism. Indonesia has generally dealt firmly and effectively with Islamic extremists and domestic terrorism. It remains a moderate secular state. That it is so is of fundamental importance to Australia and other countries in the region. Australia needs Indonesian co-operation especially for its own security.

Leadership

Joko Widodo, 53, generally known as Jokowi, a Javanese businessman and former mayor of Surakarta assumed the Presidency after serving 18 months as the Governor of Jakarta. Despite his limited political background and his lack of experience in international affairs, his election was welcomed in Indonesia and overseas. He was never

associated with the political elite and his election as President was seen as an important break from Indonesia's past. He was largely seen as a man of the people who would govern for the "orang kecil" (the poor and less influential people).

In a cover story published last October, TIME magazine described him as "A New Hope" which indicated a break from a corrupt political elite dominated past and a fresh beginning. Initially, in Indonesian polls he enjoyed 75% support. Recently, however, this has dropped to 60%. It has been a problem for him that Jokowi does not lead a political party and secured the Presidency in part through the support of a former President, Megawati Sukarnoputri, and the current leader of the PDI - P.

In fact, after seven months in office Jokowi, according to a number of commentators in Jakarta and Australia, has not so far lived up to the hopes expressed after his election.

Megawati has used her position as party leader to play a prominent role in nominating the Cabinet, some members of which were not Jokowi's choices. For example, Budi Gunawan was pushed by Megawati for the role of Police Chief. Initially Jokowi did not withdraw Budi's nomination although the Corruption Eradication Commission (KPK), one of the most respected institutions in Indonesia, had announced he was under investigation. Jokowi has since done so.

On the positive side, Jokowi is aware of the need to streamline investment procedures, including in respect of mineral developments. He has established co-operative relations with a number of prominent Indonesian business leaders. It is of interest to note that when President Jokowi ceased to be the Governor of Jakarta and became President of Indonesia, he was succeeded as Governor of Jakarta by his Deputy who is a Christian, ethnic Chinese.

Jokowi ordered on the 9th May the release of 5 Melanesian political prisoners in Jayapura, the capital of

West Papua. He also lifted restrictions on visits to Papua by foreign journalists. He has however maintained his support for the death penalty in respect to drug trafficking. On 9 May he declared that the death penalty for crimes related to drug smuggling was still "our positive law" which, he, "as President would carry out". Jokowi has already fulfilled his pre-election promise of eliminating fuel subsidies that were absorbing some 15-20% of revenue. These savings enable him to move ahead with infrastructure projects which he has said he would do.

Australia's relations with Indonesia, as I have noted, are complex. They have entered a more difficult phase since the Australian Governments' and Parliaments' persistent pleas for clemency for Sukurmaran and Chan failed. There is still a perception in Indonesia that Australia is still essentially a Western country, more influenced by European countries, than it is by its neighbour Indonesia.

Under President Jokowi Indonesia remains a nationalist, sensitive, post-Colonial society which will not buckle under what it sees as intrusive Western pressure. As I warned both the Government and the Opposition

last January - too late as it turned out - excessive public political pressure was likely to prove counterproductive and could actually reduce the prospects of clemency being granted by the President.

The pressures, related to widespread domestic opposition to the death penalty, were also seen as inconsistent (the Howard Government had supported the death penalty for Saddam Hussein and the Bali bombers), "gesture" politics related to Australian domestic politics, such as the withdrawal of our Ambassador put Jokowi, a new and nationalist President, into a position in which he and his supporters considered he could not yield to foreign, especially Australian, pressure. We would in future be well served if we lectured less and consulted and listened more. Indonesia reacts negatively to what is often referred to as "megaphone diplomacy".

Jokowi also has difficulties with the Indonesian Parliament (DPR) as up till now he and his supporters do not command a Parliamentary majority. This is a complicating factor which could change depending on Indonesian domestic policies as Jokowi's term unfolds.



G20 Leaders' Summit Reception, Australia's Foreign Minister Julie Bishop with Indonesia's President Joko Widodo. Photograph by Rob Maccoll / G20 Australia

What's next?

To conclude, the importance of our future relations with Indonesia, and in the context of the Asian century, cannot be overstated despite the present level of irritation and dissatisfaction in each country about the other. It is essential that each country comes to know more about its neighbour.

