



AUSTRALIA – INDONESIA

FREE TRADE AGREEMENT

JOINT FEASIBILITY STUDY

This study was prepared by the Department of Foreign Affairs and Trade, Australia and the Ministry of Trade, Republic of Indonesia



Australian Government

Department of Foreign Affairs and Trade



**DEPARTEMEN PERDAGANGAN
REPUBLIK INDONESIA**

Ministry of Trade Republic of Indonesia

Table of Contents

Executive Summary	1
Chapter 1. Introduction	4
1.1 Background to the Study	4
1.2 Objectives and Outline of the Study	5
1.3 Environment for a Bilateral Free Trade Agreement	6
1.4 Political and Strategic Implications of an FTA	8
Chapter 2. Indonesia-Australia Trade and Investment Links	11
2.1 The Australian and Indonesian Economies	11
2.2 Australia's Exports to Indonesia	16
2.3 Indonesia's Exports to Australia	20
2.4 Investment Links	24
Chapter 3. The Impact of Liberalising Bilateral Trade and Investment	30
3.1 Impediments to Australian Exports and Investment	30
3.2 Impediments to Indonesian Exports and Investment	36
3.3 The Implications for Australian Exports of Goods and Services	40
3.4 The Implications for Indonesian Exports of Goods and Services	44
3.5 Implications of Rules of Origin	47
Chapter 4. Macroeconomic and Sectoral Impact of an Indonesia-Australia FTA	51
4.1 Overview	51
4.2 The Model and Modelling Assumptions	51
4.3 Macroeconomic Impact for Australia and Indonesia	54
4.4 Sectoral Economic Impact for Australia	59
4.5 Sectoral Economic Impact for Indonesia	61
4.6 The Pace of Liberalisation	63
Chapter 5. Other Areas for Possible Inclusion in a Bilateral FTA	65
5.1 Customs Procedures	65
5.2 Standards, Technical Regulations and Conformity Assessment Procedures	68
5.3 Electronic Commerce	70
5.4 Government Procurement	72
5.5 Intellectual Property	74
5.6 Competition Policy	77
5.7 Economic Cooperation and Capacity Building	79
Chapter 6. Architecture of a Bilateral FTA	84
6.1 Objectives and Principles of a bilateral FTA between Australia and Indonesia	84
6.2 Relationship to AANZFTA	85
6.3 Scope and Coverage	85
Chapter 7. Conclusions and Recommendations	88
Glossary of Acronyms and Abbreviations	90

List of Tables and Graphs

Table 2.1 Australia and Indonesia: 2007	15
Chart 2.1 GDP Growth in Australia and Indonesia	18
Chart 2.3 Australia's Exports to Indonesia	19
Chart 2.4 Composition of Merchandise Exports to Indonesia: 2007	20
Table 2.2 Australia's Principal Merchandise Exports to Indonesia	21
Table 2.3 Australia's Services Exports to Indonesia	22
Chart 2.5 Indonesia's Exports to Australia	23
Table 2.4 Australia's Position in Indonesia's Exports	23
Chart 2.6 Composition of Indonesia's Goods Exports by Sector 2007	24
Table 2.5 Indonesia's Principal Merchandise Exports to Australia	25
Table 2.6 Australia's Services Imports from Indonesia	25
Table 2.7 Level of Australian Direct Investment Abroad: Major Destinations	28
Table 2.8 Foreign Investment in Australia: Level of Investment by Country	30
Table 3.1 Indonesia's Tariffs (Simple, average applied rates) by Sector: 2008	34
Table 3.2 Tariffs on Key Australian Exports to Indonesia: 2008	35
Table 3.3 Percentage of Tariff Lines with Tariff-Free Treatment following Implementation of AANZFTA	36
Table 3.4 Percentage of Tariff Lines with Tariffs in the 0-5% Range following Implementation of AANZFTA	36
Table 3.5 Percentage of Base Period (2005) Imports from the Other Country with Tariff-Free Treatment following Implementation of AANZFTA	36
Table 3.6 Analysis of Australia's 2008 MFN applied tariff by WTO Sectors	40
Table 3.7 Australia's Tariffs for Indonesian Exports Products by HS2 (2008)	40
Table 3.8 Percentage of Tariff Lines with Tariff-Free Treatment following Implementation of AANZFTA	42

Table 3.9 Percentage of Tariff Lines with Tariffs in the 0-5% Range following Implementation of AANZFTA	42
Table 3.10 Percentage of Base Period (2005) Imports from the Other Country with Tariff-Free Treatment following Implementation of AANZFTA	42
Chart 4.1 Estimated Impact of Liberalisation on Indonesia's Real GDP	59
Chart 4.2 Estimated Impact of Liberalisation on Australia's Real GDP	59
Chart 4.3 Source of Indonesia's Gains NPV 2008	61
Chart 4.4 Bilateral Indonesia-Australia Trade	62
Chart 4.5 Source of Australia's Gains NPV 2008	63
Chart 4.6 Main Economic Impacts under Different Phase-in Scenarios	67
Chart 4.7 Present Value of Economic Impacts under Different Phase-in Scenarios NPV	68

Executive Summary

In July 2007 Australia and Indonesia agreed to undertake a joint feasibility study on the merits of a bilateral free trade agreement (FTA), with the findings to inform the decision on whether or not to proceed to negotiate a bilateral FTA between the two countries.

Australia and Indonesia enjoy a wide-ranging relationship, encompassing extensive political, security, commercial, development and people-to-people links. These linkages have been expanded and strengthened in recent years, reflecting a shared commitment to advancing cooperation between the two countries, including in a variety of bilateral and regional fora.

At the same time, both Governments recognise that two-way trade and investment links fall short of their potential relative to Australia's trade and investment with other ASEAN members. Noting the complementarities between the Australian and Indonesian economies, a comprehensive FTA, allowing for freer movement of goods, services, investment capital and people offers an opportunity to expand bilateral economic linkages. Deeper economic integration would strongly complement already close strategic, security and political engagement between the two countries.

In preparing the study both Governments accorded a high priority to consultations with key stakeholders, including different levels of government, business and other interested groups. In addition, an independent economic consultancy was commissioned to undertake economic modelling to investigate the economic impact of a bilateral FTA. These consultations in combination with the economic modelling have helped inform the broad judgements and the detail of this study.

The feasibility study finds that a bilateral FTA between Australia and Indonesia would provide worthwhile benefits for Australia. It finds that the gains for Indonesia would also be worthwhile, and would, consistent with expectations, be of a greater magnitude.

More broadly, however, the feasibility study confirms that while a range of impediments to bilateral trade will be eliminated by each country as part of the recently concluded ASEAN-Australia-New Zealand FTA (AANZFTA), significant barriers to trade and investment flows between Australia and Indonesia will remain after AANZFTA enters into force.

The study shows that the greatest gains would be achieved under an FTA that would eliminate tariffs and non-tariff barriers to all trade between the two countries. At a minimum, a bilateral FTA should go beyond each country's commitments in the World Trade Organization (WTO) and under AANZFTA. In negotiating an FTA, the study recognises that each party to negotiations would take into account its potential domestic adjustment costs for each sector.

The feasibility study also demonstrates that the objective of an FTA negotiation ought to be the removal of all barriers to bilateral services trade. Such barriers impose additional costs on exporters and consumers, and retard economic competitiveness. A

bilateral FTA would be expected to cover all services sectors of importance to each country.

In the investment sphere, the study shows that Indonesia-Australia investment levels, though not insubstantial, underperform relative to growing bilateral trade and Australian investment in some other ASEAN economies. A comprehensive FTA that eliminates the widest possible range of direct and indirect barriers to Australian investment in Indonesia would enhance the bilateral relationship in a number of important respects. First, Indonesia would be better placed to attract Australian investment, especially in key mining and resources sectors. Second, Indonesian investors may become more familiar with, and more confident about their ability to exploit the investment opportunities available to them in Australia.

A bilateral FTA would be expected to intensify and strengthen already wide ranging cooperation between Australia and Indonesia, including in the areas of trade and investment promotion, customs services, sanitary and phytosanitary measures, technical regulations and standards, intellectual property rights, electronic commerce, competition policy, and government procurement. This cooperation could take a variety of forms, including agreement on common regulatory principles and approaches, as well as programs to facilitate exchange of experience, information and expertise. Both countries recognise that capacity building and economic cooperation would be an important aspect of an Indonesia-Australia FTA.

While acknowledging that nothing in the study pre-judges how particular issues might be addressed in an FTA, six principles are considered to be important to achieve the shared objectives of accelerating sustainable economic growth and raising living standards in both countries:

- The two sides should negotiate as equal partners;
- Negotiations should take into account that the two countries are at different stages of economic development and have different comparative advantages and adjustment costs;
- Negotiations should be comprehensive, covering liberalisation and facilitation of goods and services trade across all sectors and liberalisation and protection of investment. Negotiations should seek to achieve a balanced outcome through a single undertaking;
- An FTA must be consistent with WTO rules, APEC's principles and goals for trade and investment liberalisation, and the respective commitments of both countries under the AANZFTA;
- An FTA would need to include arrangements to facilitate dispute settlement mechanisms; and
- An FTA should deliver significant outcomes for both parties as soon as it enters into force.

Independent modelling provides some insights into how an FTA, assuming the immediate and comprehensive removal of all tariff and non-tariff barriers as at 2010, might impact on bilateral trade and investment flows for the period 2010-2030. In interpreting the modelling results, it is important to recognise that economic models simplify reality, depend on the currency and quality of data inputs, and rely on

numerous assumptions regarding economic parameters, behaviour and relationships. For these reasons, modelling results should be used only to infer the outcome of trade and investment liberalisation (positive or negative), and the magnitude of such impacts.

The results of the economic modelling suggest that an FTA would confer worthwhile economic benefits on both countries. Significantly, the modelling shows that the greater the sectoral coverage, the deeper the liberalisation, and the faster the rate of implementation, the greater the net benefit to both countries.

The feasibility study shows, therefore, that an ambitious and comprehensive bilateral FTA could improve trade and investment links, deepen bilateral and regional economic integration and provide positive outcomes in key agricultural and manufacturing sectors of importance to both Australia and Indonesia. In so doing, an FTA would be expected to provide significant opportunities for business and more particularly for exporters in both countries. It would build on the gains made under AANZFTA as well as providing a solid foundation for what is a growing engagement between the two countries in a range of areas, including security, environment, economic cooperation, education, transnational issues and people-to-people links.

Chapter 1. Introduction

1.1 Background to the Study

Australia and Indonesia agreed in July 2007 to undertake a joint feasibility study on the merits of a bilateral free trade agreement (FTA). The decision to consider a bilateral FTA followed a recommendation by an Experts Group, established under the bilateral Trade and Investment Framework (TIF). Australia and Indonesia agreed that the study would form a basis for deciding whether they should then proceed to negotiate a bilateral FTA.

Australia and Indonesia already enjoy a wide-ranging relationship, encompassing extensive political, security, commercial, development and people-to-people links. The bilateral relationship has developed considerably in recent years, reflecting a shared commitment to advancing cooperation on a wide range of bilateral and regional interests. Australia and Indonesia have worked closely together on such issues as counter-terrorism, people-smuggling, illegal fishing, health and natural disaster recovery. Cooperation is likely to expand further in the future given the importance of the two nations in the East Asian region, with Indonesia the largest economy in ASEAN and the world's fourth most populous nation, and Australia as a developed economy, and one of the largest economies in the region.

The trading relationship is already substantial. Two-way bilateral trade amounted to some A\$10.3 billion (Rp 79,422 billion¹) in 2007. Two-way trade will likely slow in 2009 as a result of the global economic slowdown, but should return to growth from 2010. Indonesia is Australia's 13th largest trading partner. For Indonesia, Australia is its 12th largest trading partner. There are significant complementarities between the two economies. Australia supplies Indonesia with a wide range of agricultural, resource-based products, manufactures and services. Indonesia supplies Australia with a variety of primary products and labour-intensive and other manufactures. Trade in crude oil goes in both directions.

The FTA negotiated by ASEAN, Australia and New Zealand (AANZFTA), which will substantially reduce existing tariff and non tariff barriers to trade between Australia and ASEAN, will expand and deepen regional economic integration, including between Australia and Indonesia. It was concluded in August 2008 and was signed in February 2009. There remains, however, considerable scope to further strengthen bilateral trade and economic ties by addressing remaining barriers to trade and investment. Opportunities exist to expand trade in specific goods, as well as trade in services (Australia's services exports to Indonesia have declined in recent years, as have Indonesia's services exports to Australia). A bilateral FTA could also transform the Indonesia-Australia investment relationship. In addition, opportunities exist for Australia to work closely with Indonesia, including through strengthening a number of economic cooperation projects, to enhance Indonesia's capacity to effectively exploit new market opportunities created by a bilateral FTA.

¹ Australian dollar Indonesian Rupiah exchange rate calculated using IMF International Financial Statistics average rate for 2007.

1.2 Objectives and Outline of the Study

Australia and Indonesia agreed that the joint feasibility study would assess the prospects for building on the progress achieved under AANZFTA. According to the terms of reference, the Joint Study Group (JSG) was to examine the benefits and costs to Australia and Indonesia of a World Trade Organisation (WTO)-consistent FTA that included:

- comprehensive tariff liberalisation;
- enhanced bilateral trade by addressing non-tariff barriers;
- broad-based liberalisation of the services sector;
- potential for greater access to government procurement contracts;
- addressing impediments to the two-way flow of investment;
- measures to strengthen intellectual property regimes;
- competition policy reform;
- improved customs procedures;
- measures to address technical barriers to trade, such as differing technical regulations and standards; and
- capacity building.

The terms of reference for the JSG require that it consider the broader trade, political and strategic implications of an FTA for both Indonesia and Australia. These would include consistency with Australian and Indonesian trade policies; the impact of an FTA on economic growth and welfare; trade, investment and commercial linkages and competitiveness; the value of an FTA as a framework for pursuing bilateral trade concerns, and the potential for an FTA to enhance support for the WTO.

In preparing the study, both Australia and Indonesia have accorded high priority to consultations with key stakeholders. The Australian Government undertook extensive consultations with State and Territory Governments, business and other interested groups in 2007 and 2008. Australia's Department of Foreign Affairs and Trade received over 25 submissions from the public in relation to the study. The Ministry of Trade of the Republic of Indonesia also identified the study as a priority program for 2008, holding public consultations with related Departments/Ministries and private sector stakeholders. In both cases, these consultations have helped to inform both the broad judgements and the detail of the study.

The study is organised as follows:

- Chapter 2 looks at the broad characteristics of the two economies, and the nature of the trade and investment links between them;
- Chapter 3 looks at the impact of liberalising bilateral trade and investment between Australia and Indonesia, given current and post-AANZFTA impediments to trade and investment between the two countries;

- Chapter 4 examines the potential macroeconomic implications of a bilateral FTA and summarises the findings of an independent consultancy commissioned to model the impact of an FTA using the CIEG-Cubed economic model;
- Chapter 5 examines the varied cooperation links between Australia and Indonesia. It also examines areas where a bilateral FTA could serve as a basis for additional cooperation, including customs procedures; standards, technical regulations and conformity assessment procedures; electronic commerce; competition policy; intellectual property; economic cooperation and capacity building and government procurement;
- Chapter 6 examines the FTA architecture needed to strengthen the Indonesia-Australia relationship and increase economic growth and welfare in both countries; and
- Chapter 7 draws together the conclusions and key recommendations from the study.

1.3 Environment for a Bilateral Free Trade Agreement

The strength of the world economy in recent years has been driven by exceptionally rapid expansion in China, solid growth in the United States and Europe, and modest recovery in Japan. It has been accompanied by high commodity prices. At the time of writing, however, the risks to global economic growth have risen substantially, reflecting volatility on world financial markets arising from the United States (US) sub-prime mortgage crisis. Current forecasts suggest that the US economy will contract in 2009. China's economic growth is now also expected to slow considerably, with various recent forecasts suggesting that China's GDP may grow by between 5 and 7 per cent in 2009, down from the official 9 per cent in 2008.

The global economic slowdown, which gathered real momentum in late 2008, continues to challenge policy makers in both Australia and Indonesia. Both countries are members of the G20 group of countries which confirmed the vital importance of resisting protectionist pressures and advancing trade reform to support economic growth and development. An open trading system and further reform – whether multilateral or bilateral – will be important to the long-term growth prospects for both Australia and Indonesia. An FTA that addresses impediments to bilateral trade and investment will help promote this goal.

For many of the economies of East Asia, which have a strong interest in an open, rules-based international trading system, the recent slow progress of the WTO Doha Round negotiations has been disappointing. Both Australia and Indonesia seek, as the highest priority of trade policy, a successful and substantial outcome from the Doha Round. Both have worked actively in the WTO, in APEC and other international and regional fora to achieve this objective. A substantial Doha Round outcome would not only lay the basis for a stronger world economy in the medium and longer term, but would also have an immediate impact on global economic confidence.

For many countries, including Australia and Indonesia, FTAs have emerged as an important complement to WTO disciplines. The spread of FTAs is underpinned by a variety of factors, including: a desire to improve market access, and/or maintain

economic competitiveness as other countries negotiate FTAs, as well as limited progress at the WTO. In addition, some countries seek FTAs to pursue broader non-economic foreign policy or strategic objectives, while in other cases the contribution such agreements can make to domestic reform initiatives is a factor.

Like many countries in the region, Australia has pursued an active FTA agenda in recent years. Four such bilateral agreements – with Singapore, Chile, the United States and Thailand – have entered into force since 2003. Steps are continuing to further strengthen and deepen economic integration with New Zealand, with which Australia has a long-standing free trade agreement (ANZCERTA). In addition, Australia is a party to the recently concluded AANZFTA, and is negotiating four new trade agreements – with China, Japan, the Gulf Cooperation Council, and Malaysia. In 2008, the Australian Government also announced that Australia will participate in negotiations for a Trans-Pacific Partnership Agreement (TPP). The TPP will expand on the current Trans-Pacific Strategic Economic Partnership Agreement between Brunei Darussalam, Chile, New Zealand and Singapore, which entered into force in 2006. The United States and Peru will also join the TPP negotiations. Finally, Australia is studying the feasibility of agreements with Korea, India, and Indonesia.

The Australian Government which took office in late 2007 undertook a review of Australia's experience with recent FTAs as part of a broader review of Australia's export policies and programs. The review concluded that FTAs should form an integral part of Australia's future market access strategy. However, in assessing possible future FTA partners, the government should consider several key objectives, including: the potential for achieving substantial trade liberalisation in a more timely way than is possible through other negotiating mechanisms; the need to ensure WTO consistency while also ensuring that agreements go beyond current WTO commitments and the need to enhance foreign and security relations.

Through its membership of ASEAN, Indonesia is a party to the ASEAN Free Trade Area (AFTA). It 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. ASEAN's aim is to form an ASEAN Economic Community, with a single market for goods and services by 2015. AFTA commits six member nations (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand) to eliminate import duties, except on sensitive and highly sensitive products by 2010, and the other four member nations (Cambodia, Laos, Myanmar and Vietnam) to similarly eliminate duties by 2015 except on sensitive and highly sensitive products.

Again through its membership of ASEAN, Indonesia has been involved in negotiations for FTAs with a number of other economies. It is thus a member of separate agreements between ASEAN and China, the Republic of Korea and Japan. It is a party to AANZFTA and participated in the recently concluded negotiations between ASEAN and India. Indonesia also recently concluded its first bilateral trade agreement with a non-ASEAN member, the Economic Partnership Agreement with Japan. Indonesia is also negotiating bilateral agreements with Pakistan, India and the European Free Trade Area.

As noted above, the fact that Australia and Indonesia have both been involved in the AANZFTA negotiations raises important issues for this study. The AANZFTA negotiations were completed in late 2008, and the Agreement was signed in February 2009. AANZFTA is a comprehensive FTA, with commitments on trade in goods and services, investment, intellectual property, competition and provision for enhanced economic cooperation to facilitate implementation of the FTA and strengthen economic relationships between ASEAN, Australia and New Zealand. In particular, AANZFTA provides for extensive tariff elimination commitments although the commitments on trade in services and investment are more modest.

Given the scope of its coverage, AANZFTA will have a significant and positive impact on the economic relationship between Australia and Indonesia. Furthermore, as a regional FTA, AANZFTA will have benefits additional to those of bilateral FTAs. Its use of regional rules of origin (ROO) should encourage greater use of regional supply chains, and contribute to both more extensive intra-regional trade flows and improved economic efficiency in the region. As a result, AANZFTA is expected to encourage a deeper economic integration between Australia and Indonesia as part of a process of broader regional economic integration.

A key question, therefore, is how a bilateral FTA might build upon AANZFTA. While AANZFTA will have a significant positive impact on the Indonesia-Australia relationship, there remain important opportunities to make bilateral commitments beyond those which were made under AANZFTA. An Indonesia-Australia FTA could add value by: providing for faster or more extensive tariff elimination between the two economies; making additional commitments in areas such as services and investment, as well as customs procedures, intellectual property and competition policy, and strengthening economic cooperation in a range of areas. These valuable opportunities are detailed in this report.

1.4 Political and Strategic Implications of an FTA

For both Indonesia and Australia, broader foreign policy and strategic objectives are taken into account in determining partners for FTAs. For both countries, the negotiation of a bilateral FTA would be consistent with these broader foreign policy and strategic objectives.

From a bilateral relations perspective, an FTA would be an important further step in current efforts to broaden and deepen Indonesia-Australia ties. Both Governments have demonstrated a strong commitment to expanding further the already extensive cooperation currently taking place across a range of fields, such as law enforcement, defence, development cooperation, customs, immigration, tourism, transport, cultural exchanges and education. Both Governments acknowledge, however, that two-way trade and investment links have fallen short of their potential, particularly given the strong complementarities between our two economies.

For Australia, Indonesia is crucially important. Australia's foreign policy approach to Indonesia is guided by the fundamental premise that Australia's interests are served by a democratic, prosperous, stable and united Indonesia. As close neighbours, the security and prosperity of both countries are closely interlinked. Indonesia's dramatic

progress in managing political, economic and security challenges over the past decade underlines its great potential. Indonesia's successful, and ongoing, transition in the post-Soeharto years has, in particular, highlighted the potential gains for Australia and the region if Australia continues to support Indonesia's economic and democratic development.

Through the Australia Indonesia Partnership (the bilateral development cooperation program), Australia is the largest bilateral grant donor to Indonesia and Indonesia is the largest recipient of Australian development assistance anywhere in the world. In addition to the increases in Australian development assistance to Indonesia, the Australia-Indonesia Partnership has adopted a more strategic, enabling approach. The partnership now aims to strengthen Indonesian systems and resource allocation. The increased emphasis on partnership also places the bilateral relationship as a whole in a position where it can progress towards enhanced engagement around areas such as trade.