Jokowi appears to have little warmth towards or interest in Australia, although he had a son at school in Sydney. He looks North rather than South (as we also do). Prime Minister Tony Abbott should try to change this attitude.

It follows that we need to be genuinely and continuously engaged - not just in a rhetorical sense or in going through the motions - with our very large neighbour of increasing regional and global importance. Two matters should be addressed.

Firstly, it is vital that Australia does not continue to allow single issues, such as the problems related to East Timor in the late 1970s and again in the late 1990s, or the recent execution of the two Australians convicted of drug smuggling, to excessively influence our attitudes.

The second issue of importance is that as Jokowi has only been in office for seven months it would be foolish for Australian political leaders to assume that he may not consolidate his position in the future. Australian leaders need to endeavour to establish closer contacts with him and his ministers.

The bilateral relationship will continue to be of paramount scope and importance. Both countries will share this neighbourhood for the rest of time.



Richard Woolcott AC is the Founding Director of Asia Society Australia and a member of its Advisory Council.

He is also a member of the International Council of the New York based Asia Society. In June 2008 he was appointed the Prime Minister's Special Envoy to develop an Asia Pacific Community concept.

He was Secretary of the Department of Foreign Affairs and Trade from 1988 to 1992. Prior to that appointment he had served as deputy to the High Commissioner in Malaysia, Commissioner in Singapore, High Commissioner to Ghana, Ambassador to the Philippines, Ambassador to Indonesia and Ambassador and Permanent Representative to the United Nations (1982-1988), where he also represented Australia on the Security Council (1985-1986). He was Chairman of the Australia Indonesia Institute from (1992-1998) and a member of the Advisory Panel for the first Government White Paper on Foreign and Trade Policy, published in 1997. Between 1992 and 2005 he was on the Boards of a number of companies in the private sector.

Mr Woolcott was closely involved with the establishment of the Asia Pacific Regional Economic Cooperation forum (APEC) and in 1989 was appointed as former Prime Minister Hawke's Special Envoy charged with developing the APEC concept. He has also carried out Special Envoy roles for Prime Ministers Holt, Whitlam, Howard and, most recently, Rudd.

He was made an Officer in the Order of Australia in 1985 and a Companion in the Order in 1993. He was awarded the Bintang Mahaputra Utama by the Government of Indonesia in 2000 for his contribution to bilateral and regional relationships. He was awarded the 2008 Sir Edward "Weary" Dunlop Asia Medal for his contribution to Australia's relationships with Asian countries. In 2008 he was selected as one of the inaugural Fellows of the Australian Institute of International Affairs. He was awarded an honorary degree of Doctor of Laws by the University of Melbourne in March 2012. Mr Woolcott gave the 15th Annual Hawke Lecture in Adelaide in November 2012. In May 2013, Mr Woolcott addressed the Centre for Indonesian Law, Islam and Society (CILIS) at the University of Melbourne on "Indonesia and Australia in the Asian Century". The speech was then published as a CILIS Policy Paper.

Mr Woolcott has contributed articles to leading Australian and overseas newspapers and journals. He is the author of *The Hot Seat: Reflections on Diplomacy from Stalin's Death to the Bali Bombings*, which was published in 2003 by Harper Collins and *Undiplomatic Activities*, published by Scribe in 2007.

Growth and Opportunity in Indonesia



ANDREW PARKER
Partner, Asia Practice Leader, PwC
Advisory Councilor, Asia Society Australia

Indonesia is emerging as a major global economic powerhouse. But how is Australian business responding? The opportunities and implications are significant.

INDONESIA AT A GLANCE:

5th largest
economy by 2030

250 million
people today

141 million
middle class consumers by 2020



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A Growing Economic Powerhouse

Indonesia has delivered strong and consistent economic growth since the difficult days of the Asian financial crises. They are now on their way to being the 4th largest economy by mid-century.

Indonesia is set to become one of the world's major economic powers over the next 30 years.

We forecast Indonesia to climb from its current ranking as the world's 9th largest economy to 5th by 2030 and 4th by 2050 (GDP at PPP rankings). By mid-century our closest neighbour will become an even more significant player, in a region long overshadowed by China, India and Japan.

Yet Australian business is woefully under-invested and under-engaged with our largest neighbour.

It's important that companies understand what's driving Indonesia's current growth, where their economy is heading, and what it all means for them.

A long way in a short time

Economically, Indonesia has come a long way in a relatively short period of time.