A bilateral FTA would complement Australia's other links with Indonesia. This includes the close working-level security cooperation, under the umbrella of the Lombok Treaty which entered into force in 2008, that has done much to address the common threats of terrorism, people smuggling and other transnational crimes. On global challenges, like climate change and the global financial crisis, Australia and Indonesia are also working more closely than ever before to bolster our respective capacities to respond and to ensure our interests are taken into account in multilateral fora.

The emerging strategic partnership between Australia and Indonesia, which would be strengthened by a robust, ambitious bilateral FTA, also carries important, positive symbolic value for the global community. It is highly significant that Australia and Indonesia, despite our different histories and circumstances, can work so closely and productively together to advance our mutual interests, both bilaterally and in regional and global fora. Australia is a multicultural country with Western democratic traditions and a high standard of living. Indonesia is the world's most populous Muslim-majority democracy and has been a strong voice for the Group of 77 developing countries.

A freer flow of goods, services and people under a bilateral FTA would help bring the countries closer: a strategic goal of both nations. Experience has shown that closer people-to-people links follow naturally from intensified economic engagement. Equally, improved people-to-people links seed economic engagement – closing a virtuous circle. Closer economic ties can contribute to Indonesia's economic development and therefore its prosperity and stability, which is positive for Australia's strategic, security as well as economic interests in the region.

A bilateral FTA with Indonesia would, in particular, help to deepen economic integration with Australia's largest neighbour and 13th largest trading partner (2007). Indonesia, for example, continues to offer export potential for Australian companies, including in agribusiness; food and beverages; consumer products (fashion items and cosmetics); ICT (mobile telephony); and mining supplies. There is also scope to meaningfully expand services exports in construction and infrastructure development, finance, education and franchising sectors.

Although Australia's largest markets in the region are in North-East Asia, South-East Asia is also of key importance in both economic and political terms. ASEAN accounted for almost 16 per cent of Australia's two-way merchandise trade in 2007. The dynamism of many of the ASEAN economies suggest that Australia's trade and investment ties with them are likely to grow strongly. Australia has a strong stake in the stability of ASEAN economies, given their proximity to Australia and their importance for Australia's maritime links with the rest of the world.

Australia's relationships with Indonesia, and with ASEAN, are part of a wider commitment to close engagement with Asia, which has been an enduring theme of Australian foreign policy for more than two decades. In part, Australia's interest is economic, with Asian economies accounting for six of its top ten trading partners for goods and services. But Australia also has strong security, defence and other interests in engagement with the region. This importance is reflected in the priority which Australia has accorded to Asia Pacific Economic Cooperation (APEC) since its formation in 1989 and more recently the East Asian Summit and the concept of an Asia Pacific Community.

Indonesia is a major player in ASEAN and has helped to drive its emergence as a key forum in East Asia. Indonesia is also emerging as a significant player in global issues including trade, climate change and the development of democracy. Reflecting this expanding regional and global role, Indonesia places very high priority on developing relations with a second circle of neighbours, including to the east and south, as well as the economies of North-East Asia. A strong bilateral FTA between Australia and Indonesia, which builds on the outcomes of AANZFTA, would set a positive example by encouraging greater trade liberalisation, economic reform and economic integration across South-East Asia.

Chapter 2. Indonesia-Australia Trade and Investment Links

Australia and Indonesia are the two largest economies in South-East Asia and Oceania. The links between them have developed within a wider region where trade and investment linkages have generally been growing rapidly. They have also developed in the context of profound shocks, most notably the East Asian economic crisis of 1997-98 and the current global economic crisis. Identifying the nature of the links between the two economies, which is the task of this Chapter, is an important step in assessing the possible gains from a bilateral FTA.

Two themes run through the Chapter. The first – already noted in Chapter 1 – is the significance of existing economic links between the two countries, including trade and economic cooperation. The second theme is the differences between the two economies in levels of development, structure and international specialisation. Differences between the two economies make the task of negotiating an FTA more difficult than if both were of a similar level of development. But it also suggests complementarities, and significant potential for further strengthening the bilateral trade and investment relationship.

The potential to strengthen the economic relationship offered by trade and investment liberalisation is further supported by data showing that Indonesia-Australia bilateral trade in goods and services remains below bilateral trade between Australia and other ASEAN members relative to the size of the respective economies. For example, while bilateral trade between Australia and Thailand makes up 3.3 per cent of Australia's total trade in goods and services, bilateral trade with Indonesia makes up just 2.3 per cent of Australia's trade, yet Indonesia's GDP is almost twice as large as Thailand's (2007). Australia has a free trade agreement with Thailand.

2.1 The Australian and Indonesian Economies

2.1.1 *The Australian Economy*

Although Australia's population of 21 million people is small by Indonesian standards, its GDP is substantial, at some US\$ 911 billion in 2007. In purchasing power parity terms (which largely adjusts for price distortions and price differences for non-tradeable goods and services), Australia's economy was around 91 per cent of that of Indonesia in 2007 (see Table 2.1).

In Australia, the services sector makes up a high proportion of economic activity, accounting for about 63 per cent of GDP² and around 85 per cent of the work force. As in many other developed economies, the manufacturing sector has declined in relative terms, and now makes up about 11 per cent of economic activity. The broader industry sector (including construction) makes up around 26 per cent of GDP. Agriculture constitutes only about 3 per cent of GDP, though it is much more important in Australia's exports.

² To ensure consistency between the CIE modelling and the feasibility study, the method for calculating services as a percentage of GDP does not include construction.

Australia has had uninterrupted economic growth for 17 years, averaging real growth of around 3.3 per cent a year over this period. While economic growth is projected to fall in the current global slowdown, growth should strengthen in 2010.

Australia's prolonged economic expansion has been underpinned by extensive reforms undertaken since the early 1980s. Key reforms included floating the Australian dollar, tariff liberalisation, financial market deregulation, taxation reform and labour market reform. As a result of successive tariff reductions, Australia has become one of the most open economies in the world, with a simple average tariff of around 3.5 per cent (2007). Australia's domestic support levels for industry are also among the lowest in the world. All of these steps have made the Australian economy highly flexible and resilient.

The economic climate at the start of 2009 is significantly different from that of a year ago. Indeed the world is now facing one of the most hazardous economic situations since the Great Depression of the 1930s. Around half of the world economy is in recession, including the United States, the Euro area and Japan. Like all economies', the Australian economy is not immune from the effects of the current global financial crisis. Growth in China, which is vitally important for Australian growth prospects, is now slowing sharply.

However, trade and economic reform has meant that Australia is better-placed than many economies to weather the storm. Australia's financial system is very strong – no Australian banks have collapsed or needed government bail-outs. The government's strong budget position has given it the flexibility to respond to the crisis, announcing a range of measures to stimulate economic growth and employment, including a \$10.4 billion Economic Security Strategy (equivalent to around 1 per cent of GDP), as well as sector specific packages and the temporary establishment of a government backed deposit guarantee scheme. The Australian Government also recently passed a A\$42 billion fiscal stimulus package.

The latest IMF forecasts suggest that without further significant policy stimulus the Australian economy will contract in 2009, before returning to positive growth in 2010.

While unemployment fell from a peak of almost 11 per cent 15 years ago to 4.3 per cent in October 2008 – the lowest level since the 1970s - it has since risen to 4.5 per cent in December as the impact of the global financial crisis begins to impact on the Australian corporate sector.

Table 2.1
Australia and Indonesia: 2007

	Australia	Indonesia
Compound Annual Growth, 2001-07, per cent	3.3	5.1
GDP, current prices, US\$ billion	911.0	432.9
GDP, at PPP, PPP dollars, billion (2007)	762.9	838.5
GDP, per capita, current prices, US\$	43,010	1,925
GDP, per capita, PPP, PPP dollars (2007)	36,226	3,728
Structure of output, per cent		
Agriculture	2.5	13.8
Industry (a)	25.7	42.3
of which manufacturing	11.0	27.4
Services	63.4	43.8
Population, million	21.2	224.9
Surface Area, thousand sq km	7,692	1,905
Rural population as per cent of total (2006)	11.8	51.9
Life Expectancy at birth, years (2006)	81	68
Educational enrollment, per cent (2006)		
Tertiary	73	17
Exports, US\$ billion		
goods & services	182.6	130.5
goods	142.3	118.0
services	40.4	12.5
Imports, US\$ billion		
goods & services	199.5	109.6
goods	160.3	85.3
services	39.2	24.3

(a) Industry includes mining, manufacturing and construction.

Sources: IMF World Economic Outlook Database, October 2008; CEIC Database; Australian Bureau of Statistics, World Bank, World Development Indicators 2007, Department of Foreign Affairs and Trade, Economist Intelligence Unit, International Comparison Program.

Notes: (1) PPP, or purchasing power parity, measures GDP in a way which takes into account differences in price levels between countries. The values given in the table are from the most recent estimates released by the International Comparison Program. PPP estimates are benchmarked to the US dollar. (2) Data on education measures enrolment as a percentage enrolled as a share of the age group that corresponds to that level.

Australia ranked 27th globally as a merchandise exporter in 2007. Australia's export mix remains somewhat unusual compared with other developed economies as a result of a small population and modest industrial base but with significant, easily extractable natural resources. Minerals and fuels made up 33 per cent of total exports in 2007, with rural products constituting 11 per cent. Manufactures constituted 21 per cent of exports and services 22 per cent.³ The focus of Australia's exports is illustrated by the top ten exports in 2007, these being coal; iron ore; education services; recreational travel services; gold; crude petroleum; aluminium ores; aluminium; professional, technical and other business services, and natural gas and bovine meat. Australia is also an exporter of sophisticated manufactures: elaborately transformed manufactures made up almost two thirds of manufactured exports in 2007.

Australia ranked 20th globally as an importer of goods in 2007. Australia's imports have expanded rapidly in recent years, largely reflecting rapid growth in the economy. Imports of goods made up almost 81 per cent of total imports in 2007, with services imports constituting over 19 per cent. Imports of goods are dominated by manufactures, which made up over 77 per cent of total merchandise imports in 2007. Fuels constituted 13 per cent of merchandise imports. The top ten imports in 2007 were crude petroleum; passenger motor vehicles; personal travel services (excluding

³ Other goods made up over 12 per cent of exports in 2007. These include confidential items and items which are not classified.

education); refined petroleum; freight transportation services; computers; passenger transportation services; medicaments; gold and telecommunications equipment.

2.1.2 The Indonesian Economy

Indonesia has the largest economy in South-East Asia and is the world's fourth most populous nation. In 2007, Indonesia's GDP reached US\$ 432.9 billion (see table 2.1), representing 33.8 per cent and 47.5 per cent of ASEAN and Australia's GDP respectively (in current US dollar terms). The Indonesian economy grew at an average rate of 5.3 per cent per annum between 2001 and 2007. The industrial sector accounted for 42.3 per cent of GDP in 2007, with services and agriculture accounting for 43.8 and 13.8 per cent of GDP respectively. Economic growth was also strongly assisted by exports of goods and services, which represented 30.6 per cent of GDP in 2007.

Indonesia's rapid economic development has transformed it from a rural economy to a manufactures-based economy. In the 1980's, more than 30 per cent of Indonesia's GDP was derived from agriculture, with manufacturing representing almost 30 per cent of the economy, and the services sector accounting for the remainder of economic output. Today, the manufacturing sector dominates Indonesia's economy led by mineral resource intensive products while technology and capital intensive industries remain relatively under-developed.

The East Asian economic crisis of 1997-98 saw a sharp decline in Indonesia's output. Indonesia has since embarked on a new era of reform (*reformasi*), wherein good governance has been a central theme of government reform programmes. From 1998 to 2003 a series of unilateral economic reforms including restructuring the financial sector, dismantling state monopolies, and reinforcing policies of trade and investment liberalization have helped stabilise the economy. Since 2004, the Government has focussed on improvements to Indonesia's investment climate designed to further accelerate economic growth. It is intended that these reforms will impart greater dynamism to the Indonesian economy, thereby, enabling it to better cope with external pressures including from recent instability in global financial markets. The reform package has encompassed fiscal and investment policies in the energy sector. The Government has also outlined its intention to reduce fuel demand and encourage the progressive development of new energy sources such as bio-fuels. Fiscal incentives were also introduced to help industry, including by strengthening competitiveness, improving the business climate and compensating workers. The incentives, listed in the October 2005 package also involved changing the value added tax status of primary products to non-taxable products, and waiving customs duties for several industrial inputs.

Between 2001 and 2005 the economy continued to grow steadily. By the end of 2005, however, the economic growth story was mixed, with growth running well over 6 per cent early in the year, then slowing as interest rates rose and consumers adjusted to increases in fuel prices. The slowdown reflected a difficult economic adjustment needed to bring Indonesian energy prices closer to market prices, seen as a vital step to sustainable and higher long-term economic growth. The impact of the slowdown was mitigated by strong export growth and an expansionary fiscal policy (including a program of cash transfers to the poor). Economic growth improved in 2007, reaching

6.3 per cent, underpinned by buoyant consumer spending and business investment. Rising investment contributed strongly to the return to growth. Investment increased by 9.2 per cent in 2007. In the four years to 2007, the investment to GDP ratio increased from 19.5 per cent in 2003 to 25.9 per cent.

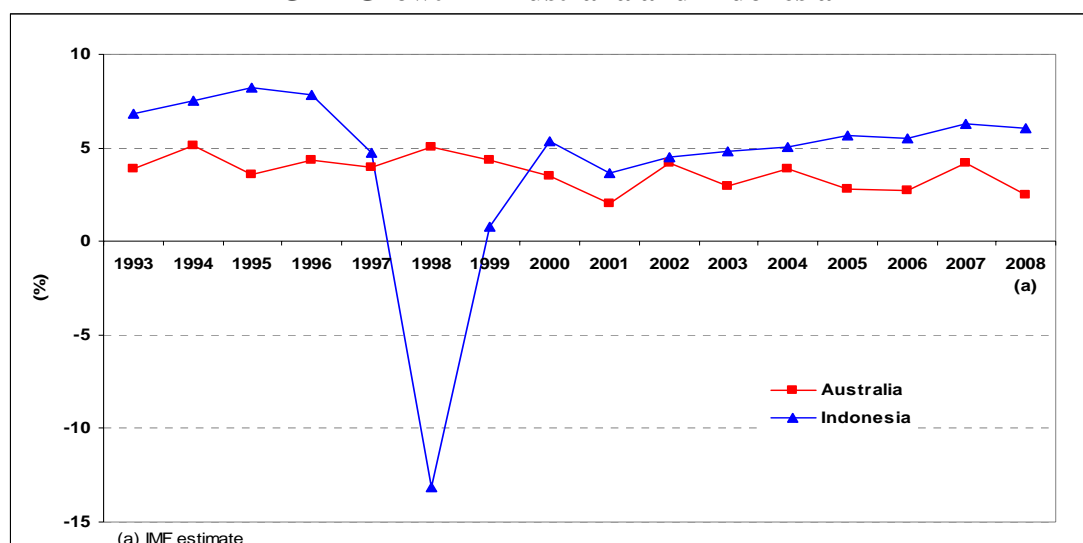
Trade has played an important role in supporting Indonesia's economic recovery post the East Asian economic crisis (1997-98). Indonesia ranked 32nd globally as an exporter of goods in 2007. Indonesian exports grew 15.8 per cent per year on average for the period 2002-07. As Chart 2.6 shows, Indonesia's exports in 2007 were dominated by manufactured products (46 per cent) followed by mining and mineral products (32 per cent) and agriculture products (21 per cent). Products that have significant shares in Indonesia's exports are crude oil, crude palm oil, gas, coal, rubber, copper, nickel, paper and paperboard, textiles, wood and wood products, footwear and seafood.

Despite strong economic fundamentals, Indonesia's economy has not been immune to the current economic down turn brought on by the global financial crisis. The Jakarta stock index has experienced significant falls since October, while the Rupiah has depreciated against the US dollar. Further, reduced appetite for risk by banks has meant a decline in the availability of credit while debt funding costs have risen for both corporate borrowers and the Government. In addition, the demand for Indonesian exports has fallen. As a result, economic growth will slow in 2009, which is likely to increase the incidence of poverty.

To confront these new challenges, the Indonesian Government recently announced a series of measures to lessen the impact of the global financial crisis. For example, the Government is preparing a stimulus package, equivalent to 1.4 per cent of GDP. The package provides for tax cuts, increases in government spending on infrastructure projects, the retention of fuel subsidies for industry, and reduced import tariffs on raw materials.

Indonesia ranked 32nd globally as an importer of goods in 2007. Indonesia's imports have grown at an average of 20 per cent per year over the period 2002-2007, reflecting rapid economic growth. Indonesia's main imports were petroleum, transport equipment, wheat, electronic equipment, iron and steel, sugar and plastics.

Chart 2.1
GDP Growth in Australia and Indonesia



Source: World Bank, 2007

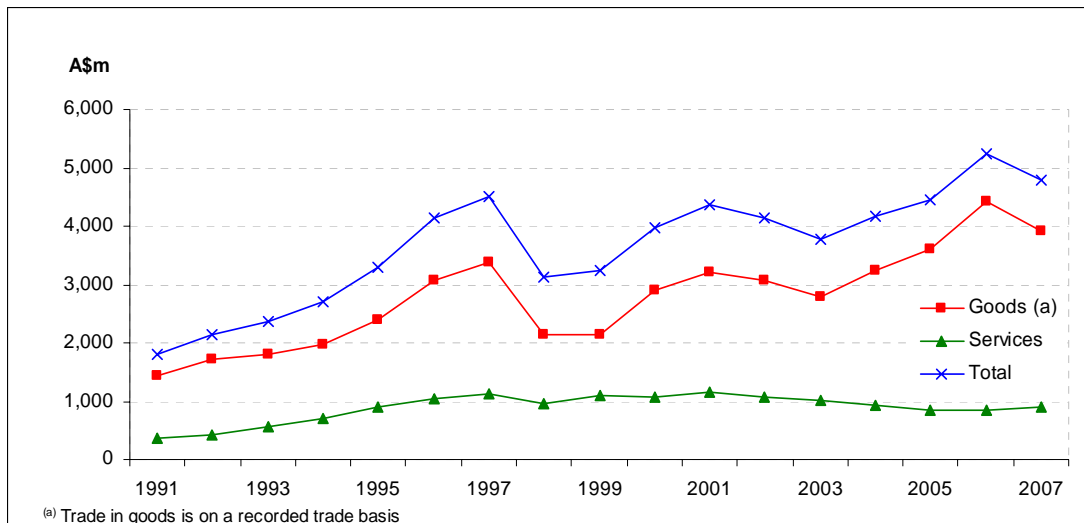
2.2 Australia's Exports to Indonesia

2.2.1 Overview

Indonesia is an important market for Australia. In 2007, Australia's total exports to Indonesia (including both goods and services) totalled A\$4.8 billion. Indonesia was Australia's 11th largest market in 2007, taking around 2.2 per cent of Australia's total exports of goods and services. It was Australia's third largest export market in ASEAN, with only Singapore and Thailand ranking higher.

As Chart 2.3 shows, progress in expanding exports has been uneven over the past 15 years. Australia's exports to Indonesia grew rapidly in the years leading up to the 1997 East Asian economic crisis, at a compound annual rate of 17 per cent between 1991 and 1997. However, they slumped sharply – by over 30 per cent - in 1998, as economic activity in Indonesia contracted and as the Indonesian rupiah depreciated. Although there was a partial recovery in following years, total exports did not regain their pre-crisis levels until 2006. While merchandise exports are now well above pre-crisis levels, services exports are still below the levels achieved in 1997.

Chart 2.3
Australia's Exports to Indonesia



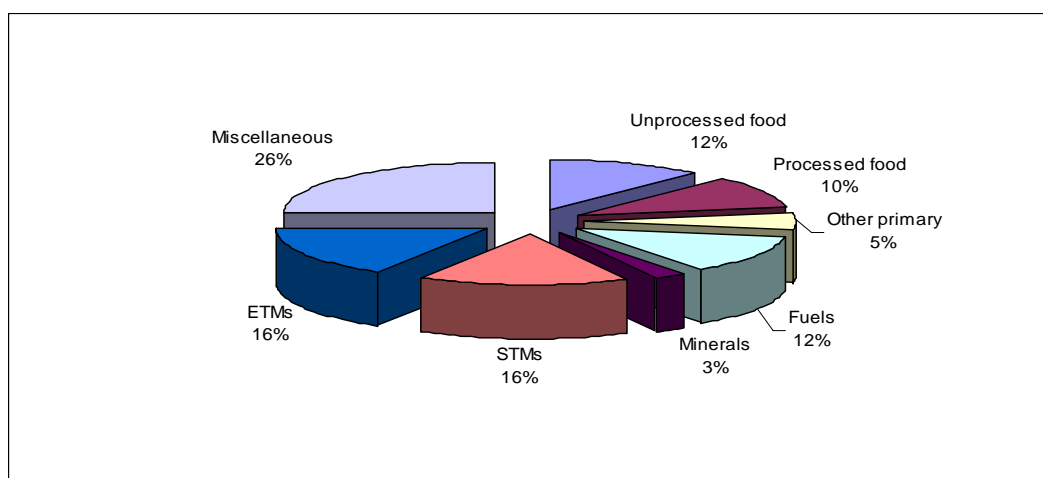
Source: DFAT STARS database, ABS. Trade in goods is on a recorded trade basis.

2.2.2 Merchandise Exports

Australia's merchandise exports to Indonesia were valued at A\$3.9 billion in 2007. Indonesia was Australia's 11th largest merchandise export market in that year, taking 2.3 per cent of all merchandise exports. It was Australia's third biggest merchandise export market in ASEAN (after Singapore and Thailand). Exports were well above the level which would be suggested by Indonesia's share of world merchandise imports (around 0.65 per cent), reflecting complementarities between the two economies, and their position as close neighbours.

The broad composition of Australian exports to Indonesia in 2007 is shown in Chart 2.4. As the Chart shows, Australia's exports were quite diverse. Manufactured products made up about 33 per cent of merchandise exports, and were split roughly evenly between elaborately transformed manufactures and simply transformed manufactures. Fuels made up 12 per cent of exports. Processed and unprocessed food constituted another 22 per cent. This breakdown should, however, be interpreted with caution given the large sector of miscellaneous and confidential items, which account for an estimated 25 per cent of Australia's merchandise exports to Indonesia.

Chart 2.4
Composition of Merchandise Exports to Indonesia: 2007



Source: DFAT, STARS database. ETMs are elaborately transformed manufactures, while STMs are simply transformed manufactures⁴.

Table 2.2 identifies the top 25 merchandise exports to Indonesia. As the Table shows, exports of wheat and meslin made up the single largest export category in 2007, followed by crude oil from petroleum and bituminous minerals and live bovine animals. Wheat exports are confidential, the value being calculated from quantity data and ABARE average bulk unit prices. Confidential commodities include, among other things, alumina, with exports estimated from Indonesia's trade statistics at A\$228 million in 2007.

⁴ Trade Exports Classification (TREC) was developed by the Department of Foreign Affairs and Trade. The aim of TREC is to group export commodities according to their level of processing. The broad levels of the classification are: primary products, divided into unprocessed and processed; manufactures, divided into simply transformed and elaborately transformed; and miscellaneous products. The TREC classification is based on the Australian Harmonised Exports Commodity Classification (AHECC) at the 8 digit level. TREC defines manufactures as either 'simply transformed' (STM) or 'elaborately transformed' (ETM). STM consist mainly of basic metal manufactures, chemicals and other intermediate manufactured goods which will be used as inputs into other goods. ETM in broad terms are defined as products with unique features which permit their identification as differentiated products on world markets, i.e. 'finished goods'. ETM comprise the bulk of world trade in manufactures. Although there are inevitably some items for which the distinction between STM and ETM may seem rather arbitrary, the overall distinction between STM and ETM provides an important basis for analysing the performance of Australia's manufactured exports.

Table 2.2
Australia's Principal Merchandise Exports to Indonesia

AHECC Code	Description	2001	2002	2006	2007	
		A\$m	A\$m	A\$m	A\$m	Share %
1001	Wheat and meslin ^(a)	605	624	866	518	13.3
2709	Crude oil from petroleum and bituminous minerals	51	27	729	458	11.7
0102	Live bovine animals	174	257	247	341	8.7
7601	Unwrought aluminium	137	131	291	255	6.5
9999	Confidential items and items not classified	171	109	75	249	6.4
1701	Cane sugar ^(b)	23	31	280	207	5.3
5201	Cotton, not carded or combed	541	395	243	158	4.0
7403	Refined copper and copper alloys, unwrought	24	35	168	113	2.9
0402	Milk and cream, concentrated or sweetened	69	110	104	113	2.9
7204	Ferrous waste & scrap, remelting scrap ingots of iron or steel	12	20	65	91	2.3
7326	Articles of iron or steel nes	48	60	68	79	2.0
0202	Meat of bovine animals, frozen	37	49	41	72	1.8
1101	Wheat or meslin flour	28	31	64	68	1.7
2301	Flours, meals and pellets, unfit for human consumption; greaves	32	23	32	64	1.6
7901	Unwrought zinc	54	56	63	62	1.6
8431	Parts suitable for use in lifting, loading, grading, etc machinery	67	62	47	61	1.6
7606	Aluminium plates, sheets and strip, thicker than 0.2 mm	37	35	46	39	1.0
3102	Mineral or chemical fertilisers, nitrogenous	20	16	32	37	0.9
4707	Waste and scrap of paper or paperboard	16	25	25	36	0.9
8413	Pumps for liquids	12	18	33	34	0.9
8708	Parts and accessories of motor vehicles	33	35	33	30	0.8
8474	Machinery for sorting, screening, grinding, shaping etc	35	30	29	30	0.8
0406	Cheese and curd	16	25	26	29	0.7
2710	Refined oil from petroleum & bituminous minerals	45	26	35	29	0.7
0404	Whey; products consisting of natural milk constituents, nes	14	13	26	22	0.6
	Total merchandise exports	3,220	3,059	4,409	3,906	100.0

(a) Includes an estimate for the confidential component based on ABARE average wheat export prices.

(b) Includes the confidential data released by the ABS.

Source: DFAT, STARS database consistent with ABS Cat. 5368.0, November 2008.

Between 2001 and 2007, Australia's merchandise exports to Indonesia expanded by a compound annual rate of around 5.8 per cent. As Table 2.2 shows, there were significant increases in a number of large exports to Indonesia. These included increases in the value of unwrought aluminium from A\$137 million to A\$255 million and in the value of crude oil exports, which rose from A\$51 million in 2001 to A\$458 million in 2007. These increases explain a significant portion of the increase in merchandise exports to Indonesia over this period. There were, however, increases in the value of a number of other commodity exports. At the same time, there were declines in some exports. Cotton exports, for example, fell from A\$541 million to A\$158 million over this period. Elaborately transformed manufactures as a group fell from A\$809 million to A\$644 million, principally reflecting a decline in the value of engineering products exported to Indonesia, as well as smaller declines in the value of chemicals.

2.2.2 Services Exports

Australia's services exports to Indonesia totalled A\$896 million on a balance of payments basis in 2007, making Indonesia the twelfth largest destination among countries separately identified. Indonesia took some 1.9 per cent of Australia's services exports in 2007.

Table 2.3
Australia's Services Exports to Indonesia

	2001	2002	2003	2004	2005	2006	2007
	A\$m	A\$m	A\$m	A\$m	A\$m	A\$m	A\$m
Transportation services	162	151	112	84	69	53	57
Travel services	823	740	745	710	648	664	705
<i>Business</i>	27	32	25	25	25	35	50
<i>Personal</i>	796	708	720	685	623	629	655
<i>Education related</i>	565	522	512	500	476	477	488
<i>Recreational travel</i>	231	186	208	185	147	152	167
Communication services	14	4	1	2	np	3	2
Construction services	np	9	np	np	np	0	np
Insurance services	0	0	0	0	0	0	0
Financial services	0	0	0	0	0	0	0
Computer & information services	11	13	np	11	10	7	19
Royalties & license fees	np	20	15	np	17	5	13
Other business services	50	60	51	49	47	46	42
Personal, cultural & recreational services	29	33	23	12	np	12	np
Government services	41	44	44	47	47	46	45
Services exports	1,144	1,073	1,004	932	855	836	896

Source: ABS. np = not published.

Table 2.3 indicates that the single largest item in services exports was education-related travel services. This made up some 55 per cent of services exports to Indonesia in 2007, reflecting the significance of Australia as a destination for Indonesian students. Recreational travel services made up another 19 per cent of services exports. Other categories of services are much smaller in magnitude. This partly reflects impediments to trade in these areas (see Chapter 3), but also the fact that some of these services are not captured in balance of payments statistics since they are supplied predominantly through commercial presence in the host country. Some of the companies providing services through commercial presence are discussed in the section on investment which follows.

Services exports to Indonesia fell by 22 per cent between 2001 and 2007. The decline was 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 A\$162 million to A\$57 million) was in transportation services. In the case of education, Indonesia fell from being the third largest source of student enrolments in 2002 to become the eighth largest source. Student numbers from Indonesia have declined, while numbers from other countries have grown.

2.3 Indonesia's Exports to Australia

2.3.1 Overview

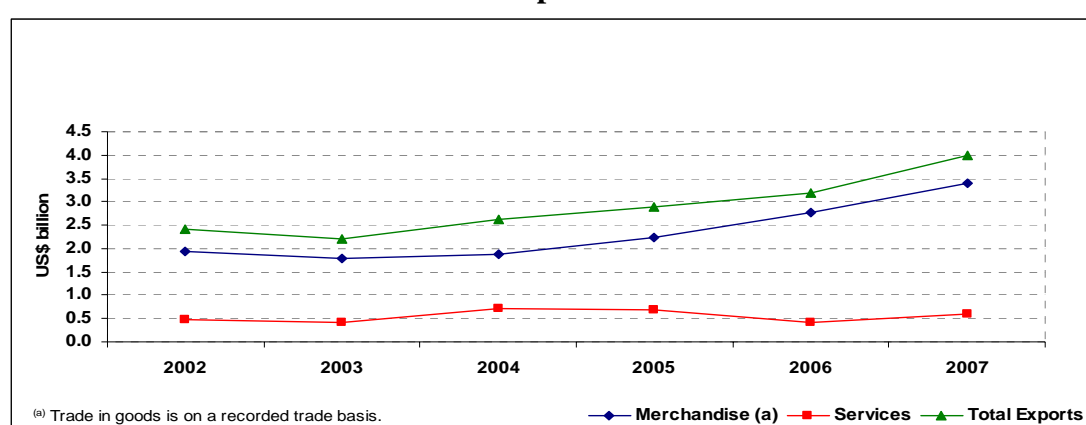
Indonesia's exports to Australia increased significantly between 2002 and 2007, averaging growth of 11.3 per cent a year. Indonesia's total merchandise and services exports to Australia reached US\$4 billion in 2007, an increase of 25.3 per cent from 2006.

As Chart 2.5 shows, the increase in Indonesia's exports to Australia was driven by merchandise exports, which increased by an average of 13.1 per cent per year over the

period 2002-07. Merchandise exports accounted for 85 per cent of total exports to Australia in 2007. The value of total merchandise exports to Australia in 2007 reached US\$3.4 billion, an increase of 22.5 per cent compared to the previous year. Major exports to Australia include: petroleum, gold, light vessels, uncoated paper, cruise ships, insulated wire, wood and furniture. Australia is currently the eighth largest export destination for Indonesian exports, accounting for approximately 3 per cent of Indonesia's total merchandise exports.

Indonesia's services exports to Australia totalled US\$598 million in 2007. The largest component of services exports was recreational travel services. Transportation was also a significant export. Services exports increased by 29 per cent in 2007, underpinned by a 69 per cent increase in recreational travel services.

Chart 2.5
Indonesia's Exports to Australia



Source: BPS and ABS database

2.3.2 Merchandise Exports

Indonesia's main destinations for exports are still Japan, the United States, Singapore, China, and South Korea, which together accounted for 55.2 per cent of Indonesia's exports in 2007. Australia is Indonesia's 8th most significant export destination, with growth of 13.1 per cent per year over the period 2002-07. In 2007, Indonesia's merchandise exports to Australia totalled US\$4 billion, a 3.4 per cent share of Indonesia's total exports for the year (Table 2.4).

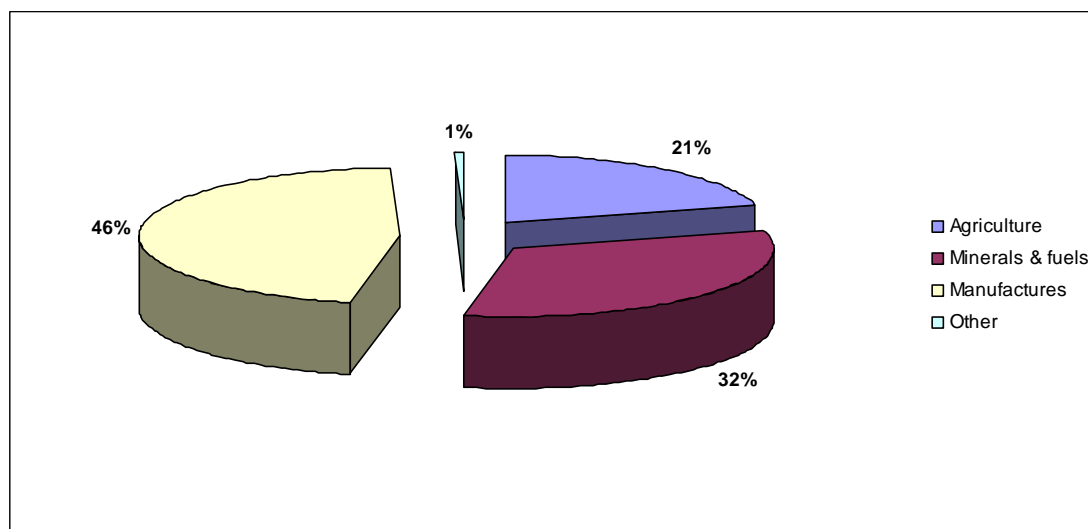
Table 2.4
Australia's Position in Indonesia's Exports

Rank	Partner Country	2002	2007	Trend (%)	Growth (%)
		US\$bn	US\$bn	2002-2007	2006/07
	All Countries	57.2	114.1	15.8	13.2
1	Japan	12.0	23.6	15.0	8.7
2	United States	7.6	11.6	10.6	3.4
3	Singapore	5.3	10.5	15.8	17.6
4	China	2.9	9.7	28.4	16.0
5	Korea, South	4.1	7.6	15.9	-1.4
6	Malaysia	2.0	5.1	20.0	24.0
7	India	1.3	4.9	29.1	45.8
8	Australia	1.9	3.4	13.1	22.5
9	Thailand	1.2	3.1	21.0	13.1
10	Netherlands	1.6	2.7	14.1	9.2
	Others	17.1	31.9	13.8	16.4

Source: BPS, 2007

Resource based commodities comprise a significant portion of Indonesia's exports to Australia; with oil accounting for more than 40 per cent of total merchandise exports to Australia in 2007. This contrasts with the period 2003-2004, wherein a decline in the level of Indonesian oil production resulted in a reduction in the export of oil to Australia and consequently a reduction in the level of overall exports to Australia. Since 2005, however, the total value of exports to Australia has increased sharply, owing in large part to the strong performance of Indonesia's exports of non oil and gas products.

Chart 2.6
Composition of Indonesia's Goods Exports by Sector 2007



Source: Australian import data from DFAT, STARS database consistent with ABS Cat. 5368.0.
ETMs are elaborately transformed manufactures, while STMs are simply transformed manufactures.

Table 2.5 identifies Indonesia's top 25 non oil and gas exports to Australia. More than 25 per cent of Indonesia's non oil and gas exports to Australia are resource based commodities. For example, gold exports reached US\$241 million in 2007, making it the largest non oil and gas commodity export to Australia by value in 2007. Gold exports to Australia represent 34.7 per cent of Indonesia's total gold exports. Australia has also become an important market for several of Indonesia's manufactured products, including prefabricated buildings. In 2007, 37.2 per cent of Indonesia's prefabricated buildings exports were destined for Australia. Australia has also become an important export market for Indonesian light vessels and cruise ships (70.2 per cent), machinery, plant and laboratory equipment (21.2 per cent), machinery for sorting, screening (40.2 per cent), and toilet or facial tissue stock (22.2 per cent).

Petroleum is Indonesia's top oil and gas export to Australia, with exports reaching approximately US\$1.52 billion in 2007. Indonesia is the 3rd largest exporter, after Vietnam and Malaysia, of petroleum to Australia with a 13.7 per cent share of Australian petroleum imports in 2007. Indonesia's petroleum exports to Australia represented 16.4 per cent of Indonesia's total petroleum exports in 2007. These exports grew 15.8 per year over the period 2002-2007.

Table 2.5
Indonesia's Principal Merchandise Exports to Australia

Rank	HS	Description	Export value (US\$ million)			Share (%) 2007	Trend Growth 2002/07	Growth 2006 to 2007
			Australia		World 2007			
			2002	2007				
TOTAL NON-OIL AND GAS EXPORTS			1,063.3	1,867.9	92,012.3	2.0	11.9	16.5
1	1804	Cocoa Butter, Fat And Oil	5.6	29.3	230.2	12.7	33.9	20.2
2	2306	Oilcake and other solid residues	0.0	18.9	244.2	7.7
3	2604	Nickel Ores And Concentrates	6.6	26.1	608.4	4.3	30.8	4.6
4	3904	Polymers Of Vinyl Chloride Etc., In Primary	5.4	17.1	211.7	8.1	27.1	38.4
5	3907	Polyethers, Epoxides & Polyesters, Primar	25.5	38.6	439.3	8.8	9.1	-14.9
6	3920	Plates, Sheets, Film etc. plastics	10.3	17.0	324.3	5.2	12.7	-5.5
7	4001	Natural Rubber, in primary form	3.3	29.7	4,870.5	0.6	47.4	9.7
8	4011	New Pneumatic Tires, Of Rubber	12.8	22.4	895.6	2.5	8.5	59.7
9	4409	Wood, Continuously Shaped (Tongued, Gro	5.2	90.3	431.3	20.9	64.3	92.5
10	4412	Plywood, Veneered Panels & Similar Lamin	12.3	26.7	1,524.6	1.7	20.2	0.4
11	4418	Builders' Joinery And Carpentry Of Wood	32.4	27.4	471.6	5.8	-0.3	-32.9
12	4802	Uncoated paper and paperboard	38.3	72.3	1,754.4	4.1	13.8	10.9
13	4803	Toilet or facial tissue stock, towels etc of pa	9.8	27.4	123.4	22.2	23.5	12.7
14	4810	Paper & Paperboard, Coated With Kaolin E	29.2	24.7	648.2	3.8	-2.3	-14.0
15	6403	Footwear with leather uppers, rubber, leathe	7.8	15.9	1,150.5	1.4	17.8	26.6
16	7108	Gold (Incl Plat Plated),	184.1	240.9	694.7	34.7	0.3	85.9
17	7208	Flat rolled products of iron or steel	1.7	42.3	521.5	8.1	80.9	53.7
18	7304	Tubes, Pipes Etc, Seamless, Iron Nesoi & S	1.9	18.0	272.8	6.6	107.8	2254.3
19	8414	Air or vacuum pumps	5.9	13.8	212.5	6.5	11.1	3425.2
20	8474	Machinery For Sorting Screening, separatin	2.2	15.7	39.0	40.2	47.2	19.0
21	8528	Television receivers, Incl Video Monitors &	16.1	26.7	171.7	15.5	10.4	15.9
22	8544	Insulated Wire, Cable Etc; Opt Sheath Fib C	8.7	55.0	917.8	6.0	38.1	5.8
23	8905	Light-Vessels, Fire-Floats, dredgers, floatin	1.6	181.9	259.3	70.2	..	81.6
24	9401	Seats (Except Barber, Dental, Etc), And Pa	18.2	15.9	562.4	2.8	-2.0	-32.5
25	9403	Furniture and parts	34.1	44.5	1,348.4	3.3	4.2	3.1
TOTAL OIL AND GAS EXPORTS			861.0	1,526.7	22,088.5	6.9	14.7	30.7
1	2709	Crude Oil From Petroleum And Bituminous	805.8	1,515.8	9,226.0	16.4	15.8	30.4

Source: BPS

2.3.3. Services Exports

Indonesia's services exports to Australia are not recorded separately in Indonesian statistics. They can, however, be derived from Australian import data on services trade released by the Australian Bureau of Statistics (ABS). According to the ABS, Australia's services imports from Indonesia were valued at US\$598 million in 2007, making Indonesia Australia's fourteenth largest source of services imports among countries for which data are separately identified. The largest component of this trade is in personal travel services (other than education). Transportation services are also a significant item in Australia's services imports from Indonesia.

Australia's services imports from Indonesia declined appreciably in both 2005 and 2006, with 2006 imports some 43 per cent below those in 2004. As a consequence of this decline, Australia's services imports from Indonesia are well below the 2001 level. The biggest single factor in the decline in services imports over 2004-2007 was a fall in recreational travel services, from A\$642 million in 2004 to A\$438 million in 2007. The number of Australian residents travelling abroad and listing Indonesia as their main destination fell from around 335,000 in 2004 to 283,000 in 2007.

Table 2.6
Australia's Services Imports from Indonesia

	2001	2002	2003	2004	2005	2006	2007
	A\$m	A\$m	A\$m	A\$m	A\$m	A\$m	A\$m
Transportation services	259	292	201	212	186	138	160
Travel services	593	510	391	715	640	348	494
<i>Business</i>	78	79	51	57	50	44	42
<i>Personal</i>	515	431	340	658	590	304	452
<i>Education related</i>	41	21	15	16	19	16	14
<i>Recreational travel</i>	474	409	325	642	571	288	438
Communication services	17	17	np	np	np	np	7
Construction services	0	0	0	0	0	0	0
Insurance services	0	0	0	0	0	0	0
Financial services	4	4	4	4	4	4	4
Computer & information services	0	np	0	0	0	np	np
Royalties & license fees	np	0	0	0	0	0	0
Other business services	20	20	16	17	17	20	21
Personal, cultural & recreational services	np	np	np	np	np	np	np
Government services	13	16	16	18	18	19	20
Services imports	922	876	651	983	885	552	713

Source: ABS. np = not published.

2.4 Investment Links

2.4.1 The Investment Environment in Australia and Indonesia

Australia welcomes foreign investment, including direct investment. It has an open and transparent foreign investment regime. The Australian Government actively supports foreign investment in Australia. Foreign investments play a significant part in the national economy. The level of direct investment in Australia has increased significantly in recent years, rising from A\$218.8 billion at the end of 2001, to A\$382.8 billion at the end of 2007, or about 35 per cent of GDP.

Economic strength, a positive economic outlook and high disposable incomes, make Australia an attractive destination for foreign direct investment. Investors in Australia benefit from operating in a politically stable, democratic country with a well-established and functioning legal system. Regulation of business is limited. According to the World Bank, regulatory procedures associated with starting a business in Australia take just two days (compared to the OECD average of 15 days). The workforce is highly skilled, with over 30 per cent possessing tertiary qualifications. Business costs are highly competitive: the Australian Government states that the cost of prime office space in Sydney is 70 per cent less than in Tokyo and 50 per cent less than in Hong Kong. Tax revenue as a proportion of GDP is well below the OECD average. Australia ranks third in the Asia Pacific in terms of the Economist Intelligence Unit's e-readiness ranking, and is among the top countries in the world in terms of internet and per capita computer use.

Companies investing in Australia can increasingly benefit from the network of FTAs that Australia is building, which, among other things, give preferential access to the huge United States market. Australia's strategic location in the Asia Pacific region also allows it to serve as a bridge between Asian and western economies.

In Australia, foreign investment proposals above certain thresholds are screened to ensure that they are not contrary to the national interest, either under the Foreign Acquisitions and Takeovers Act 1975 (FATA) or broader foreign investment policy. The Foreign Investment Review Board, which is a non-statutory authority, provides advice on these matters to the Treasurer. The Treasurer may reject a proposal by a foreign person to acquire control of an Australian business or an interest in Australian urban land (above certain thresholds) under the FATA. Foreign investment in certain sectors, including banking, the media, airports, international air services, and telecommunications are subject to special provisions (for example, in the telecommunications sector, there are special limits on ownership of Telstra).

The overwhelming majority of foreign investment proposals which are considered are approved. In 2007-08, for example, 8548 proposals were considered, but only 14 proposals – less than 0.2 per cent of the total – were rejected. All of the proposals which were rejected involved the acquisition of residential real estate.