Under a tightly governed political and social system, the Indonesian economy grew rapidly between 1990 and 1996, averaging 8% GDP growth, and rightly aspired to be one of the Asian Tigers.

In 1997, the Asian economic crisis took hold of the region and left the Indonesian domestic economy in tatters. Inflation rates hit an average of 58% and foreign direct investment contracted sharply.

Billions of dollars in IMF loans, accompanied by tough structural reforms, followed. The reforms, largely seen as ineffective, were widely resented, and what is often described today as Indonesian economic nationalism can be traced to this period.

But since those difficult days, Indonesia has taken great strides to reform and strengthen many of its economic and political institutions.

The enactment of decentralisation laws in 1999, which moved the country away from the centralised model of the Suharto government and allowed regional areas to grow, was a significant reform.

Another was the launch of the State Owned Enterprise (SOE) reform and value creation program in 2000, which led to dramatic improvements in the

return on capital – and aggregate value – of the nation's 141 SOEs.

And more recently, there has been a decisive political shift in Indonesia. The 2014 General Election in this, the world's 3rd largest democracy, witnessed a remarkably peaceful transition of power to the 'rakyat's' (people's) choice over the traditional elite, represented by Soeharto's son-in-law General Prabowo.

Business leaders we speak to who have invested throughout the region argue that despite the complexity, red tape, and lack of transparency, once they gain experience it is one of the most productive countries that they work in.

There is growing confidence – within the country, throughout our region, and globally – in the potential of Indonesia as a major developing economic power.

Strong and consistent economic performance

Indonesia's economic performance post the Asian financial crisis has been impressive.

Since 2004, annual GDP growth has been consistently over 5%, with only a slight drop during the global financial crisis in 2008 and 2009.

Gross national income (GNI) per capita has more than doubled from US\$4,010 in 2000 to US\$9,270 in 2013.



And the increasingly dynamic Indonesian business community is thriving, with almost 50,000 new businesses opening in 2012, more than double the number in 2004 (20,598).

As incomes have risen, so has consumer spending, which increased from an average 522,446 IDR billion (US\$40.1 billion) between 2000-2014, to an all-time high of 1,200,000 IDR billion (US\$92.2 billion) in the fourth quarter of 2014. Consumer spending now accounts for more than half of Indonesian GDP.

Infrastructure investment key to sustained growth

Like Australia, resource-rich Indonesia initially rode the China-driven global commodities boom, which contributed directly around one-fifth of real GDP growth between 2002 and 2012.

But falling commodity prices, combined with the withdrawal of US monetary stimulus, have weakened the Rupiah and weighed heavily on the country's terms of trade. There are signs that consumer spending has slowed and GDP growth is trending below 5%, its lowest level since 2009.

President Joko Widodo, or Jokowi as he is commonly referred to, came to power in October 2014 promising a reform agenda and an average annual GDP growth target of 7% over the term of his Presidency to 2019.

Jokowi's reform agenda includes boosting domestic manufacturing and exports, reforming the bureaucracy and super-charging spending on infrastructure by inviting foreign investment and boosting Government spending.

During the election campaign Jokowi revealed the need for IDR 6,600 trillion (USD\$554 billion) to fund its infrastructure plans over the next five years, to fast track investment in major road, rail, port and power projects. Significantly SOE's have been given a central role in the national infrastructure program.

Achieving these ambitious targets will require a lot to go well for Jokowi. A strengthening US economy, a slowing Chinese economy and the flow on effects on commodity prices will weigh heavily on the Indonesian economy in 2015.

The Government is targeting growth of between 5.4% and 5.7% for 2015 and remains confident that Government spending will pick up in the second half to fill the gap.

The effectiveness of Government's spending programs, particularly the implementation of the infrastructure agenda, have been areas of under achievement in the past and ones that will potentially define Jokowi's Presidency.

Photograph by Alviansyah Kuswidyatama / Flickr

What's Driving Growth?

Demographic change, increasing digital connectivity and a positive political climate are underpinning Indonesia's current trajectory of economic growth.

Better education + increasing urbanisation = growing middle class

Indonesia is a vast archipelago of more than 17,000 islands that span over 5,000 km from Sabang in the west to Merauke in the east. With a population of close to 250 million it is the fourth largest in the world. Nearly half of the population is under the age of 30 years old.