Indonesia welcomes foreign direct investment and the Government has introduced a series of policy reforms to encourage greater foreign investment in Indonesia. For example, in February 2006 an investment policy package was introduced covering the following areas: i) general investment policies; ii) customs; iii) taxation; iv) the labour market; and v) small and medium-size enterprises (SMEs). In March 2006, the Government also introduced The Infrastructure Development Package to provide a policy framework for public private partnerships and risk sharing to enable an acceleration of the building of infrastructure with private sector participation. In July 2006, the Financial Sector Reform Package was introduced, which aims to improve coordination between the Government and the Central Bank (Bank Indonesia) and to continue reform steps to strengthen the banking industry, non-bank financial institutions and capital markets.⁵ In addition, an ongoing program of deregulation and administrative and bureaucratic reforms aims to increase the efficiency and good governance of the public service.

Indonesia recently adopted a new Investment Law that introduces several new principles. The New Investment Law (Law No. 25 – 2007) was approved by the Parliament on 29 March 2007. The principles underpinning the new investment law include: legal certainty; equal treatment for foreign investors; protection from nationalisation and expropriation; provisions regulating dispute settlement; and transparency and accountability. In addition, the new law seeks to: provide clearer guidelines regarding which sectors of the economy are open to foreign investors; streamline procedures for investment approvals; provide incentives for new investors in selected sectors (e.g. pioneer sectors) and regions and streamline immigration for expatriates.

Despite the introduction of numerous policy packages designed to improve the investment climate, policy coordination between agencies and with local government remains a challenge. To address this issue, President Yudhoyono formed a National Team for Enhancing Exports and Investment (Timnas PEPI) in 2005 - a high level coordinating committee consisting of cabinet ministers. In 2006, a Secretariat was

⁵ Those reform packages were accompanied by new laws and implementing regulations such as the risk sharing framework for infrastructure, the revised Customs Law, and the Investment Law which were passed in Parliament on 29 March 2007

established to facilitate and initiate policy dialogue between government agencies and to hold consultations between government and the private sector. PEPI was charged with the clarification and revision of Presidential Decrees on “Negative Lists” of investment. PEPI has also been given the task of providing policy recommendations on logistics, incentives for investment⁶ and procedures for investment.

The effort to attract investment has shown some positive results. In the last three years domestic investment approvals have almost doubled, from Rp.26 trillion to Rp. 50.6 trillion⁷. Most domestic investment has been concentrated in the food, chemicals and pharmaceuticals industries as well as in electricity, gas and water supplies. Foreign direct investment (FDI) tends to fluctuate considerably from year to year but has shown positive growth since 2003, reaching US\$9 billion in calendar year 2007. Foreign direct investment is concentrated mainly in the plantation, chemical, automotive, and pharmaceutical sectors, with smaller but still significant levels of foreign investment in the transportation, warehousing, communications and construction sectors.

2.4.2 Australian Investment in Indonesia

Australia has a lengthy history of investment in Indonesia. According to the Economic Analytical Unit of the Department of Foreign Affairs and Trade,

“Australian investment in Indonesia dates back to 1959 in the automotive industry, when General Motors Holden shipped completely knocked down Holden packs to Indonesia for assembly. The 1990s saw the greatest increase ever recorded in new investment. The ‘boom’ period of 1991-1996 resulted in an influx of small and large companies as the Indonesian economy was experiencing strong growth. This business expansion came to an end abruptly, with the onset of the 1997 East Asian financial crisis.”⁸

Table 2.7
Level of Australian Direct Investment Abroad: Major Destinations

A\$ million, at year end	2001	2007	% share 2007
United States of America	107,378	150,991	46.7
New Zealand	16,405	46,671	14.4
United Kingdom	36,627	27,839	8.6
Germany	990	11,053	3.4
Singapore	2,135	7,999	2.5
Hong Kong (SAR of China)	4,943	6,445	2.0
Luxembourg	np	3,252	1.0
Bermuda	np	2,815	0.9
Papua New Guinea	1,315	2,630	0.8
Malaysia	370	2,415	0.7
Indonesia	519	1,839	0.6
China, People's republic of	395	1,689	0.5
Total all countries	214,654	323,633	100.0

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

⁶ Fiscal incentive package will be given to new investors for selected sectors (e.g. Pioneer sectors) and regions: investment allowance (6 years, 30%), carry forward losses 10 years and accelerated depreciation (PP1-2007 and revised Tax Law). There are several sectors of investment closed/open with conditions, such as: national interest: health, moral, national security, environment.

⁷ In 2006, actual domestic investment until November amounted to Rp 153.9 trillion and actual foreign investment amounted to Rp 42.8 trillion (Indonesia’s currency rate Rp 9,100 for 1 US\$).

⁸ Economic Analytical Unit, The Australia-Indonesia Commercial Relationship: Background Paper, April 2007, p.21.

Both countries acknowledge that bilateral investment links could be stronger. At the end of 2007, Australia's total investment in Indonesia (including portfolio investment) was A\$3.4 billion, making Indonesia our twentieth largest destination. Australian direct investment in Indonesia amounted to A\$1.8 billion at the end of 2007, well above pre-Asian financial crisis levels.⁹ However, as Table 2.7 indicates, direct investment in Indonesia was below investment in some other regional economies. Direct investment in Indonesia was 11 per cent of Australia's direct investment in ASEAN.

The flow of new Australian direct investment to Indonesia has been limited in recent years, averaging only A\$92 million per annum in the three years ending 2007 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.

The Australian Trade Commission has estimated that there are around 400 Australian companies – both small and large - doing business in Indonesia. Areas in which Australian business have invested in Indonesia include the mining and energy sectors, as well as agribusiness, transport, finance, health and education.

In the mining sector, companies involved include Leighton International (part of the Leighton Group), which provides construction and contract mining services to various coal mines in Indonesia, as well as to the Toka Tindung Gold Mine in North Sulawesi. Newcrest, an Australian-based publicly listed company is mining the Gosowong gold deposit as well as adjacent sites, through its Indonesian subsidiary, PT Nusa Halmahera Minerals. In finance, both the ANZ Bank and the Commonwealth Bank are represented in the Indonesian market, as is Macquarie (see Box). In the transport sector, PT Linfox Logistics Indonesia, a wholly owned subsidiary of Linfox Australia, has been established in Indonesia since 2001. Clough Engineering – an Australian-based engineering, construction and asset support contractor – is also involved in projects ranging from mining infrastructure to water treatment facilities. In the food sector, Coca-Cola Amatil is the principal Coca-Cola licensee in Indonesia, while Manildra Flour Mills supplies noodle, bakery and biscuit segments of the Indonesia market.

⁹ Current foreign direct investment levels cannot be compared exactly with pre-Crisis levels because of changes in methodology by the ABS.

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

Box: Financial Services

Australia's ANZ Bank has enjoyed a presence in Indonesia since 1973 when its former subsidiary, ANZ Grindlays Bank, established a representative office in Jakarta. ANZ's current business in Indonesia includes:

- a 30.2 per shareholding in Panin Bank, based in Jakarta, with over 270 branches
- an 85 per cent holding in a joint venture, ANZ-Panin Bank. ANZ-Panin Bank currently offers corporate and retail banking services, including credit cards.

Australia's Commonwealth Bank owns 99 per cent of PT Bank Commonwealth. PT Bank Commonwealth has 53 branches in Indonesia, and also offers life insurance and financial services. The bank employs a local workforce of around 1200 Indonesians and develops their skills through regular training opportunities.

The Macquarie Group Australia has been active in Jakarta for more than a decade, providing a range of financial services including wholesale structuring, financing, underwriting, institutional cash equities, financial analysis and corporate advisory services. Macquarie Capital Securities is one of the leading foreign brokers in Jakarta and now accounts for around 3-4 per cent of daily turnover on the Indonesian Stock Exchange.

Australian financial services providers, including ANZ, the Commonwealth Bank and the Macquarie Group, have played an important role in enabling Indonesia to benefit from the liberalisation of its banking sector through their expertise in the areas of corporate governance, risk management, banking products, technology, marketing and customer service.

An open financial services sector promotes greater competition. It can deliver lower interest rates and other cost savings for consumers and reduce the cost of producing other goods and services for domestic use or for export. Foreign banks can introduce innovation, expertise and new technologies and increase the attractiveness of the local market to international investors.

2.4.3 Indonesian Investment in Australia

Indonesia does not release data on its investment in Australia, but the amounts involved can be obtained from the ABS. ABS data shows Indonesian investment in Australia is limited. The stock of inward investment (including portfolio investment) from Indonesia totalled A\$409 million at the end of 2007. Indonesian investment in Australia has grown at a trend rate of 4.4 per cent per annum in the past five years.

Table 2.8
Foreign Investment in Australia: Level of Investment by Country

No	Country A\$ million, at year end	2002	2003	2004	2005	2006	2007	Trend growth (%)
	Total all countries	906,424	988,331	1,144,487	1,222,992	1,457,806	1,659,593	12.9
1	United States of America	238,687	287,541	362,279	334,254	372,229	445,850	11.5
2	United Kingdom	253,439	259,735	276,387	299,738	354,280	410,441	10.3
3	Japan	49,494	46,417	49,144	51,021	51,513	57,520	3.2
4	New Zealand	18,487	19,859	21,671	27,172	35,257	42,843	19.2
5	Hong Kong (SAR of China)	35,568	27,833	29,282	31,366	38,224	41,656	5.3
6	Netherlands	19,037	22,165	27,756	28,706	31,131	34,334	12.1
7	Singapore	25,139	22,233	20,256	19,665	27,305	32,308	5.4
8	Germany	14,275	15,740	17,248	21,061	24,471	31,639	17.0
9	Switzerland	np	21,269	18,748	19,940	28,838	29,973	..
10	France	8,198	11,145	16,035	16,331	22,992	24,900	24.8
31	Indonesia	377	362	513	568	507	409	4.4

Sources: ABS data

Chapter 3. The Impact of Liberalising Bilateral Trade and Investment

Australia and Indonesia enjoy a healthy economic relationship. There is, nonetheless, substantial scope to further strengthen trade and investment links. A range of tariff and non-tariff impediments to bilateral trade and investment flows remain, even taking into account the efforts Indonesia and Australia have already undertaken.

This Chapter begins by detailing current impediments to trade and investment flows between Indonesia and Australia, including key tariff and non-tariff barriers that impact trade (in goods and services) and investment flows, as at January 2009. These will remain relevant until entry into force of AANZFTA, and will remain relevant even after that date, for products that do not meet the AANZFTA ROO.

The Chapter then outlines the key commitments made by Indonesia and Australia under AANZFTA. It is clear from this analysis that even after AANZFTA enters into force, a range of impediments will continue to affect trade and investment flows between Indonesia and Australia.

The third part of the Chapter examines the implications for Australia and Indonesia of removing these remaining impediments and demonstrates that a bilateral FTA could add value to the bilateral trade and investment relationship in a variety of areas of importance to both Australia and Indonesia. The study finds that liberalisation could provide significant opportunities for some individual products and sub-sectors. Also a bilateral FTA could provide opportunities to expand trade in services and facilitate investment flows.

3.1 Impediments to Australian Exports and Investment

From Australia's perspective, there are impediments to bilateral trade with Indonesia across a range of areas. The simple average MFN tariff in Indonesia is 7.8 per cent (2008), but some Australian exports, such as sugar and motor vehicles and parts face much higher tariffs. This will continue to be the case for certain product lines even after AANZFTA enters into force. In addition, Australian companies exporting goods face non-tariff barriers, including many complexities in the rules and regulations governing imports into Indonesia. There are substantial impediments to services trade with Indonesia. Likewise, despite recent reforms, and also progress made under AANZFTA, significant barriers still limit Indonesia's attractiveness as a destination for Australian investment.

3.1.1 Goods

Current Tariff Impediments

Indonesia is a relatively open developing economy, and much progress has been made under the AANZFTA negotiations to further reduce Indonesian tariff barriers. However, a range of impediments still limit Australian goods exports. Some of these impediments will remain even after AANZFTA enters into force.

In its unilateral policies, Indonesia has reduced and harmonised tariffs in line with the ASEAN Tariff Harmonization Program. Following the implementation of the tariff harmonization program, Indonesia tariffs fell significantly in 2008. The simple average applied tariff for Indonesia in 2008 was 7.6 per cent. 80.9 per cent of the Indonesian tariff lines range between 0-10 per cent, and 64.9 per cent range between 0-5 per cent. Tariffs ranging between 0-10 per cent have increased significantly since 1996, when the proportion of tariff lines in this range was only 56.1 per cent. Tariffs ranging between 15-35 per cent have decreased from 42.8 per cent of total tariff lines in 1996 to only 15.7 per cent in 2008. More liberal economic conditions are expected to bring a more competitive market domestically for both foreign and domestic producers and suppliers. However, tariffs for some products of interest to Australia remain high.

Table 3.1 breaks down the 2008 tariff by sector. The average applied tariff on agricultural products was 11.4 per cent, while the average tariff on non-agricultural products (including fish, but excluding petroleum) was lower at 6.2 per cent. By sector, tariffs are particularly high for beverages and spirits, transport equipment and grains. Tariffs can be higher than averages shown. In the case of transport equipment, for example, tariffs range up to 80 per cent for certain automobiles.

Table 3.1
Indonesia's Tariffs (Simple average, applied rates) by Sector: 2008

	Tariff Lines	Share	Averages
All products	8749	100%	7,6%
Agricultural Product	1151	13,2%	11,4%
1 Live Animals	128	1,5%	4,5%
2 Dairy Products	35	0,4%	5,7%
3 Coffee, Tea, Cocoa, sugar, etc	223	2,5%	9,1%
4 Cut Flowers and plants	65	0,7%	7,6%
5 fruit and vegetables	234	2,7%	5,2%
6 grains	16	0,2%	3,1%
7 oil seeds, fats, oil and products	190	2,2%	4,8%
8 beverages and spirit	75	0,9%	87,4%
9 tobacco	30	0,3%	17,3%
10 other agricultural products, n.e.s	155	1,8%	4,1%
Non-agricultural Products (excl. Petroleum)	7547		6,2%
11 Fish and fishery products	206	2,4%	5,7%
12 Mineral products, precious stones	440	5,0%	5,7%
13 Metals	943	10,8%	7,6%
14 Chemicals and Photographic supplies	1236	14,1%	5,8%
15 Leather, rubber, footwear, travel goods	285	3,3%	9,4%
16 Woods, pulp, paper, furniture	444	5,1%	4,5%
17 textiles and clothing	1005	11,5%	10,9%
18 transport equipment	469	5,4%	17,8%
19 Non-electric machinery	1217	13,9%	2,5%
20 Electric machinery	588	6,7%	5,7%
21 Non-agricultural products, n.e.s(714	8,2%	6,6%
Petroleum	34	0,4%	0,6%

Source: Indonesia 2008 tariff - Ministry of Finance Indonesia

Indonesia has bound 93.2 per cent of its tariffs in the WTO. However, the average bound tariff for all products, at 37.5 per cent, is much higher than the average applied rate for all products. Based on consultations with Australian industry, this is a potential source of uncertainty for exporters, since there is no legal impediment that would prevent Indonesia from appreciably raising its tariffs to the level of the binding. The ASEAN Free Trade Area (AFTA) and other FTAs 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 3.2 looks more closely at the tariffs applied 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. 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 10 per cent) and motor vehicle parts and accessories (where the MFN tariff is 15 per cent, but products from ASEAN economies can enter at 5 per cent).

Table 3.2
Tariffs on Key Australian Exports to Indonesia: 2008
(Per cent unless otherwise indicated)

Code	Description	MFN 2008
9999	Confidential items, items not classified	
	wheat	0
	cane sugar	R p 550/kg
	alumina	0
2709	Crude oil from petroleum and bituminous minerals	0
7601	Unwrought aluminium	0
0102	Live bovine animals	0-5
5201	Cotton, not carded or combed	0
7403	Refined copper and copper alloys, unwrought	0-5
0402	Milk and cream, concentrated or sweetened	5-10
7326	Articles of iron or steel nes	5-15
7204	Ferrous waste and scrap; remelting scrap ingots or iron or steel	0
1101	Wheat or meslin flour	5
7901	Unwrought zinc	0-5
8431	Parts suitable for use mainly in lifting, loading, grading, etc. machin	0-10
7606	Aluminium plates, sheets, etc., thicker than 0.2 mm	5-15
0202	Meat of bovine animals, frozen	5
2710	Oil (not crude) from petroleum & bituminous minerals, etc.	0
8708	Parts and accessories of motor vehicles	15
8413	Pumps for liquids; liquid elevators	0-10
2301	Flours, meals and pellets, unfit for human consumption; greaves	0
3102	Mineral or chemical fertilisers, nitrogenous	0
8474	Machinery for sorting, screening, grinding, shaping, etc.	0-5
0404	Whey; products consisting of natural milk constituents, nes	5
0406	Cheese and curd	5
4707	Waste and scrap of paper or paperboard	0-15
0206	Edible offal of bovine and other animals, fresh, chilled or frozen	5
7801	Unwrought lead	5

Source: Indonesia 2008 tariff – Ministry of Finance

Tariff Impediments Post-AANZFTA

The recently concluded AANZFTA will provide for significant reduction of tariff barriers faced by Australian exporters to Indonesia. As part of its AANZFTA commitments, Indonesia will eliminate tariffs on 93.2 per cent of tariff lines by 2025. While only 1 per cent of tariff lines are excluded from Indonesia's tariff commitments, this includes a range of products of trade interest to Australia, including some sheep meat and frozen beef lines, wine, rice, maize and sugar. For a range of other products of trade interest to Australia, Indonesia is reducing but not eliminating tariffs, including some on live cattle, certain categories of sheep meat, frozen pork, processed seafood, some dairy products, some fresh and processed fruit

and vegetables, some motor vehicles, and some iron and steel lines. For a third group of products of trade interest to Australia, including motor vehicles and some automotive parts lines, tariffs are being eliminated but not within commercially relevant timeframes.

Tables 3.3, 3.4, and 3.5 summarise Indonesia's tariff reduction and elimination commitments. Imports by Indonesia from Australia that meet AANZFTA ROO will face tariff-free treatment on 21 per cent of tariffs on entry into force (EIF) in 2009, rising to 58 per cent in 2010, 84.9 per cent in 2013, 91.1 per cent in 2015, and 93.2 per cent in 2025. Most other tariff lines in Indonesia will be subject to tariff reductions. At the end of the transition period, in 2025, 96.7 per cent of Indonesia's tariff lines will be in the 0-5 per cent range.

Table 3.3
Percentage of Tariff Lines with Tariff-Free Treatment following Implementation of AANZFTA

Country	2005 Base Tariffs (%)	2010 (%)	2013 (%)	Final Tariff Elimination (%)	Year Achieved
Indonesia	21.2	58	84.9	93.2	2025

Table 3.4
Percentage of Tariff Lines with Tariffs in the 0-5% Range following Implementation of AANZFTA

Country	2005 Base Tariffs (%)	2011 (%)	2013 (%)	2017 (%)	2020 (%)	2025 (%)
Indonesia	59.4	85	92.4	95.6	96.2	96.7

Table 3.5
Percentage of Base Period (2005) Imports from the Other Country with Tariff-Free Treatment following Implementation of AANZFTA

Country	2005 (%)	2010 (%)	2013 (%)	Final Tariff Elimination (%)
Indonesia	67.1	81.3	85.4	93.4

Other Impediments to Trade in Goods

Indonesia maintains non-tariff measures for some products that are of interest to Australia. According to the WTO Secretariat, import licensing restrictions apply to 141 tariff lines, including alcoholic beverages. Indonesia has also recently announced the introduction of new import licensing controls on sugar, as well as revised import arrangements for a range of other products. Sugar imports are closely regulated to protect domestic farmers and importers.¹¹ Rice imports are controlled, with a state trading enterprise (Bulog) operating to support domestic producers and stabilise prices. Table salt imports are subject to some controls. A number of Australian companies have expressed concern about anti-dumping actions effecting their trade with Indonesia. Concern about the transparency of regulations and administration in Indonesia also has an impact on prospects for developing trade and acts as an important non-tariff barrier.

¹¹ See WTO Secretariat, *op. cit.*, pp.46-48.

AANZFTA affirms or incorporates relevant WTO disciplines applying to a range of non-tariff measures. It also provides for a review of non-tariff measures to consider additional means of facilitating trade between the parties. The agreement includes chapters on Customs Procedures; Sanitary and Phytosanitary Measures; and Standards, Technical Regulations and Conformity Assessment Procedures that provide a framework for enhanced cooperation between the parties on these issues. A chapter on Safeguard Measures governs the use of transitional safeguards measures to address any adjustment difficulties that are caused by the tariff reduction and elimination commitments. While the AANZFTA disciplines in these areas make a very important contribution to the evolution of regional cooperation on these areas, they will not lead to the elimination of all of Indonesia's non-tariff barriers.

3.1.2 Services

Indonesia maintains barriers to services trade in many sectors. For example, Indonesia has relatively restrictive rules governing legal, accountancy and architecture services, as well as education, telecommunications and construction.

In the WTO, Indonesia has numerous reservations in its market access and national treatment commitments on services, including limits on foreign equity and nationality requirements (Indonesia's 2007 Investment Law has removed some of these restrictions). Its overall Uruguay Round commitments and Doha Round offers cover only 34 per cent of all services sectors. Indonesia's commitments under AANZFTA are also relatively modest. While Indonesia has made some important improvements to its WTO commitments, Australian service exporters will continue to face barriers after the entry into force of AANZFTA.

The following outlines some impediments to Australian services exports in selected sectors.¹²

In relation to **education**, for example, foreign direct investment is limited to 49 per cent in higher education and non-formal education. This is reflected in Indonesia's AANZFTA commitments which require the establishment of a partnership with a local institution.

For **legal services**, foreign law firms cannot establish offices in Indonesia. However, individual foreign lawyers may work for Indonesian law firms as employees or experts in international law. Under Indonesia's AANZFTA commitments, there are limits on the number (five) and the percentage (20 per cent) of foreign lawyers who can work in Indonesian law firms. Indonesian citizenship and a degree from an Indonesian legal faculty or other recognised institution are required to practise Indonesian law.

¹² 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/

Likewise, Australian **accounting** firms must operate in Indonesia through a cooperation agreement with a local public accountancy firm and cannot practise under their own name. Indonesian citizenship is necessary to become a licensed accountant. Foreign agents and auditors can only operate as consultants. Indonesia has made no AANZFTA commitments for access to its accounting services market.

In **financial services**, foreign ownership of up to 99 per cent is permitted in the banking sector (although Indonesia has only committed to permit up to 51 per cent under AANZFTA) and 80 per cent for insurance companies (the AANZFTA commitment is 80 per cent). There nevertheless remain restrictions on foreign bank lending and operations. For example, under AANZFTA, Indonesia has retained restrictions on the period of time various personnel can be retained in a foreign financial services operation in Indonesia, for example technical experts are only permitted a three month stay in any given year. These types of restrictions inhibit the commercial activities of Australian financial service suppliers in Indonesia and curtail significantly the opportunities for exchange of skills and experience between Indonesian and Australian staff.

There has been gradual **telecommunications** reform in recent years. Also, under the new investment regime published in June 2007, foreign investors are permitted to own up to 65 per cent of mobile telephone companies. Foreign investment in fixed line networks is permitted up to 49 per cent. These limits are not, however, reflected in Indonesia's AANZFTA commitments: Indonesia has committed to permit only up to 35 per cent foreign equity participation in key telecommunications sectors.

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. State enterprises retain a significant market share in this sector. Where there is private involvement, the Government restricts foreign investment and employment of nationals. Under AANZFTA, Indonesia has retained restrictions on foreign equity participation (49 per cent) in relation to certain energy services, and has made no commitments on environmental services.

Foreign **construction** firms are 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. Indonesia has made limited AANZFTA commitments in this sector, with commercial presence permitted through a joint operation or joint venture with maximum 55 per cent foreign ownership.

3.1.3 Investment

There are a number of impediments to greater Australian investment in Indonesia. These include limits on foreign equity participation; complex business regulation; difficulties identifying the relevant level of government (central and provincial or local authorities); complex 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 World Economic Forum's Global Competitiveness Index ranked

Indonesia 50th of 125 countries in 2006. The World Bank recently ranked Indonesia 123rd out of 178 countries in terms of ease of doing business (but noted positive reforms).¹³

The Indonesian Government has sought to introduce a number of reforms to improve the investment environment. These steps have included new investment legislation that was passed by the Parliament in March 2007 (discussed in more detail in Chapter 2) and the release in July 2007 of a negative investment list that liberalises equity requirements in a number of sectors. A key principle of the new law is the extension of national treatment to foreign investors. There remain restrictions in areas of interest to Australian investors. Likewise, a new mining law was passed in late 2008 but its commercial significance remains unclear pending passage of the implementing legislation. 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 implemented.

Australia and Indonesia are parties to a bilateral investment treaty (BIT) that has been in effect since 1993. The treaty contains commitments by each country to provide important post-establishment legal protections to investors and investment from the other. The AANZFTA chapter on Investment also includes a set of important disciplines relating (primarily) to the post-establishment treatment of foreign investors and investment (for example, in relation to standards of treatment and expropriation). It also provides for a work program to develop investment market access schedules, covering national treatment issues such as pre-establishment foreign equity limits, within five years of entry into force of AANZFTA.

3.2 Impediments to Indonesian Exports and Investment

For its part, Indonesia has identified certain key barriers to trade that will remain in place even after AANZFTA enters into force: including for passenger motor vehicles (PMV), textiles and clothing. In the services area, Indonesian service suppliers experience some difficulties securing opportunities for temporary employment in Australia.

3.2.1 Goods

Current Tariff Impediments

Australia undertook a major opening of its economy in the 1980s and 1990s in order to improve competitiveness and allocative efficiency. Nonetheless, Australia maintains a number of barriers that impact upon Indonesian exports. This section describes the Australian tariffs that currently apply and also notes important changes to them that will take effect when AANZFTA enters into force.

As a result of unilateral reductions Australia's overall simple average applied MFN tariff rate fell from 4.5 per cent in 2002 to 3.6 per cent in 2008. The applied tariffs on

¹³ Doing Business 2008: Comparing Regulation in 178 Economies, September 2007, at www.doingbusiness.org

TCF and PMVs in particular were reduced significantly. While 96.7 per cent of Australia's tariffs are bound, more than 40 per cent of its bound rates currently exceed applied MFN rates by at least five percentage points.

Table 3.6
Analysis of Australia's 2008 MFN applied tariff by WTO sectors

	Tariff	Tariff rates				
		MFN applied duties			WTO bound duties	
Product Group	Lines	Min	Max	Av ¹	Max	Av ²
Animal products	91	0	5%	0.4%	16%	1.6%
Dairy	22	0	4%	0.2%	21%	4.4%
Fruit, vegetables, plants	195	0	5%	1.6%	29%	3.6%
Coffee, tea	24	0	5%	1.0%	17%	3.9%
Cereals and preparations	81	0	5%	1.4%	17%	2.5%
Oilseeds, fats & oils	73	0	5%	1.6%	14%	2.9%
Sugars and confectionary	17	0	5%	1.9%	15%	7.0%
Beverages and tobacco	105	0	5%	3.1%	25%	10.3%
Cotton	5	0	0%	0.0%	2%	1.2%
Other agricultural products	135	0	5%	0.4%	20%	1.90%
Fish and fish products	125	0	5%	0.0%	10%	0.8%
Minerals and metals	957	0	10%	2.9%	45%	6.7%
Petroleum	47	0	0%	0.0%	0%	0.0%
Chemicals	941	0	17.5%	2.0%	55%	9.1%
Wood, paper, etc	449	0	10%	3.7%	25%	7.0%
Textiles	677	0	17.5%	6.6%	55%	18.3%
Clothing	259	0	17.5%	14.5%	55%	41.1%
Leather, footwear, etc.	195	0	17.5%	5.6%	55%	14.4%
Non-electrical machinery	631	0	10%	3.2%	50%	8.2%
Electrical machinery	312	0	10%	3.3%	45%	10.3%
Transport equipment	227	0	10%	4.4%	40%	12.6%
Manufactures, nes	435	0	10%	1.6%	40%	6.3%

Notes: 1. Averages based on ad valorem tariffs only.

2. The WTO have calculated averages including estimates non-ad valorem equivalents

Source: Australian Customs and Border Protection Service; and WTO.

Table 3.7 shows Australia's simple average applied tariff rates on selected imports from Indonesia at the 2-digit HS level for 2008. It confirms that Australian tariffs barrier on major imports from Indonesia are low.

Table 3.7
Australia's Tariffs for Indonesian Export Products by HS2 (2008)

HS Code	Product Name	Tariff rates		Imports from Indonesia (A\$ million)
		MFN Simple average (Applied)	Simple Average Bound	

27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	0.2%	0.4%	2,414.90
71	Natural or cultured pearls, precious and semi-precious stones, precious metals, metals clad with precious metal and articles thereof; Imitation jewellery; Coin	1.0%	11.8%	439.5
85	Electrical machinery and equipment and parts thereof; Sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles	3.2%	8.9%	369.1
44	Wood and articles of wood; Wood charcoal	3.7%	4.4%	201.9
84	Nuclear reactors, boilers, machinery and mechanical appliances; Parts thereof	3.2%	9.3%	184.4
48	Paper and paperboard; Articles of paper pulp, of paper or of paperboard	4.2%	9.3%	155.3
94	Furniture; Bedding, cushions and similar stuffed furnishings; Lamps and lighting fittings, not elsewhere specified or included; Illuminated signs, illuminated name-plates and the like; Prefabricated buildings	4.5%	14.7%	86.4
40	Rubber and articles thereof	5.7%	13.9%	83
39	Plastics and articles thereof	5.1%	10.6%	72.5
9	Coffee, tea, mate and spices	0.0%	0.1%	55.4
73	Articles of iron or steel	4.6%	12.2%	53.3
28	Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, of radioactive elements or of isotopes	0.6%	9.6%	52.6
18	Cocoa and cocoa preparations	2.3%	8.4%	52.6
62	Articles of apparel and clothing accessories, not knitted or crocheted	14.3%	42.1%	47.2
26	Ores, slag and ash	0.0%	1.0%	44.6
70	Glass and glassware	3.3%	13.2%	42.5
64	Footwear, gaiters and the like; Parts of such articles	6.5%	21.4%	41.7
29	Organic chemicals	0.7%	9.3%	41.1
76	Aluminium and articles thereof	4.2%	4.6%	35.1
19	Preparations of cereals, flour, starch or milk; pastrycooks' products	3.9%	6.4%	25.7

Notes: Simple average tariff rates based on ad valorem rates only. Bound tariff averages are based on HS1996 nomenclature.

Source: Australian Customs and Border Security and DFAT STARS database consistent with ABS Catalogue 5368.0.

Despite the cuts in tariffs applied to TCF and PMV products in Australia since the late 1980s, the resulting rates are still higher than the average applied MFN rate. In addition, non-ad valorem rates, applying to a few tariff lines, tend to conceal some tariff peaks.

The PMV and TCF sectors are important for Indonesia but Indonesian exports to Australia of these products currently face tariff rates above 5 per cent. Motor vehicles attract an average applied tariff of 10 per cent until 2010, when it will be reduced to 5 per cent. For used vehicles, there is a further A\$12,000 specific duty applied. In practice, the specific component of this tariff rate is hardly ever applied. For the TCF sector, applicable tariffs vary by industry sub-sector, with: (1) tariffs on clothing and certain finished textiles now at 17.5 per cent; (2) tariffs for cotton sheeting, woven

fabrics, carpet and footwear now at 10 per cent; and (3) tariffs on sleeping bags, table linen and some footwear parts now at 7.5 per cent.

Tariff Impediments Post-AANZFTA

Under AANZFTA, Australia will eliminate tariffs on 100 per cent of tariff lines by 2020. Most of the tariff lines on which tariff elimination will be delayed until 2020 are of priority trade interest to Indonesia, particularly including a range of TCF products in which it has a comparative advantage, as well as passenger and other vehicles, and some consumer electronics and furniture items where there is current trade. A bilateral FTA would provide an opportunity to put Indonesia on a similar footing to other ASEAN countries, which will enjoy zero-duty access for some PMV products under AANZFTA before Indonesia.

Tables 3.8, 3.9 and 3.10 summarise Australian tariff reduction and elimination commitments. Australian tariffs on all imports from Indonesia that meet AANZFTA ROO will be eliminated over the transition period, with imports on 80.7 per cent of tariff lines facing tariff-free treatment on the Agreement's expected entry into force (EIF) in the second half of 2009, rising to 96.4 per cent of tariff lines on 1 January 2010 and 100 per cent of tariff lines on 1 January 2020.

Table 3.8
Percentage of Tariff Lines with Tariff-Free Treatment following Implementation of AANZFTA

Country	2005 Base Tariffs (%)	2010 (%)	2013 (%)	Final Tariff Elimination (%)	Year Achieved
Australia	47.6	96.4	96.5	100	2020

Table 3.9
Percentage of Tariff Lines with Tariffs in the 0-5% Range following Implementation of AANZFTA

Country	2005 Base Tariffs (%)	2011 (%)	2013 (%)	2017 (%)	2020 (%)
Australia	86.2	96.7	96.9	97.5	100

Table 3.10
Percentage of Base Period (2005) Imports from the Other Country with Tariff-Free Treatment following Implementation of AANZFTA

Country	2005 (%)	2010 (%)	2013 (%)	Final Tariff Elimination (%)
Australia	72.6	99.1	99.1	100

Other Impediments to Trade in Goods

Australia's product standards, and also its quarantine regulations and procedures, remain a major concern for Indonesian exporters, even taking into account the outcomes of AANZFTA. Indonesian companies have experienced difficulties with Australia's labelling requirements and have been subject to holding orders for Indonesian food, vegetables and fruits exports to Australia. These holding orders substantially impact a number of Indonesian exporters. For Australia, these are

matters of health and safety. Australia has a rigorous, science-based quarantine (sanitary and phytosanitary) regime which Indonesian producers strive to comply with but which has a meaningful impact on their ability to export product to Australia.

3.2.2 Services

Australia maintains an open services market and, as under its WTO commitments, Australia's AANZFTA commitments on services are wide ranging. However, Indonesian service suppliers still experience some challenges when seeking to take advantage of the market access opportunities available to them in Australia.

For example, Australia maintains high standards for the education and qualification of services suppliers, for example teachers, lawyers, nurses and engineers. While these requirements serve to protect the Australian consumer, they create challenges for Indonesians wishing to export their services. For example, due in part to language differences, but due also to differences between the education and training systems of Australia and Indonesia, it is not always easy for Indonesian service suppliers to gain the necessary Australian licences. This also has an impact on Indonesians' ability to take advantage of the range of Australian visas that are available for persons from other countries, including Indonesia, who wish to come to Australia temporarily to work or provide services.

3.2.3 Investment

Australia maintains an open and transparent foreign investment regime. The Australian Foreign Investment and Review Board considers proposed investments in Australia that exceed specified thresholds (currently A\$50 million), and also investments including urban land and investments by foreign governments. Australia also controls investment in certain specific companies and sectors, for example Telstra, Qantas and the media. These regulatory requirements impose a compliance burden on some forms of foreign investment however their commercial impact is limited. This is demonstrated by the high levels of foreign investment – including from some other ASEAN countries – in Australia (detailed in Chapter 2).

Despite the presence of low barriers to Indonesian investment in Australia, ABS data shows Indonesian investment in Australia is limited. The stock of inward investment (including portfolio investment) from Indonesia totalled A\$409 million at the end of 2007. Indonesian investment in Australia has grown at a trend rate of 4.4 per cent per annum in the five years to 2007.

3.3 The Implications for Australian Exports of Goods and Services

A bilateral FTA would provide opportunities to address the remaining impediments to Australian exports to Indonesia (of goods and services) and also Australian investment in Indonesia.

3.3.1 Impact of liberalisation on Australia's Agriculture Sector

Potential trade gains for Australian farmers from a bilateral FTA are significant. The treatment of about US\$91 million (or 3.5 per cent) of Australian agricultural exports to Indonesia (2005) will not change after AANZFTA enters into force. For example:

- Australia exported sugar to Indonesia in 2005 valued at US\$73.6 million but sugar is currently excluded from Indonesia's AANZFTA tariff commitments. Including sugar would reduce prices for Indonesian consumers and upstream manufacturers, and would benefit Australian exporters. Binding tariff commitments also would increase certainty for producers and consumers alike;
- Indonesia made no tariff commitments on rice under AANZFTA. Australia is not a large rice exporter, but still has interests as an exporter of small quantities of specialised product lines. Australia exported rice valued at US\$2.4 million to niche markets in Indonesia in 2005. This trade has the potential to expand without competing directly with Indonesian producers; and
- Wine and some meat product lines have been excluded from Indonesia's tariff commitments under AANZFTA.

On many other agricultural products, tariffs have either not been eliminated or the rate of removal is gradual. A bilateral FTA would provide an opportunity to accelerate these AANZFTA commitments. For example:

- A number of horticulture products will not benefit from tariff elimination under AANZFTA, with tariffs ranging from 3 per cent (turnips) to 19 per cent (mandarins). Several horticulture products are of significant export interest to Australia;
- Tariffs will not be eliminated on some livestock and meat products, especially certain live cattle (2.5 per cent) and sheep meat (3 per cent to 4 per cent); and
- Dairy products (milk, powder, whey and cheese) will still be subject to a tariff of 4 per cent in 2015 under AANZFTA.

These are all examples of products for which there is a high income elasticity of demand in Indonesia, especially among the urban middle classes, and which Australia would be well-placed to supply if border restrictions were eased or eliminated.

3.3.2 Impact of liberalisation on Australia's Manufacturing Sector

An ambitious FTA could create specific opportunities for Australia in a wide range of manufactures:

- Over US\$78 million worth of industrial products (3.1 per cent of total 2005 Indonesian imports from Australia) will be excluded from Indonesia's tariff elimination commitments under AANZFTA. Some chemical products (alcohol-based) would still face rates of duty of up to 85 per cent under AANZFTA.
- Indonesia imported US\$20.5 million dollars worth of refined copper cathodes and sections of cathodes from Australia in 2005. This product will continue to be subject to a 5 per cent duty under AANZFTA.

- Australian oil products exports (worth US\$13.8 million in 2005) would benefit from the elimination of tariffs, which would still be 15 per cent in 2025 under AANZFTA.
- Australian exports of iron and steel products worth US\$10.9 million in 2005 would gain a competitive advantage over other exporters to the Indonesian market by the elimination of those tariffs that will remain in place under AANZFTA.
- Australian plastic products, including tubes and pipes, floor coverings and stoppers, worth US\$4.4 million in 2005, would be more competitive in the Indonesian market if the current tariffs on Australian exports were eliminated under a bilateral FTA.

Australia identified the automotive sector as a priority sector under AANZFTA, proposing early tariff elimination because of potential gains to all parties from linking regional supply chains. The automotive industry is an important manufacturing sector in both Indonesia and Australia. On automotive parts, Indonesia will eliminate tariffs on most tariff lines by 2013. However, there would still be scope for accelerating the elimination of tariffs on a range of tariff lines in the automotive parts sector. Likewise, Indonesia's commitments on motor vehicles do not provide for tariff elimination until 2014 (for larger engine cars) or 2019 (for smaller and medium engine cars). There would, as a consequence, be considerable scope for improved outcomes to be achieved in a bilateral FTA in this area. Given the complementarities between Australia and Indonesia in this sector, eliminating tariffs would benefit both countries. Also, given the importance of regional and global supply chains to the automotive industry, it is worth noting that, careful consideration would need to be given to the ROO that would apply to automotive products under a bilateral FTA.

3.3.3 Impact of Liberalisation on Australia's Services Sector

As explained above, a variety of impediments inhibit Australian services exports to Indonesia. Under a bilateral FTA, Indonesia could commit to reform or eliminate some of these impediments to Australian services exports. In many sectors, Australian service suppliers would not compete directly with Indonesian operators. Instead, they would offer a complementary range of services that would be highly attractive to both domestic and foreign investors. In those sectors where Australian suppliers might compete, either directly or in a marginal way, with Indonesian operators, the presence of Australian service suppliers in the domestic market would provide new impetus for improved efficiency, and would also give rise to valuable opportunities for the exchange of skills, experience and ideas.

For example, in the **legal** services area, Australia possesses considerable expertise but remains a small exporter in global terms. If permitted to operate in Indonesia, Australian firms would compete directly with very few Indonesian firms as the majority of Indonesian firms primarily offer legal services in domestic law. Instead, Australian firms would seek to service Australian and international clients investing or otherwise doing business in Indonesia by providing commercial and transactional legal advisory services. To the extent that Indonesian firms already supply these types of services, the presence of a small number of Australian firms in the market would be an opportunity (to gather new ideas and improve service quality and complexity through joint projects) rather than a competitive threat. Importantly, the presence of

Australian firms will provide Indonesian firms the opportunity to link into Australian firms' reach throughout the region. The same would be true if Australian accountants, architects or engineers were permitted to establish Australian-controlled practices in Indonesia.

A similar example can be found in the **telecommunications** sector. While Indonesia's established fixed line operators service very large numbers of residential and small business customers, Australian telecommunications operators aim to supply niche communications services to international corporations whose business activities span or cross the Indonesian archipelago. Again, the presence of Australian suppliers in the Indonesian market could create opportunities for productive partnerships.

Were Indonesia to eliminate existing impediments to trade in services under a bilateral FTA, a range of possible benefits could flow to Australia. For example the number of Indonesian **students** studying in Australia (or studying at Australian institutions in Indonesia) could increase; Australian **professional** service suppliers could find it easier to do business temporarily in Indonesia (especially if the FTA included improved commitments by Indonesia on the temporary entry of service suppliers and business people); opportunities to supply services through **commercial presence** (foreign direct investment) in Indonesia could be meaningfully improved; and opportunities for Australian **telecommunications** operators in Indonesia could be enhanced if a bilateral FTA included disciplines on the pro-competitive regulation of the Indonesian telecommunications market that go beyond those agreed under AANZFTA.

The impact of a bilateral FTA on services trade will depend not only on the degree of reform undertaken by Indonesia (via the elimination of existing barriers to services trade), but also on the degree to which the reforms undertaken by Indonesia are made subject to new binding commitments under a bilateral FTA. Under AANZFTA, Indonesia substantially improved on its WTO commitments in some sectors (for example, insurance and construction). However, Indonesia's AANZFTA commitments in a number of key sectors of Australian interest, including professional, education, banking, telecommunications, environmental and mining and energy services do not improve substantially on its WTO commitments. A notable feature of the AANZFTA services outcome for Indonesia is the wide gap between commitment levels bound in its schedule and actual applied levels of regulatory openness, particularly in such sectors as banking, telecommunications and education.

Against this background, there would be considerable scope for a bilateral FTA to enhance certainty for Australian services suppliers by broadening and deepening commitment levels achieved in AANZFTA, including by closing the gap between bound and applied levels of market access in key sectors. If this were achieved, a bilateral FTA could serve as the impetus for increased services investment and trade. Australian suppliers could gain confidence that their efforts in the Indonesian market would be rewarded, not only in the short term, but also over the medium to long term.

3.4 The Implications for Indonesian Exports of Goods and Services

An Indonesia-Australia FTA would provide opportunities to address the remaining impediments to Indonesian exports to Australia (of goods and services). A bilateral FTA could also create opportunities to enhance Indonesian investment in Australia.

3.4.1 Impact of Liberalisation on Indonesia's Agriculture Sector

While Indonesian exporters of agricultural products will face few tariff barriers after 2010 under AANZFTA, tariffs on processed vegetable mixtures will be maintained until 2020. The phase-in periods for this product could be accelerated under a bilateral FTA. Australia has a risk assessment-based regulatory framework requiring that foods produced using biotechnology be found to be safe and be approved before being sold for human consumption. Australia also has a strict quarantine regulation which affects Indonesian exports of food and products derived from plants. A bilateral FTA could provide an opportunity for cooperation in complying with some of these requirements.

3.4.2 Impact of Liberalisation on Indonesia's Manufacturing Sector

An ambitious FTA would create diverse and important trading opportunities for Indonesia, for example:

- Most of the Australian tariffs not being eliminated early in the AANZFTA phasing are industrial products. Some US\$75 million worth of 2005 imports from Indonesia will still face tariffs of up to 15 per cent in 2010;
- Indonesia's automotive exports to Australia have increased significantly in recent years albeit from a low base. A bilateral FTA would provide Indonesia with a level playing field vis-à-vis other Australian FTA partners in this important industrial sector. In 2006, Indonesia exported US\$20.2 million of automobiles and automotive components, a significant achievement for a sector that was considered "inward looking" in the past decades. Australia has made preferential concessions in the PMV sectors in other bilateral FTAs.
- Consumer electronics worth about US\$48 million will not see tariffs eliminated until 2020 under AANZFTA. Earlier elimination of these tariffs would provide improved market access opportunities for Indonesian exporters into the Australian market.
- The TCF industry is an important driver of economic well being in Indonesia. The TCF sector contributed 15.1 per cent to Indonesia's non-oil exports in 2006 and supported more than 1.64 millions jobs. Indonesia's total TCF exports grew by 12.51 per cent and 8.18 per cent in 2005 and 2006 respectively. However, Indonesian exports of those products to Australia increased by just 1.96 per cent and 3.8 per cent over the same period. Total Australian TCF imports were valued at US\$105.45 million in 2006. Tariffs will remain on TCF products worth US\$19 million. Tariffs on some TCF items will remain as high as 10 per cent until 2019 under AANZFTA. Bringing forward tariff elimination would benefit Indonesia's clothing manufacturers, assisting them to compete with other suppliers. A bilateral

FTA could also potentially provide a level playing field for Indonesian TCF products in the Australian market vis-à-vis suppliers from other FTA partners.