That population is projected to increase to around 293 million by 2030, and 321 million in 2050.

Not only is the population growing, it is becoming better educated. In 2012, 82.5% of secondary school age students were enrolled in school, up from 61.7% in 2005. There is an additional 1 million students who finished high school in 2012 compared to 1999. This growth trend is expected to continue into the foreseeable future.

The population is also becoming more urban. Today over half of Indonesians now live in urban areas, including the major cities of Jakarta, Surabaya and Medan. This urban shift has helped fuel economic growth but also puts enormous strain on underdeveloped infrastructure.

Another impact of urbanisation has been the need to provide new jobs. Between 2001 and 2011 20 million jobs were created in Indonesia, the vast majority in urban areas. As a result, unemployment, which hit

a peak of 11.2% in 2005, has been steadily declining over the last 10 years and was 6.2% in 2013.

These demographic factors are combining to create an emerging middle and affluent class. In 2012 it consisted of around 74 million people, but is expected to double to 141 million by 2020. Middle class domestic consumption is, and will continue to be, a major driver of economic growth.

Digital connectivity is increasing

Indonesia is more digitally connected now than ever before, with huge implications for business, political participation, culture, and social interaction.

The country has one of the highest social media usage rates globally. Indonesian citizens have taken to Twitter, Facebook and LinkedIn in vast numbers: 29 million use Twitter, and there are more than 11 million Facebook users in Jakarta alone.

Corporate Indonesia is taking to social media too. Medco, Telkomsel and Pertamina have the most popular accounts on LinkedIn, while top beverage brand Pocari Sweat is the third most watched YouTube channel in Indonesia.

Mobile phone subscriptions are also growing rapidly: from a standing start in 1997 to 129 subscriptions per 100 people today.

And with the price of smartphones falling, we see greater numbers of Indonesians using mobile devices for commercial activities (e.g. Mobile Wallet) and connecting into social media networks.

The increased digital connectivity, combined with rising middle-class consumption, is leading to the growth of e-commerce. Indonesians are expected to spend around USD \$4.9 billion in 2016 on e-commerce goods and services.

However, one potential handbrake on the digital economy is the speed of internet in Indonesia, which is among the slowest in the world. Indonesia recognises it needs to increase investment in digital infrastructure to help fuel continued growth.

A political climate that is good for business?

A month after becoming President, Jokowi told the business world at the APEC CEO summit in Beijing in 2014 that Indonesia was now 'open for business'.

He has since shown that necessary economic reform is underway, stressing that his government will invest heavily in infrastructure, and reform business regulation – two areas that are hampering Indonesia's efforts to grow.

For example, his government has already taken the bold move of



Photograph by Azlan DuPree / Flickr

removing expensive energy subsidies, worth around US\$20 billion or 15-20% of the budget, to free up much needed finance for investment in infrastructure and other sectors.

It is also tackling the cumbersome regulatory environment for business by proposing a One Stop Service (OSS) centre, which will integrate service across key ministries and institutions.

Politically, however, it has not all been smooth sailing for the new President, who has already faced challenges in dealing with his own party, the PDI-P. The combination of intra-Party tensions and opposition strength in the Legislature (DPR) has constrained the President's freedom of action. This has led to growing disappointment amongst voters who were expecting more decisive leadership - and faster programs of reform.

For some commentators there have been worrying signs that economic nationalism is not being dampened as hoped for under President Jokowi. In fact, many worry that it may even be increasing.

Whilst that analysis is true on some levels, it should be balanced by the complex economic and political realities within Indonesia.

On the one hand, Jokowi faces a difficult domestic political climate where creating jobs for Indonesians and protecting local interests takes a high priority. On the other, Indonesia

has commitments to its fellow ASEAN - and APEC - members as well as under various other free trade agreements.

Add the impact of falling global commodity prices, and Indonesia, like Australia, can no longer rely on its resources industry for GDP growth. Protectionism will need to be balanced with pragmatism.

Importantly, the infrastructure needed to support Indonesia's economic growth aspirations are far beyond the capacity of local institutions to fund or build. Foreign investment will be required to help Indonesia reach its growth potential.

A key power in the growing ASEAN economic community

Indonesia is situated in one of the fastest growing areas of the world. Together the countries that make up ASEAN have a combined GDP of USD \$2.4 trillion in 2013.