- Indonesia would also gain from earlier liberalisation of tariffs on several leather products which are manufactured by small and medium enterprises. Under AANZFTA, Australia's tariff on several leather clothing products, which are currently set at 17.5 per cent, will be completely eliminated in 2020.
- Rubber glove exporters could take advantage of a 7.5 percentage point reduction in duties (elimination of the remaining 7.5 per cent duty): rubber glove imports from Indonesia in 2005 were worth US\$4.1 million.
- Indonesian furniture manufacturers exported product to Australia valued at around \$US5.6 million in 2005. These products did not receive immediate tariff elimination under the regional FTA and would benefit from accelerated staging.

3.4.3. Impact of liberalisation on Indonesia's Minerals and Energy Sector

The mining industry benefits Indonesia in many ways. Perhaps of most significance are the opportunities for the development of remote regions of Indonesia that might otherwise not be developed at all, or at the pace often driven by international investors. Mining companies are in many cases the only significant employer in some of these remote areas of Indonesia. In 2006, the Indonesian mining industry's contribution to GDP increased by 7 per cent (compared to 2005) to 56 trillion Rupiah. Although the Indonesian mining industry contributed only 3 per cent of Indonesia's GDP in 2006, in many provinces such as Papua, Bangka-Belitung, West Nusa Tenggara and East Kalimantan its contribution to regional output was far greater.

At the same time, international mining companies, including Australian operators, rank Indonesia highly as a potential source of minerals and other valuable commodities. Australian mining and energy companies have strong interests in Indonesia and seek new and expanded opportunities to do business there. However, they have serious concerns about Indonesia's mining policies and its general investment climate.

The Indonesian mining industry faces a major test if it intends to remain a significant player in the global mining industry. The impact of the recently enacted Mining Law will depend on the implementing regulations. Indonesia would like to attract more investment in 'greenfield' exploration and/or production expansion in the near future. This could assist Indonesia to participate in the benefits of the inevitable return to strong performance in the global mining industry arising from future high demand for energy and mineral products. This is a crucial time for industry players and the Government to work together and reshape the industry for the benefit of all stakeholders, including the people of Indonesia.

A bilateral FTA would therefore present a win-win opportunity to attract Australian interest and investment to Indonesia, which would benefit both the Indonesian and Australian economies and peoples.

3.4.4 Impact of liberalisation on Indonesia's Services Sector

Under a bilateral FTA there would be considerable opportunities to promote further bilateral services trade and investment to the benefit of both countries. From Indonesia's perspective, the negotiation of a bilateral FTA with Australia could provide a useful opportunity to experiment with the elimination of some key barriers to services imports, without exposing its domestic service suppliers to significant competitive threats. At the same time, opening the Indonesian market to Australian suppliers could provide Indonesian suppliers with very valuable opportunities to acquire new, commercially valuable skills. Finally, the negotiation of a bilateral FTA could provide useful impetus to important domestic regulatory reforms that are of importance to the Indonesian Government and highly beneficial to the Indonesian people.

Endowed with a large population, Indonesia has the potential to supply trained workers. Indonesia is already in the list of top-20 developing-countries with respect to value of remittances received from migrant workers, with a conservative estimate of \$US6 billion in 2007. For example, many Indonesian technicians, maritime and construction workers, as well as health service suppliers already go overseas temporarily to work or provide services. Likewise, although Indonesia has not matched India as a recipient of outsourced work for information technology (IT), Indonesia has a pool of talented young IT engineers. Indonesia is currently promoting its capacity in software programming for IT and businesses purposes and creative industry (i.e., art design and audiovisual services). Indonesia's capacity to carry out outsourced IT work for Australian clients could be further explored under a bilateral FTA.

A bilateral FTA could provide an opportunity for Indonesia to consider cooperative arrangements that could improve the capacity of Indonesian service suppliers and assist them to obtain internationally recognised certifications. The presence of Australian firms in Indonesia will also provide opportunities to benefit from Australian firms' reach throughout the region. This would increase their competitiveness in the global market.

A bilateral FTA could also help to drive domestic reform and boost Indonesia's exports of services. Indonesia can benefit from an FTA by opening up and further enhancing the transparency of regulations for foreign investment. For example, the development of an efficient financial services sector has been an important focus for the Indonesian Government for some decades. This sector is important as a source of finance for small and medium-sized enterprises, which do not have easy access to international capital markets. Regulation or prudential supervision of the Indonesian financial services sector – which is intended to provide greater security for depositors, insurance policy holders and members of pension schemes – will remain a key priority of the Indonesian Government. A bilateral FTA could create an opportunity to advance the domestic reform agenda in ways that will further enhance Indonesia's attractiveness as a place for Australian banks and other financial service suppliers to invest. This would be an important opportunity to promote growth in the real economy through a deepening of Indonesian financial and capital markets.

An FTA could also help to attract investment to Indonesia in services sectors of importance. For example, tourism employs over 8 per cent of Indonesian workers. It has vast potential to attract foreign investment and could be a sector in which new Indonesian businesses might thrive even more in future. However, a number of local regulations impede the capacity of Indonesian operators to fully integrate with foreign tourism operators, including Australian operators. If Indonesia agreed, under a bilateral FTA with Australia, to eliminate these impediments, local tour providers could improve their linkages with foreign tour operators and could gain new opportunities to acquire operating “know how” and experience with international industry standards. This in turn could assist Indonesian tourism services providers to link themselves more effectively with the global market.

Also, under a bilateral FTA, Indonesia and Australia could agree to new arrangements designed to assist Indonesia to strengthen key regulatory regimes, while at the same time preserving the Indonesian Government’s commitment to poverty alleviation. For example, Australia might agree to assist Indonesia to develop important technical regulations, such as universal services obligations in the health or telecommunications sectors, which would help to ensure achievement of the Government’s broader social welfare objectives. At the same time, Indonesia could take further concrete steps toward reforming services sector by allowing more competition among service providers, which could in turn be expected to provide benefits for Indonesian consumers.

3.5 Implications of Rules of Origin

ROO are used to determine whether a good traded between parties to an FTA qualifies for access to the tariff arrangements negotiated under the agreement. They are necessary to ensure that the benefits reciprocally negotiated under an FTA accrue principally to the parties to that FTA. At a minimum such rules should ensure that goods that are transhipped, subject to only minimal processing or are not significantly transformed in an FTA party countries do not qualify for tariff preferences under the FTA.

Generally, to qualify for preferential tariff treatment under an FTA, a good must fall into one of three categories.

- The first category covers goods that are *wholly obtained* - that is, wholly sourced, produced or manufactured - in the territory of the FTA parties. Examples of this category are primary products such as minerals and energy resources, and agricultural, fishing and forestry products produced in the territory of the FTA parties.
- The second category involves products manufactured in the territory of the FTA parties entirely from materials that themselves satisfy a ROO (that is, from materials that are “originating” goods in their own right in the territory of one or the other FTA party).
- The third category involves products using non-originating materials (that is, using materials imported from non-FTA party countries) but produced in such a way as to satisfy a prescribed ROO.

To qualify for preferential tariff treatment as originating goods in the third category (above), goods must undergo substantial transformation. There are a number of tests which may be used separately or in combination to ascertain whether substantial transformation has occurred:

- *Change in tariff classification (CTC)* method requires a good, after production, to be classified under a sufficiently different tariff classification (generally a change of Chapter, heading or subheading) of the Harmonized Commodity Description and Coding System from the classification of the non-originating imported component materials.
- *Value added* method prescribes a threshold proportion of the value of a good that must be derived from materials and processing within the territory of an FTA party.
- *Processing* method requires specific manufacturing or processing operations to be undertaken in an FTA party's territory, such as a chemical reaction.

3.5.1 Australia's Approach

Australia has used a number of different ROO regimes under various trade agreements and other preferential arrangements. These ROO regimes can be broadly classified into two main groups.

The first, based on factory cost combined with the last process of manufacture, is a variant of the value added approach. This was originally adopted in ANZCERTA concluded with New Zealand in 1983. The local content threshold for this agreement was set at 50 per cent, calculated on an ex-factory costs basis. The same basic approach was also employed in the FTA concluded with Singapore in 2003, but with a number of exceptions allowing lower levels of local content in recognition of the unique nature of Singapore's manufacturing structures. The factory cost approach was also used in a number of earlier Australian preferential trade arrangements.

The other approach, using product-specific ROO primarily based on the CTC method, has been employed in Australia's more recent FTAs (see Annex I). These ROO were initially employed in Australia's FTAs with the US and Thailand. As explained above, these require imported input materials to undergo a specified change in tariff classification, supplemented in some cases (e.g. for some textiles, clothing, footwear, automotive products and parts and machinery and electronic equipment) by a regional value content (local content) requirement, or by specific process requirements. Australia recently renegotiated the ROO in our agreement with New Zealand to adopt the approach based primarily on CTC, with the new ROO entering into force on 1 January 2007.¹⁴

¹⁴ Under the new rules, there is a five year transition period, during which importers can still claim origin under the factory cost approach if they prefer to do so.

3.5.2 Indonesia's Approach

Indonesia has utilised a number of different ROO regimes in its bilateral and multilateral trade and economic cooperation agreements, including: ASEAN-FTA (AFTA), ASEAN-China FTA (ACFTA), Indonesia-Japan Economic Partnership Agreement (IJEPA) and ASEAN-Korea FTA (AKFTA). Indonesia's ROO regimes can be classified into two main groups.

The first approach, which is used in AFTA, is a value added ROO of 40 per cent. This approach allows cumulation, that is, originating material from parties to the agreement to be used by Indonesia in reaching the 40 per cent value added threshold. The AFTA ROO have recently been supplemented by the addition of a change of tariff classification (CTC) option for a limited number of specific tariff lines

In the second approach, the ROO combines the value added method outlined above (including the cumulative) and the CTC method. This approach is used in ACFTA, IJEPA, and in AKFTA.

3.5.3 AANZFTA Rules of Origin

The significance of the tariff reduction commitments under AANZFTA is, in most circumstances, enhanced by the operation of the ROO that apply under this agreement. Importantly, AANZFTA provides for ROO based on "co-equal" access to rules based on either the 'change in tariff classification' (CTC) model or a regional value content (RVC) test. For most goods under AANZFTA, exporters have the choice of testing their products under a CTC-based rule or an equivalent RVC-based rule. For some goods, only a single option applies. Exporters wishing to access the tariff arrangements agreed under AANZFTA will need to support their claim with a certificate of origin issued by an authorized body. The ROO provide for regional cumulation. This means that where a good which complies with the origin requirements is exported by an AANZFTA party for use as an input in the production of a good in another AANZFTA party, the good will be treated as if it originated in the party where the working or processing of the finished good has taken place. This recognises the increasing trend to global production chains in the region.

3.5.4 ROO under an Indonesia-Australia FTA

The impact of a bilateral FTA between Australia and Indonesia would be affected by the preferential ROO agreed by Australia and Indonesia as part of the FTA package. An agreement on ROO under a bilateral FTA would need to take into account the ROO negotiated under AANZFTA to remove unnecessary burdens to business. At the same time, care would need to be taken to ensure that the ROO under a bilateral FTA do not prevent Australian and Indonesian manufactured goods and exporters from qualifying for preferential tariff access.

Annex 1

The Change of Tariff Classification Approach in Australian ROO

The Harmonized Commodity Description and Coding System (HS) tariff code is used as a basis for the CTC approach where this method is used in Australian ROO. The simplest test for conferring origin involves a change in the classification of the product at the level of chapter, heading or subheading of the HS.

In the Thailand-Australia Free Trade Agreement (TAFTA), for example, the ROO for goods of HS heading 2007 (jams, fruit jellies, marmalades, fruit or nut puree and fruit or nut pastes, obtained by cooking, whether or not containing added sugar or other sweetening matter) is simply that there has been a change to heading 2007 from any other heading. So, if imported oranges (classified under heading 0805) are used to make orange marmalade (under heading 2007), a change conferring origin has occurred. In some cases, more complex rules apply. For example, the ROO for goods of subheading 8476.21 (automatic beverage vending machines incorporating heating or refrigerating devices) is a change to sub-heading 8476.21 from any other subheading except subheadings 8476.21 through 8476.89 (which cover vending machines without heating or refrigerating devices) - the rationale being that adding a heating or refrigerating device to a vending machine does not substantially transform it.

In the ROO of this type used in Australian FTAs, CTC tests are supplemented in a small proportion of cases by a regional value content test. For example, the Australia-United States FTA (AUSFTA) uses three methods, for about 12 per cent of tariff lines, to calculate regional value content:

- a.) “build down” which is calculated as a share of non-originating content to the free on board price of the finished good.
- b.) “build up”, which is calculated as the share of local materials to the free on board price of the finished good.
- c.) “net cost” which is calculated as one minus the share of non-originating materials to the “net cost” of producing the finished good. The net cost is roughly analogous to the factory cost. The net cost method only applies to automotive and automotive part goods in AUSFTA.

Chapter 4. Macroeconomic and Sectoral Impact of an Indonesia-Australia FTA

4.1 Overview

Economic modelling undertaken by the Centre for International Economics (CIE) confirms the initial expectations of the Australian and Indonesian Governments that a bilateral FTA would provide worthwhile economic benefits for both countries and would benefit Indonesia more than Australia. The modelling also confirms that the pace and scope of liberalisation will be critical in determining the magnitude of those benefits, and is particularly valuable in identifying and analysing those factors that are likely to underpin the economic gains from an FTA.

The modelling framework, including key assumptions used in constructing the counterfactual ‘business-as-usual’ baseline – what could be expected to happen to the Australian and Indonesian economies in the absence of bilateral trade and investment liberalisation is summarised below and explained at length in the CIE report. Results from computer generated simulations are presented as deviations from the baseline with differences attributed to bilateral trade and investment liberalisation between Australia and Indonesia.

Economic models simplify reality, depend on data of variable quality and rely on numerous assumptions about economic parameters, behaviour and relationships. The model presumes that countries would react to liberalisation in more or less equal fashion, regardless their stages of economic and institutional development. The unfolding impact of the global financial crisis could change the simulation results only to the extent that the structure of the Indonesian and/or Australian economies change as a result. For this reason, modelling results should be used only to infer the outcome of trade and investment liberalisation (positive or negative) and the magnitude of such impacts (significant or modest).

4.2 The Model and Modelling Assumptions

The Model

CIE used the CIEG-Cubed global economic model to estimate the impacts of Australia and Indonesia entering into a bilateral FTA.

CIEG-Cubed is the most appropriate global economic model currently available with which to analyse the welfare implications of a trade and investment agreement. The advantages of using CIEG-Cubed include:

- identification of trade flows between countries/regions;
- identification of investment flows between countries/regions;
- incorporates an integrated financial sector (comprising money, bonds, interest rates, lending, borrowing, expectations, financial flows, and wealth);

- it is a fully dynamic model that can capture the time path of adjustment for each of the economies/regions modelled;
- consumers and producers are allowed to borrow and lend money over time, with decision influenced by the return on capital versus other assets;
- inclusion of adjustment costs and expectations; and
- identification of up to 57 sectors of production and 87 countries.

The GTAP6 database underlies the CIEG-Cubed model. However, GTAP6 pertains to year 2001. In order to make the modelling results as realistic as possible, trade flows with major trading partners, trade barriers and the structure of the Australian and Indonesian economies have been updated with the latest statistics (typically year 2006). To keep the modelling tractable, 57 sectors of production and 14 regions are identified.

Three trade and investment liberalisation scenarios were modelled. The principal modelling simulation assumes that bilateral trade and investment liberalisation will be comprehensive with all barriers, including tariff and non-tariff, removed immediately upon commencement of the agreement. For the purposes of modelling, entry into force is assumed on 1 January 2010. The other simulations also assume entry into force on 1 January 2010 but allow for staged removal of all barriers by 2015 and 2020 respectively. In all three simulations, impacts on real gross domestic product (GDP), welfare, exports, imports, investment, the current account and the exchange rate, as well as on employment and real wages, are reported on a year-by-year basis for both countries to 2030.

The Baseline

The first task in economic modelling of this sort is to establish a counterfactual (referred to as the baseline or ‘business-as-usual’ scenario): that is, what could be expected to occur in the absence of trade and investment liberalisation between Australia and Indonesia. The baseline needs to encompass forecasts about the future structure of the economy and other policy decisions such as scheduled tariff reductions resulting from previous commitments made elsewhere such as in the WTO and under AANZFTA.

In developing the baseline for the modelling, CIE assumed:

- the Australia and Indonesian economies meet IMF medium term forecasts for major macroeconomic indicators;
- Australia meets its unilateral tariff liberalisation commitments as already specified/announced;
- trade liberalisation proceeds as negotiated under the recently announced ASEAN-Australia-New Zealand FTA (AANZFTA);
- Australia meets its phased bilateral trade liberalisation commitments as negotiated in the 2005 commenced trade agreements with Thailand and the United States (as do Thailand and the US);
- as a large and important trading partner of both Australia and Indonesia, China’s unilateral merchandise trade liberalisation — a condition of its WTO accession — is incorporated into the baseline;

- the recently negotiated New Zealand–China FTA enters into force (as expected) in October 2008, with the negotiated timeline for tariff liberalisation being met;
- Indonesia has announced that it will undertake unilateral tariff liberalisation over the next 5 years. Unfortunately, the pace and scope of any such unilateral liberalisation has not as yet been announced and as such cannot be included in the baseline. As the respective tariff reduction paths to meet the APEC Bogor commitment of complete unilateral trade liberalisation by 2010 for developed country members and by 2020 for developing members are voluntary and unknown, any such potential liberalisation has been overlooked. No bilateral trade liberalisation results from other trade agreements currently being negotiated/under consideration by Australia and Indonesia have been included; and
- The model does not include Indonesia’s bilateral trade agreement with Japan (Economic Partnership Agreement), AFTA, or, as part of the wider ASEAN group, free trade agreements with China and South Korea.

Dynamic Productivity Gains

Regarding calculation of dynamic productivity gains, a number of additional assumptions are made. A dynamic productivity gain is assumed to arise from each of:

- increases in imports — productivity gain is a function of the percentage change in relative prices of imports and local production and the ability of firms to absorb a reduction in mark-ups (prices) in order to maintain output. This ‘ability’ is measured by the elasticity of domestic price mark-up with respect to foreign prices, which is assumed to be 0.21;
- increases in exports — exporters are assumed to be 8 per cent more efficient than domestically orientated firms, hence if the rate of change in output exported exceeds the rate of change in output sold domestically, productivity of the sector rises through an increase in the average level of technology; and
- increases in foreign direct investment — a 1 percentage point increase in FDI sees an increase in productivity, with the productivity gain varying depending on the level of FDI, ranging between a maximum gain of 1.7 per cent at an FDI to GDP ratio of zero, to a productivity gain of 0.01 per cent at an FDI to GDP ratio of 2.

Note that the reverse also occurs. For example, if the share of output exported declines for a particular sector, then that sector will experience a fall in productivity.

As explained by CIE making the dynamic productivity gain endogenous to CIEG-Cubed means there will be second round, third round, and further round effects. For example, tariff liberalisation by Australia would see an increase in Indonesian exports to Australia, which would confer a productivity improvement to Indonesia sectors. This in turn will improve the competitive position of exporters and see a further increase in Indonesia exports, delivering a further (smaller) export related productivity gain and so on.

Interpreting the Modelling Results

Some of the assumptions upon which the baseline is based may be debated given the 20 year timeframe for the study. Examples are the decision not to include trade and investment liberalisation arising from FTA negotiations currently underway and to exclude additional liberalisation that could plausibly occur in response to fulfilment of Bogor commitments. These exclusions are not based on an assessment that further liberalisation is unlikely but simply on the fact that the precise nature of future liberalising commitments is unknown at present. IMF medium term forecasts for major macroeconomic indicators are being revised downwards in response to the global economic crisis. This again could affect the baseline, particularly in the short term. But as in the case of trade negotiations currently underway, a deepening global recession is unlikely to have any structural impact on the Australian and Indonesian economies and therefore could not change the inferred outcomes – positive or negative – though it could affect the magnitude of impacts over the short term.

The results reported in Charts 4.1, 4.2 and 4.4 (and 4.6) need to be treated with caution. Estimated increases in GDP and real consumption attributed to removing bilateral tariff and non-tariff barriers to merchandise trade, removing bilateral barriers to services trade and investment, and exploiting resulting dynamic productivity gains are illustrative only. The story on tariffs and non-tariff barriers seems clear enough but the economic gains attributed to dynamic productivity effects could be higher or lower, and the estimated gains from liberalising services trade are potentially larger, particularly for Indonesia. Restrictions on services are significant (Chapter 3) and liberalising bilateral barriers across the four modes of supply should generate important gains both within key services sectors and across economies given the importance of efficient services delivery for national competitiveness. Estimated gains are low principally because of the difficulty of quantifying services barriers: eliminating a small sub-set of quantifiable restrictions mainly explains the modest modeling outcomes on services liberalisation.

4.3 Macroeconomic Impact for Australia and Indonesia

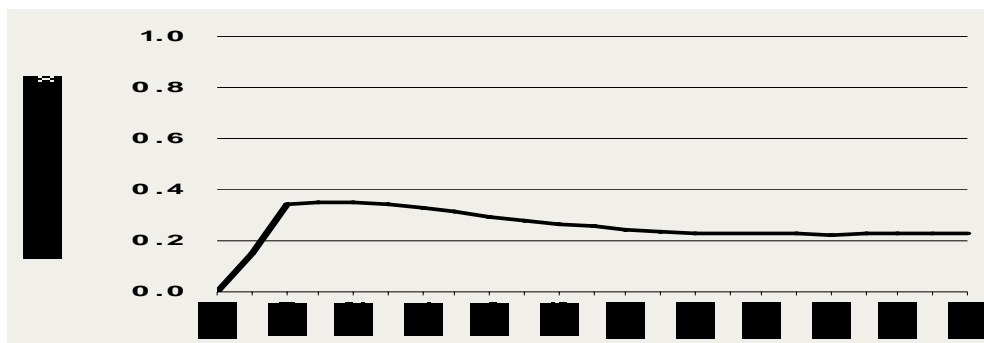
From the outset, the macroeconomic impact of a bilateral trade and investment agreement was expected to be moderated by the gains made under AANZFTA. Significant gains were, however, expected in market access, for example for Australia in agriculture, manufactures and services and Indonesia in products like passenger motor vehicles and parts and textiles, clothing and footwear. Gains also were expected more generally from improvements in economic efficiency linked to the creation of a larger market and from easing restrictions in services and investment. But the overall size of bilateral gains as a share of GDP was expected to be limited by gains to be made under AANZFTA, which sets out the basic regional-level framework for liberalising Indonesia-Australia trade and investment. Gains from a bilateral FTA were seen as depending on it having wider sectoral coverage and implementing faster rates of liberalisation than agreed in AANZFTA.