Expected to come into effect in December this year, the ASEAN Economic Community (AEC), will bring the 10 ASEAN countries under one economic banner, with the aim of facilitating the flow of goods, services and capital as well as human resources within the region.

As both the largest economy, and with the largest population, Indonesia is well positioned to lead and play a major role in shaping the success of the AEC.

What Does This Mean For Australian Business?

There is good reason to be optimistic about the future opportunities in Indonesia. But to be successful, you'll need to think differently.

The opportunities for Australia to increase both trade with, and direct investment in Indonesia are considerable. But we must move more rapidly.

Australia is way behind the game compared to other Asian investors including China, Japan and South Korea, all of which have been much quicker to invest in Indonesia. President Jokowi is proactively encouraging a strong relationship with China and has suggested that Indonesia could learn from China's economic progress.

Historically, the Australia – Indonesia bilateral economic relationship has been limited to mainly trade in commodities of crude petroleum, wheat, gold, aluminium and steel.

Australia's two-way trade with Indonesia in 2013 was worth A\$14.9 billion, making them our 12th largest trading partner. Of this, A\$11.2 billion was trade in goods, with trade in services of almost A\$3.7 billion.



Australian direct investment in Indonesia remains relatively low. It's only a fraction larger - A\$10.9 billion vs A\$9.5 billion - than we invest in our much smaller neighbour Malaysia, and heavily concentrated in the resource and agribusiness sectors.

Currently there are only about 250 Australian businesses in Indonesia. In the near future however, we believe that big and small businesses in

Australia will increasingly try to tap into the fast emerging Indonesian market.

We expect opportunities will be particularly strong in the services sector including infrastructure, higher education, financial services, ICT and telecommunications, healthcare services and tourism. Food and agriculture will also present opportunities for our primary producers.

Dealing with the challenges

There are many challenges, both experienced and perceived, faced by Australian businesses in entering the Indonesian market.

A recent PwC survey indicated that some of the common barriers include corruption, cultural barriers, an uneven playing field, legal and regulatory barriers, and trade barriers.

Indonesia is also ranked very low on the World Bank's Ease of Doing Business rankings, sitting at 117th place in 2014 – but on a positive note rising 3 spots to 114th in 2015.

We believe there are 8 fundamental steps that business needs to get right before entering a market like Indonesia:

01 

Lead with strategy and take a portfolio approach

02 

Invest in learning the culture

03 

Don't be fooled by relationships

04 

Understand 'Uniquely Asian' market dynamics

05 

Keep timelines realistic and be patient

06 

Proceed with caution

07 

Triangulate your information

08 

Go easy on the integration and remember the 80/20 rule

These steps are outlined in more detail in our recent report *Passing us by* on the opportunities for Australian businesses in Asia (*Passing us by*, PwC 2015).

Where do we go from here?

Strong economic growth, supported by a robust labour supply, emerging middle class, high online and mobile penetration and a political climate that's good for business, have positioned Indonesia to become one of the biggest world economies in the near future.

But it will not be without challenge. The President faces significant hurdles in implementing his vision for Indonesia over the remaining 4 years of his Presidency.

And Australia's political relationship with Indonesia has been punctuated by friction on a range of issues, most

recently in the wake of the Bali-9 executions, and this will probably be the case for some time to come.

Yet despite these differences, our overall bilateral relationship remains solid. Our proximity means that Australian business is well placed to be a partner to Indonesia in its transformation journey to become an economic power in the region.

It is now up to Australian businesses: will we rise to the challenge and be part of the next economic superpower, or will we stay put and watch the wave passing by?



Andrew Parker is a Sydney-based Partner at PwC where he leads the Australian Firm's Asia Practice.

Andrew joined Price Waterhouse in 1985, became a partner in 1999 and spent 12 years in PwC's London, Moscow and Jakarta offices where he gained considerable experience advising companies investing in foreign (and particularly developing) markets. Andrew has had a long association with Asia having lived and worked in Indonesia and was the leader of PwC's Asian telecoms industry team until 2012, a role he held for nearly 10 years.

He is a member of the Advisory Boards of the Asia Society and China Matters and a non-executive director of the Australia Indonesia Centre at Monash University. Andrew was the lead author of PwC's landmark report on Australia's lack of business investment in Asia titled "Passing us by" and is a regular commentator in the media and presenter at forums on Asian trade and investment in Australia and Australian trade and investment in Asia.

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