Assuming for illustrative purposes that all barriers to bilateral trade and investment are removed on entry into force of a bilateral FTA, in addition to those already agreed in AANZFTA, the modelling suggests that Australia's GDP would be 0.02 per cent

higher than under business-as-usual by 2030 - equivalent to \$A3.2 billion in real GDP in (2008) net present value terms – and Indonesia’s GDP would be 0.23 per cent higher by the same date - equivalent to A\$33.1 billion in real GDP in (2008) net present value terms (Chart 4.1). Over the period for which modelling was undertaken, the projected increase above baseline in real GDP is equivalent to A\$160 million per annum for Australia and A\$1.65 billion per annum for Indonesia.

According to the economic modelling, a bilateral FTA is likely to increase Indonesia’s GDP more than Australia’s: the approximate order of magnitude is depicted in Charts 4.1 and 4.2. Indonesia also stands to gain more in terms of real consumption, bilateral investment and employment. These outcomes were expected. Australia is a more important trading partner for Indonesia than the converse (Chapter 2) and so, plausibly, stands to gain more from the enlarged market. Indonesia has higher trade and investment restrictions than Australia (Chapter 3) and therefore stands to reap a productivity dividend by removing or reducing them, thereby complementing its domestic economic reform programme. Indonesia also stands to benefit from increased investment flows from Australia: FTAs between developed and developing country trading partners tend to result in larger direct investment in the developing country partner.¹⁵

Chart 4.1¹⁶
Estimated Impact of Liberalisation on Indonesia’s Real GDP



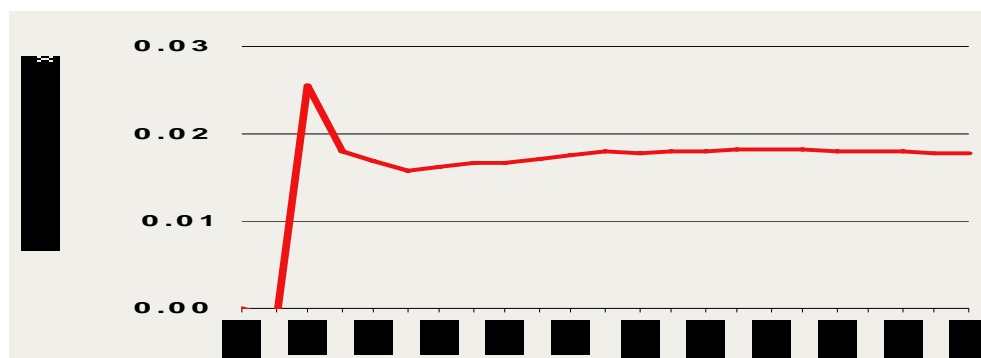
Data source: CIEG-Cubed modelling simulation.

Chart 4.2

¹⁵ ‘Estimating the impact of an Australia-Indonesia trade and investment agreement’, *Centre for International Economics*, p. 38.

¹⁶ The scale of the y-axis on the two Charts (4.1 and 4.2) is different. This has been done to assist readers in interpreting the projected impact on real GDP arising from bilateral trade and investment liberalisation.

Estimated Impact of Liberalisation on Australia's Real GDP



Data source: CIEG-Cubed modelling simulation.

These estimates are broadly in line with the expectations of the Australian and Indonesian Governments. The ‘front loading’ of benefits also was expected. A key feature of Charts 4.1 and 4.2 is that economic gains above business-as-usual are likely to peak in the years immediately following entry into force and even prior to this as businesses respond to new opportunities created by a bilateral FTA. Real GDP gains then plateau but remain above baseline through to 2030. This pattern reflects the so called ‘head-turning effect’ of FTAs in their early years and is underpinned by increases in trade and investment following the removal of restrictions (see section 4.3).

Whether businesses in the non-modelling world would respond as positively to a bilateral FTA in the short term, as suggested in Charts 4.1 and 4.2, and whether gains to real GDP would be as strong (particularly for Indonesia) amid mounting real-world concerns about recession, are open to debate. Projected trade and investment increases could plausibly be delayed and the magnitude of impacts on GDP might differ in the non-modelling world. But what the model indicates is that an ambitious FTA will impact positively on both economies in the short and long terms, cushioning to some extent the impact of international economic shocks on bilateral trade and investment flows and boosting those flows during periods of economic buoyancy.

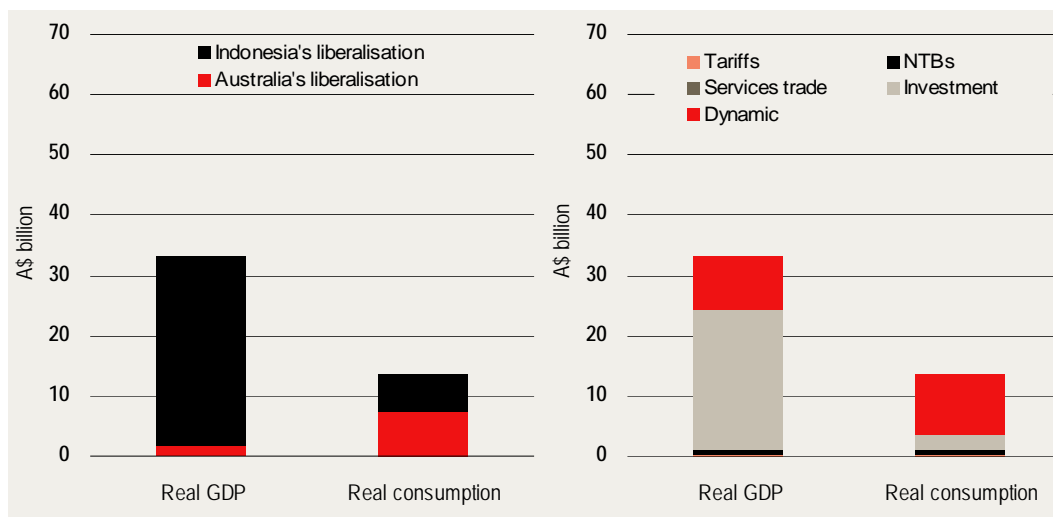
The modeling results add value by providing insights into the relative importance of the sources of FTA-related economic benefits. A particular feature of the analysis is the emphasis on dynamic productivity gains. This refers to productivity linkages, pro-competitive effects and investment dynamics associated with trade and investment liberalisation (CIE Report pp. 30-31). Many economic models arguably under-estimate this relationship. In this study, the modeling terms of reference specifically included analysing dynamic productivity gains because of their relevance not only to explaining changes in bilateral trade flows but also changes in trade with the rest of the world arising from increasing economy-wide economic efficiency and evolving competitive strength.

4.3.1 Drivers of Indonesia's economic gains

Chart 4.3 shows projected gains for Indonesia from removing all restrictions on bilateral trade and investment on entry into force of an FTA. The left hand panel identifies gains in Indonesia's real GDP and consumption over the period 2010-30, expressed in 2008 dollars. The right hand panel estimates gains specifically attributed

to removing tariffs, non-tariff barriers and restrictions on services trade and investment, and gains attributable to dynamic productivity. The gain could be over estimated because the results do not take into account potential gains from Indonesia's other FTAs.

Chart 4.3
Sources of Indonesia's Gains NPV 2008^a



^a Over 2010 to 2030, expressed in 2008 dollar terms using a 5 per cent real discount rate.
Data source: CIEG-Cubed modelling simulation.

Indonesia's economic gains arise primarily from its own liberalisation, accounting for 95 per cent of increases in real GDP above business-as-usual and for 46 per cent of consumption gains. Investment liberalisation accounts for around 20 per cent of gains in real consumption and is in line with expectations that a proportion of returns on additional investment capital will flow back to the source country (Australia). Investment liberalisation also is estimated to underpin almost 70 per cent of Indonesia's real GDP gains. Significant increases in Australian direct investment in Indonesia is projected by the modelling to follow in the wake of removing bilateral investment restrictions and Australian direct investment is projected to remain significantly above business-as-usual levels through the period to 2030.

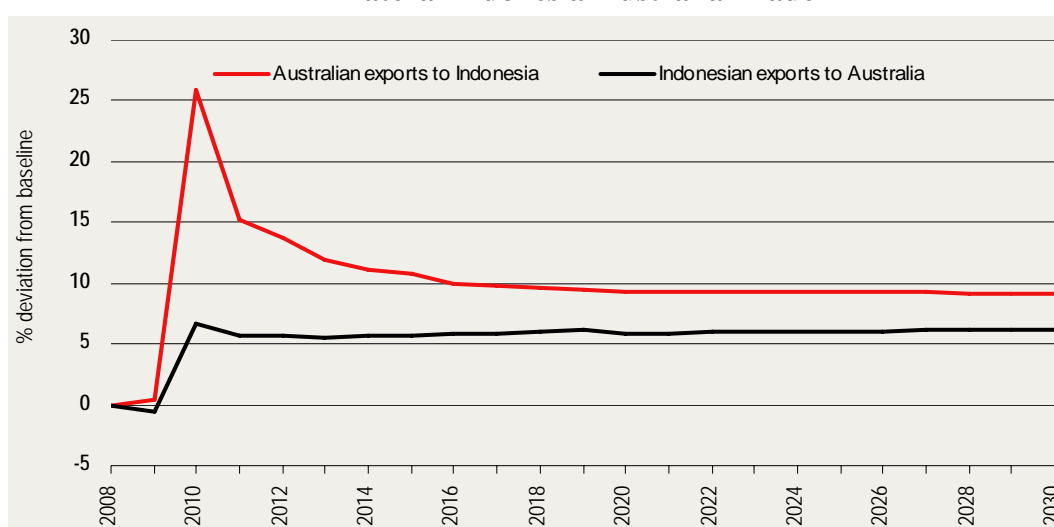
The projected impact of investment liberalisation on real GDP is consistent with the view that the Indonesia-Australia investment relationship is currently underperforming relative to the size of our two economies. Australia's direct investment in Indonesia is only one-third of Singapore's and around one-half of Australia's direct investment in Papua New Guinea. The projection also is consistent with the view that a comprehensive bilateral FTA could provide a framework for transforming Australian direct investment in Indonesia by not only removing barriers, increasing transparency and enhancing investment protection and therefore investor confidence, but also through increasing awareness of opportunities in the other market.

Dynamic productivity - the cumulative effects of productivity improvements across the economy arising from increasing imports and exports and foreign investment - is estimated to account for 27 per cent of the real GDP gain and for over 70 per cent of the consumption gain (real welfare gain). Additional investment flows should increase

Indonesia's capital stock and lead to small increases in labour productivity. This in turn could plausibly boost real wages above business-as-usual projections and increase household consumption.

Chart 4.3 suggests that Indonesian exports will benefit only to a small extent from the removal Australian tariffs and non-tariff barriers. This is in line with expectations because of Australia's low trade barriers, but two points need emphasising. First, some Indonesian exports to Australia will become more competitive as companies exploit additional opportunities to those created by AANZFTA. Possible orders of magnitude are suggested in Chart 4.4. Second, and arguably more important, liberalisation-induced dynamic productivity gains should improve Indonesia's competitive position in all international markets and not just in the markets of the bilateral trading partner.

Chart 4.4
Bilateral Indonesia-Australia Trade



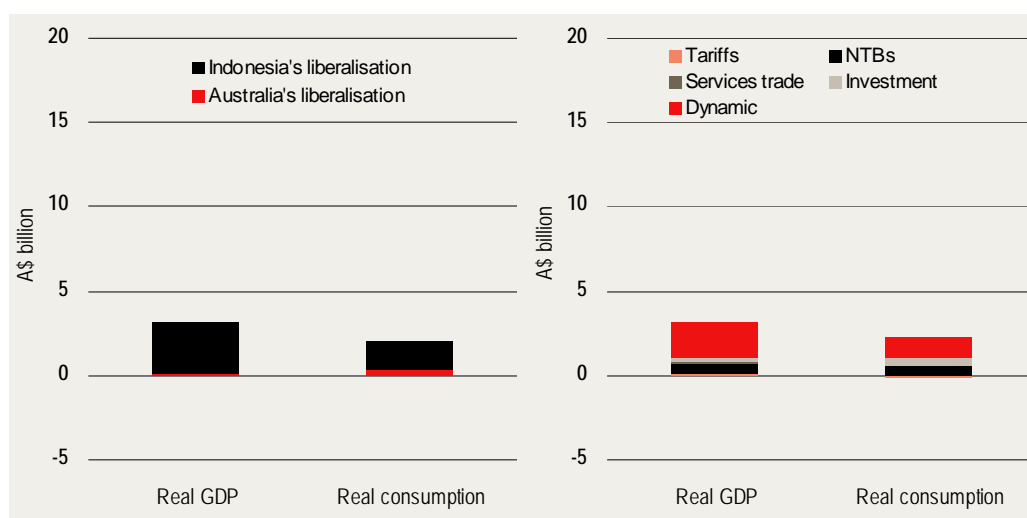
Data source: CIEG-Cubed modelling simulation.

4.3.2 Drivers of Australia's economic gains

Chart 4.5 illustrates projected gains for Australia from removing all restrictions on bilateral trade and investment on entry into force of a bilateral FTA. The left hand panel reveals that improved access to the Indonesian market accounts for almost all projected GDP and consumption gains for Australia in the period to 2030 and is manifestly more important than economic gains attributable to opening up the Australian economy to greater trade and investment flows from Indonesia. These results are consistent with expectations and particularly reflect that fact that Indonesia's barriers to trade and investment are relatively high compared to Australia's.

The right hand panel of Chart 4.5 shows that approximately two-thirds of Australian GDP gains over the period 2010-30 are attributable to dynamic productivity effects. This observation, combined with the previous observation that Indonesia's liberalisation presents significant benefits to Australia, strongly suggests that Australia's dynamic productivity gains are export based, and result from applying experience and knowledge gained by Australian exporters into economy-wide productivity improvements.

Chart 4.5
Sources of Australia's Gains NPV 2008^a



^a Over 2010 to 2030, expressed in 2008 dollar terms using a 5 per cent real discount rate..
Data source: CIEG-Cubed modelling simulation.

Of the total projected real GDP gains for Australia arising from trade and investment liberalisation, 4 per cent is accounted for by the removal of Australian and Indonesian tariff barriers, while 19 per cent of the projected gain arises from the removal of Indonesia's non-tariff barriers shown in Chart 4.5. Following the initial surge, Australian exports are estimated to increase by 9 per cent above baseline in each year to 2030. The potential for rapid export growth and the significance of the removal of non-tariff barriers in accounting for Australia's projected real GDP gains strongly suggests placing a high priority on eliminating both Australia's and Indonesia's non-tariff barriers in possible bilateral FTA negotiations.

4.4 Sectoral Economic Impact for Australia

The modelling demonstrates that over 80 per cent of the 57 sectors of the Australian economy identified in the economic modelling are projected to increase output above baseline levels as a result of Australia and Indonesia entering into a bilateral FTA.¹⁷ Of those sectors of the Australian economy projected to benefit, a little over half are involved in manufacturing, while approximately 25 per cent are in the primary and services sectors. The distribution of gains reflects high Indonesian tariff levels, particularly in manufacturing. Of those sectors expected to benefit, increases in output are primarily driven by export growth.

Agriculture

Key agriculture sectors such as dairy, sugar, cattle, and fruit and vegetables are projected to experience increases in output, employment, investment, and exports and imports, reflecting Australia's comparative advantage vis-à-vis Indonesia in those

¹⁷ 'Estimating the impact of an Australia-Indonesia trade and investment agreement', *Centre for International Economics*, p. 62-66.

products. Sugar and dairy are projected to experience, relative to the base, the largest gains in output, employment and investment (CIE Report, p 63).

Manufacturing

All the 15 manufacturing sectors examined in the CIE modelling are projected to experience increases in output by 2020 above business-as-usual, ranging from 0.01 per cent (wearing apparel) to 0.24 per cent (ferrous metals). All the increases are modest at less than half of one percentage point. Further, each of these manufacturing sectors is projected to experience increases in investment and exports beyond business-as-usual, with the largest increases in exports - approximately 2 per cent above business-as-usual by 2020 – occurring in metal products and ferrous metals.

Metals output, the single largest component of Australia's manufacturing exports to Indonesia, is forecast to increase by 0.09 per cent above baseline by 2020 following trade and investment liberalisation, with gains split evenly among the three product types making up the sector. Increases in output are projected to stimulate above baseline growth in employment, investment, exports, and imports. Ferrous metal producers are forecast to experience the greatest gains, with output projected to rise by 0.24 per cent above baseline with correspondingly large gains in employment exports by 2020.

The other area of manufacturing set to experience across-the-board increases in output, employment, investment, as well as exports and imports, is chemicals, including petroleum, coal products and chemicals and rubber and plastics. Projections suggest that economic gains arising from the removal of barriers to bilateral trade and investment will be split fairly evenly across the three sub-sectors.

Services

As explained in the CIE report, barriers to services trade delivered via a commercial presence abroad are typically barriers to FDI. For this reason, the effect of trade and investment liberalisation on this 'mode' of services trade is not accounted for in the modelling results on services (instead they are accounted for in the modelling of investment impacts). Thus, the CIE modelling on services considers barriers to services delivered via cross border supply and movement of natural persons.

The impact of a reduction in barriers to services trade between Australia and Indonesia will depend on the level of existing restrictions and the potential for market penetration by foreign firms. Tariff equivalents of barriers to services trade delivered via cross-border supply or movement of natural persons has been estimated by CIE, drawing on research undertaken by the Australian Productivity Commission. Accordingly, Indonesian barriers to services trade - delivered via cross-border supply and the movement of natural persons – are estimated by CIE at 8.7 per cent for Maritime transport, 32.8 per cent for communications and 3.5 per cent for Other Business Services.

The removal of these barriers to trade is projected to result in an increase in output for other non-public services (including other business services: includes professional services such as accountancy, architecture, engineering and legal services) equal to

0.01 per cent above baseline by 2020, while investment is forecast to increase to 0.02 per cent above baseline. By contrast, exports of other non-public services are projected to decline by 0.08 per cent by 2020. The result reflects the removal of barriers to FDI, which leads to an increase in the number of Australian firms establishing a commercial presence in Indonesia, rather than exporting their services via cross border supply as currently occurs.

While Indonesian barriers to services trade in the area of communications are high (32.8 per cent), economic modelling suggests that the removal of these barriers will not have a significant impact on the communications sector. Total output is forecast to grow by just 0.02 per cent above baseline, while investment and employment are forecast to increase by 0.03 and 0.01 per cent above baseline respectively by 2020. Exports of communications services are however forecast to increase by 1.45 per cent above baseline by 2020. The results reflect the size of the Australian communications sector relative to that of Indonesia.

4.5 Sectoral Economic Impact for Indonesia

Of the 57 sectors of the Indonesian economy to have been included in CIE's modelling exercise, 86 per cent are projected to experience an increase in output following removal of barriers to trade and investment with Australia. Of the 49 sectors expected to experience increases in output above baseline by 2020, 22 per cent are primary sectors, 47 per cent are secondary and 30 per cent are service sectors. By 2010, 96 per cent of all Australian tariff lines will be duty free, with that figure increasing to 96.5 per cent by 2013 and full elimination by 2020. Based on 2005 import data, some 99 per cent of Indonesian imports into Australia will face zero tariffs by 2010, rising to 100% in 2015. Most of the growth, however, will probably depend on increased access to investment and services liberalisation.

Agriculture

Sixteen of Indonesia's 21 agriculture sectors (at the 57 sector level) are projected to experience an increase in output above baseline and all but two see an increase in investment above baseline. The rice, vegetables and fruit, and other animal products sectors are projected to experience an increase above baseline in investment and output above baseline and a slight fall in exports (relative to the baseline) under the bilateral trade and investment agreement. As was the case for Australian sectors of the same class, the expanding Indonesian economy sees product being diverted from the export market to the local market to meet increasing domestic demand resulting from projected real GDP and welfare gains.

By contrast, Indonesia's sugar sector (sugar and sugar cane and sugar beet) is projected to experience a decline in output relative to the baseline but significantly higher exports as product is switched from the local to the export market in line with significant improvements in international competitiveness. A similar sequence of events is projected for the cattle sector.

Manufacturing

Indonesia's manufacturing sector is projected to experience the greatest gains from trade and investment liberalisation owing to high Australian tariffs on manufactures relative to other economic sectors. At the 26 sector level of aggregation, all eight of the sub-sectors that make up manufacturing are projected to experience an increase in output, while six of the eight experience increases above baseline for all indicators. The two exceptions are food and beverages and textiles and clothing, wherein labour demand falls below baseline by 2020, reflecting dynamic productivity gains and capital for labour substitution. Sectors experiencing increases in all the economic indicators include: chemicals, metal, transportation, electrical products, machinery and other manufacturing products.

The chemical sector, comprising petroleum and coal products, chemicals, rubber and plastic products, is also projected to increase output, employment, investment and exports and imports following trade and investment liberalisation with Australia. This result is expected given Indonesia's comparative advantage in chemicals relative to Australia and more broadly its competitiveness on world markets in chemical manufactures. The benefits accruing to the chemicals sector post liberalisation are shared evenly among the sub-sectors.

Textiles and clothing are forecast to experience an increase in output above baseline by 2020 of 0.26 per cent, while investment is projected to rise by 1.03 per cent above baseline by the same date. The gains are shared roughly evenly by the two sub-sectors that make up the sector, including textiles and wearing apparel. These gains are consistent with Indonesia's relative comparative advantage over Australia in textiles and clothing. Exports are also projected to increase significantly by 2020 for both textiles and wearing apparel, with gains of 0.52 and 0.41 per cent above baseline respectively. The larger increase in exports versus output suggests that gains are driven in part by export led growth, as producers benefit from the removal of relatively high Australian tariffs on textiles (9.3 per cent) and wearing apparel (13.8 per cent).

Minerals and Energy

Indonesia's minerals and energy sector experiences an increase in all indicators, including output (0.33 per cent), investment (0.91 per cent), and exports (0.33 per cent) and imports (0.04 per cent), but a fall in employment (0.24 per cent). Of the five sectors that make up minerals and fuels (coal, gas, oil, minerals nec and mineral products nec), only coal output is forecast to decline below baseline by 2020. However, employment declines below baseline by 2020 for both coal (-0.69 per cent) and minerals nec (-0.05 per cent). All five of the sub sectors are expected to see an increase in investment, with the largest investment gains in the coal sector at 1.37 per cent above baseline by 2020.

Services

Indonesia's services sector exports to Australia were valued at A\$713 million in 2007. The largest single category of service exports is recreational travel, which was valued at A\$438 million in 2007. Given that there are no barriers to this type of services trade (consumption abroad), trade and investment liberalisation will have little or no direct

impact in this area. Therefore, the types of services trade impacted by Australian liberalisation are via cross-border supply (mode 1) and commercial presence (mode 3) and to a lesser extent movement of natural persons.

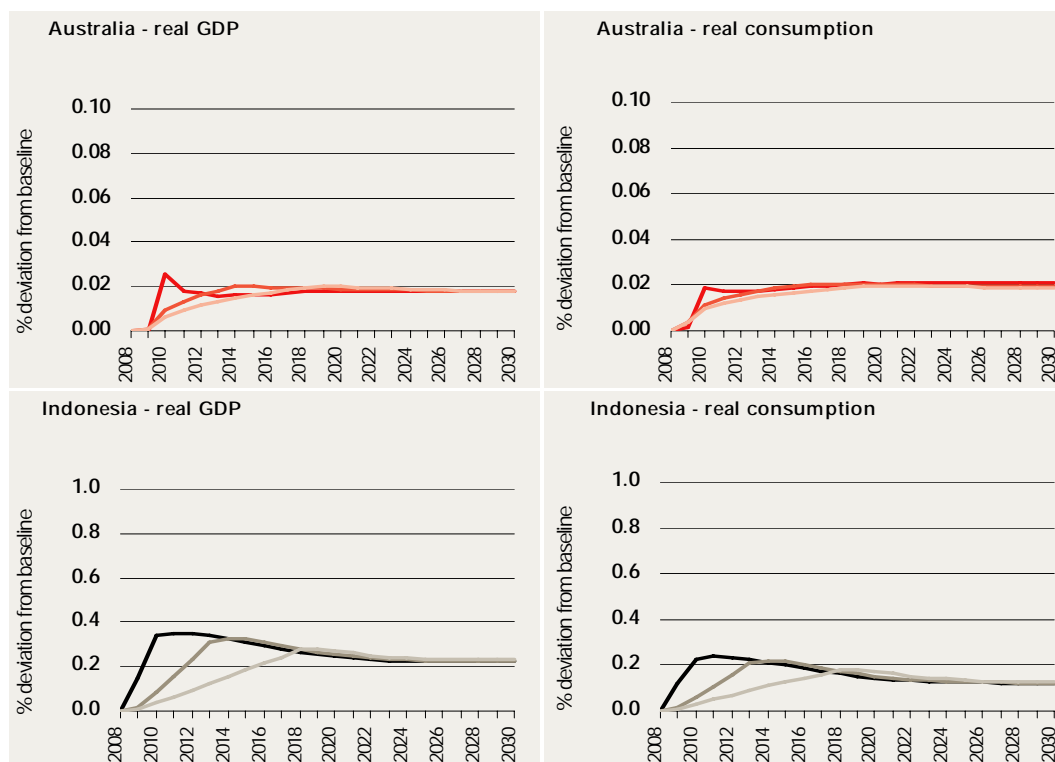
As was the case with Australia, the impact of the removal of non-tariff measures on services trade will depend on the level of existing restrictions and the potential for market penetration by foreign firms. Australia's tariff equivalents on Indonesian service exports via cross border supply and movement of natural persons are estimated by CIE at 5.2 per cent for maritime transport, zero on communications and 2.1 per cent on other business services. Given these small barriers, changes arising from trade and investment liberalisation are likely to be minimal.

Each of the sub-sectors that make up services trade are projected to experience increases in output, employment and investment, with all bar one, public services, also seeing an increase in exports. However, none of the gains are large, being limited to approximately one-quarter of one percentage point.

4.6 The Pace of liberalisation

Real GDP and consumption gains from a bilateral FTA will be reduced for both countries if bilateral trade and investment liberalisation is delayed (or is in some way narrowed in scope). Chart 4.6 shows three different GDP and consumption outcomes for Indonesia and Australia under immediate and comprehensive liberalisation (2010), phased elimination of all restrictions over 5-years (2010-2015) and phased elimination over 10-years (2010-2020).

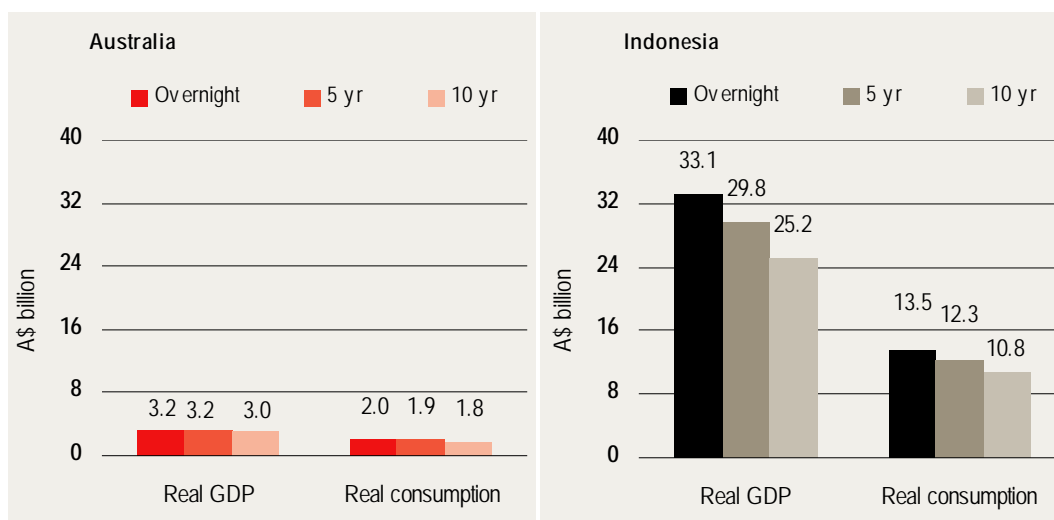
Chart 4.6
Main Economic Impacts under Different Phase-in Scenarios



Data source: CIEG-Cubed modelling simulation.

The Chart demonstrates the obvious point that comprehensive liberalisation on entry into force of an FTA maximises economic gains for Australia and Indonesia, but suggests that all three liberalisation scenarios converge over the long term to eventually deliver approximately the same increase above baseline in real GDP and consumption gains. Real GDP and consumption gains if not realised at the time are permanently foregone, however. The difference in the modeling scenarios occurs in the first 5-10 years after entry into force. A slower pace of liberalisation serves only to delay the benefits of an FTA and would penalise Indonesia in particular through forgone foreign direct investment and resulting dynamic productivity gains.

Chart 4.6
Present Value of Economic Impacts under Different Phase-in Scenarios NPV^a



^a Over 2010 to 2030, expressed in 2008 dollar terms using a 5 per cent real discount rate.

Data source: CIEG-Cubed modelling simulation.

Chart 4.6 shows real GDP and consumption gains over the period 2010-30 resulting from bilateral liberalisation. The different outcomes for the three scenarios are quite small for Australia but much larger for Indonesia. Indonesia would forgo GDP gains of around A\$3.3 billion by choosing 5-year staging compared with elimination of restrictions on entry into force, while 10-year staging would result in forgone GDP gains of A\$7.9 billion. The modeling shows therefore that Australia and Indonesia should put a premium on ambitious timely liberalisation for both countries, especially for Indonesia.

Chapter 5. Other Areas for Possible Inclusion in a Bilateral FTA

This Chapter examines the many and varied ways in which Australia and Indonesia currently cooperate to further and deepen their trade, investment and economic ties. It also outlines areas where a bilateral FTA could serve as the basis for further or expanded cooperation, including in relation to customs procedures; conformity assessment procedures relating to standards and technical regulation; electronic commerce; competition policy; intellectual property; government procurement; and economic cooperation.

The Chapter is not intended to provide an exhaustive list of the other areas that might be addressed in a bilateral FTA, but to suggest some of the key areas that could be discussed in any FTA negotiations.

5.1 Customs Procedures

As a key link in the international circulation of commodities, customs procedures play an important role in facilitating trade. Consequently, harmonising and streamlining customs procedures have been priorities for international economic cooperation, including in the WTO and APEC. Australia and Indonesia work closely together as members of the World Customs Organisation and the APEC Sub-committee on Customs Procedures. The two countries are signatories to the WTO (Customs) Valuation Agreement and the International Convention on the Harmonized Commodity Description and Coding System.

The additional costs arising from paperwork and procedures broadly defined have been estimated in some studies to be as high as 10 per cent of the value of goods traded, of which those arising from customs requirements form a part.¹⁸ Consultations and submissions for this study indicate customs requirements would be important issues to consider in any FTA between Australia and Indonesia.

5.1.1. Australia's Customs Framework

The Australian Customs and Border Protection Service (Australian Customs) is responsible for providing effective border protection for the Australian community.

The main roles of Australian Customs are to facilitate trade and the movement of people across the Australian border while protecting the community and maintaining compliance with Australian law; and to apply trade measures, collect border-related duties and taxes and trade statistics.

Australia is a signatory to the World Customs Organization Revised International Convention on the Simplification and Harmonization of Customs Procedures (Revised Kyoto Convention), which reflects the international trading environment and modern administrative practices of customs administrations.

¹⁸ See P. Dee, C. Geisler and G. Watts, *The Impact of APEC's Free Trade Commitment*, Industry Commission, Staff Information Paper, AusInfo, February 1996, especially pp.10-14, 21-23. Much lower estimates were adopted in *The Impact of Trade Liberalization in APEC: Report by the Economic Committee*, APEC, November 1997, pp.18-19.

5.1.2 Indonesia's Customs Framework

The Directorate General of Customs and Excise (DGCE) is responsible for administering Indonesia's customs procedures and regulations and the collection of excise duties. Like its Australian counterpart, the DGCE seeks to facilitate legitimate trade and travel, while also detecting and deterring unlawful movement of goods and people across Indonesia's borders.

Indonesia is a member of the World Customs Organization, and is a signatory to the 1999 Revised Convention on the Simplification and Harmonization of Customs Procedures (Kyoto Convention). As a signatory to the ASEAN Economic Community Blueprint (2015) aimed at harmonising customs procedures among member states, Indonesia created a National Single Window (NSW) in 2007 as part of the creation of an ASEAN Single Window.

In addition, and as part of ongoing efforts to reform the investment climate, the Indonesian Government issued a package of policies in early 2006 that include provisions designed to improve customs procedures.¹⁹ The Government undertook to (a) accelerate the flow of goods by speeding up the customs examination process, facilitating cargo processing, and implementing lower costs at Indonesian ports; shorten cargo processing for capital goods to seven days from the current average of 30 days; (b) expand the role of bonded zones by extending the function of bonded warehouses and automating certain of their functions²⁰; c) aim to eradicate smuggling and customs fraud²¹; and (d) accelerate the registration and application process for excise facilities.

5.1.3 Bilateral Cooperation and Capacity Building

The Australian and Indonesian Customs services have forged a strong and cooperative working relationship, including established mechanisms for sharing information and capacity building. The two countries cooperate in areas such as border security, trade facilitation, counter-terrorism, and technology transfer as well as working closely to prevent violation of customs procedures and to combat illegal foreign fishing.

At the 9th annual meeting of the Australian and Indonesian Customs Services in 2007, a Memorandum of Understanding on Cooperation and Mutual Administrative Assistance in Customs Matters was signed. The MOU is to form the basis for technical cooperation for customs administration. Specific cooperation and capacity building programs include:

- Special Travel Security Fund (STSF), which seeks to improve the DGCE's capacity to monitor sea port customs activities considered to be high risk. The

¹⁹ Presidential Instruction No. 3/2006: Policy Package to Improve the Investment Climate.

²⁰ Bonded warehouses provide businesses with the opportunity to defer payment of import duties, while allowing them to store, exhibit, sell, pack, re-pack and/or process goods originating from outside Indonesia.

²¹ According to the Directorate General of Customs and Excise, there were 220 cases of customs fraud between 2004 and April 2005 causing financial losses of Rp 130.4 billion. Customs & Excise can be viewed online at <http://www.beacukai.go.id>, 23 November 2006.

STSF also provides funds for training for Indonesian officials designed to improve customs intelligence gathering and ship search techniques, including the use of specialised equipment such as CCTV-monitors;

- The Government Partnership Fund, a multi-year initiative under the aegis of the Australia Indonesia Partnership for Reconstruction and Development, wherein officers from the DGCE undertake internships at Australian Customs;
- Indonesian Customs' officials also participate in the annual Customs International Executive Management Program hosted by Australian Customs; and.
- Establishment of Indonesian Customs Facility in Darwin as part of the Australia-Indonesia Development Area (AIDA), which seeks to facilitate trade and improve economic cooperation between Australia and the eastern regions of Indonesia. Under the terms of the agreement, DGCE officers are able to inspect Australian export goods bound for areas outside of Java and Sumatra at the Darwin port. The Facility saves Australian businesses time and money by providing a pre-classification service - verifying shipping documents and inspecting cargo - before the goods leave Australian shores. Generally, all shipments channelled through the pre-inspection process in Darwin are Green Lined (fast-tracked) upon arrival at the destination port in Eastern Indonesia. The actual customs clearance occurs at the final port of discharge in Eastern Indonesia.

The basis for bilateral cooperation on customs-related issues will be further strengthened by AANZFTA, which includes a chapter on Customs Procedures. This chapter sets out a framework for expeditious, predictable, transparent and simplified customs administration aimed at facilitating trade among the parties to AANZFTA.

5.1.4 Opportunities for Further Progress under a Bilateral FTA

Cooperation and exchange of information between customs administrators provides greater transparency, improves understanding of processes and procedures and assists customs administrators operationally in undertaking enforcement responsibilities. Both the DGCE and the ACS are party to a range of international agreements intended to facilitate cooperation and enhance operational capacity in the area of customs administration. Bilateral cooperation under a bilateral FTA should therefore seek to build on these existing commitments.

Additional cooperation between the Australian and Indonesian customs administrations would help to expedite trade between Australia and Indonesia. Areas that could be discussed in a bilateral FTA might include:

- a commitment to cooperate to improve the efficiency of customs processes;
- a commitment to exchange information on technical customs matters such as domestic customs legislation and procedures, relevant technologies and examination methods;
- a commitment on administrative appeal processes for customs' decisions to enhance the effective implementation of rules and procedures in a transparent and timely fashion;

- cooperation on implementing paperless trading initiatives to expedite the lodgement and clearance of documentation; and
- improved channels for information exchange on intelligence issues, including more timely provision of information for the prevention, investigation and combating of customs offences.

5.2 Standards, Technical Regulations and Conformity Assessment Procedures

International cooperation on standards, technical regulations and conformity assessment procedures has been developing steadily as their important role in international trade has been recognised and standards, technical regulations and conformity assessment procedures themselves have proliferated under the impact of new concerns about issues like health and the environment.

The WTO Agreement on Technical Barriers to Trade (TBT Agreement) provides a broad framework governing the preparation and application of technical regulations, standards and conformity assessment by governments, including in relation to both voluntary and mandatory technical regulations. Further, Indonesia and Australia are actively involved in the development of international standards through bodies such as the International Organisation for Standardization, the International Electro-Technical Commission and the International Telecommunications Union.

5.2.1 Australia's Approach

Several government and non-government bodies provide Australia's measurement, standards and conformance infrastructure. Standards Australia, the peak non-government standards writing body, is responsible for the formulation and publication of the majority of voluntary standards in Australia. Standards Australia is a signatory to the Code of Good Practice for the Preparation, Adoption and Application of Standards, which is an Annex to the TBT Agreement. In addition, there are at least 16 private sector bodies that prepare industry standards, codes and guides. The National Measurement Institute is responsible for establishing and maintaining Australia's units and standards of measurement and for coordinating Australia's national measurement system. Department of Foreign Affairs and Trade (DFAT) manage Australia's Enquiry Point under the TBT Agreement.

In the area of technical regulations, the Council of Australian Governments operates in accordance with a binding guide that ensures regulations are compatible with relevant international standards and consistent with international obligations.

A number of government agencies develop and enforce industry-specific standards and technical regulations, for example, the Therapeutic Goods Administration, Food Standards Australia and New Zealand, the Australian Quarantine and Inspection Service and the Department of Infrastructure, Transport, Regional Development and Local Government.

With regard to conformity assessment, the Joint Accreditation System of Australia and New Zealand provides accreditation of certification bodies, inspection bodies, and

auditor training course providers. The National Association of Testing Authorities accredits the competence of calibration and testing laboratories and inspection bodies.

5.2.2. Indonesia's Approach

Two bodies are responsible for formulating and implementing standards and technical regulations in Indonesia, the National Standardization Agency of Indonesia (Badan Standardisasi Nasional - BSN) and the National Accreditation Body (Komite Akreditasi Nasional - KAN). BSN is responsible for the development and implementation of National Standards in Indonesia (Standar Nasional Indonesia - SNI) and conformity assessment. Standards are formulated in harmony with international, regional or foreign national standards by means of adopting or adapting relevant standards. Generally, compliance with SNI is voluntary; however, those standards relating to safety, security, health, environment conservation and/or for economic considerations may also be mandatory.

BSN also conducts the operational activities of the Indonesian Enquiry Point and Notification Body dealing with matters relating to technical barriers to trade. The principal responsibilities of the Enquiry Point and Notification Body include: responding to technical enquiries on domestic regulations from other WTO Members, standards and conformity assessment procedures, and fulfilling notification obligations under the TBT Agreement.

KAN is responsible for implementing standards using the BSN accreditation and certification system. Accreditation is conducted by Certification and is provided by domestic organisations or laboratories accredited by KAN, or overseas organizations or laboratories that have mutual recognition agreements with KAN. In the case of product certification, domestic or overseas producers who consistently produce goods that conform to SNI specifications can be granted a certificate to use the SNI mark.

5.2.3 Opportunities for Increased Cooperation

A bilateral FTA could build on existing cooperation between Australia and Indonesia in relation to both international and regional arrangements, such as the APEC Sub-Committee on Standards and Conformance, of which both Indonesia and Australia are members. AANZFTA includes a chapter on Standards, Technical Regulations and Conformity Assessment Procedures which also provides for the establishment of arrangements for enhanced information exchange, cooperation and consultation among its Parties. The chapter identifies a range of possible vehicles for giving effect to enhanced cooperation. It will be important that consideration of the role of a bilateral FTA in this area take full account of the AANZFTA framework.

Cooperation on technical regulations, standards and conformity assessment procedures would complement commitments relating to liberalisation of trade in goods between Australia and Indonesia and would also facilitate trade by committing the two countries to arrangements that are transparent and promote certainty.

Additional cooperation on information exchange relating to each country's standards and technical regulations between Australia and Indonesia could provide a framework for enhancing bilateral trade through:

- improving access to information on technical regulations, standards and conformity assessment procedures;
- providing a mechanism for addressing issues on standards certification, including labelling, and technical regulations which could supplement the mechanisms already established under the TBT Agreement under AANZFTA;
- building on existing cooperation between standards, accreditation and conformity assessment organisations for the purpose of facilitating recognition and acceptance of the results of conformity assessment; and
- encouraging the reduction of transaction costs between Australia and Indonesia.

5.3 Electronic Commerce

E-commerce refers to trade in goods and services for which electronic communication is central to the transaction or delivery process. It may cover the entire transaction or only a part of the transaction. For example, the text of a book may be requested online and delivered electronically. Alternatively, a book may be bought online and a physical good delivered. In the latter case, the ordering process would be e-commerce. FTAs can encourage the use of e-commerce through the development of compatible regulation and improved consumer and business confidence, regardless of what is being traded.

5.3.1 Australia's Approach to E-Commerce

The Australian Government has seen the growth of e-commerce, and the transformational effects of information and communications technology (ICT), as primarily driven by the private sector, but with clear beneficial effects for the economy and citizens generally. In establishing regulatory settings, the Government has focused on the removal of unnecessary barriers to e-commerce, while regulating specific aspects, such as content, on their merits as required by the public interest.

The *Electronic Transactions Act 1999*, complemented by similar legislation in the States and Territories, removes legal obstacles to the use of electronic communications. The Act is based on the key principles of technological neutrality (the legislation does not prefer one form of technology over any other) and functional equivalence (paper documents and electronic transactions should be treated equally by the law²²).

The Act creates a “light touch/facilitative” regulatory regime for using electronic communications in transactions. It facilitates electronic commerce in Australia by removing existing legal impediments that may prevent a person using electronic communications to satisfy legal obligations under Australian Commonwealth law. The Act gives business and the community the option of using electronic communications when dealing with government agencies, provided specific requirements are met.

The Act provides that any other laws that deal specifically with the use of electronic communications to satisfy writing, signature, production or retention requirements will

²² The E-Commerce sections of Australia's FTAs are based on the UNCITRAL Model Law for E-Commerce.

be preserved. It is not the intention of the Act to override any existing or future laws that deal specifically with these matters. Also, where the requirements of a Commonwealth law cannot be satisfied by electronic communications but must be in more traditional paper formats, exemptions can be made.

5.3.2 Indonesia's Approach to E-Commerce

At present the use of e-commerce in Indonesia is limited. In the future, however, e-commerce transactions are expected to grow significantly in line with increasing real incomes and growing demand from business. For example, compared with Singapore or Malaysia, e-commerce activity in Indonesia remains limited, including in service sectors such as banking and telecommunications.

While demand for e-commerce has traditionally been limited by low levels of internet usage, e-commerce usage has also been hampered by the absence of a legal basis for e-commerce transactions in Indonesia. However, recent developments could pave the way for expanded use of e-commerce by Indonesian businesses. Indonesia's Information and Electronic Transaction Law has now come into force. The law is intended to provide justice and legal certainty for both information technology users and providers. The law also details a range of e-commerce related provisions, including consumer protection, privacy and data protection.

5.3.3 Opportunities for Increased Cooperation

E-commerce draws on the potential of electronic systems to deliver information on a larger scale, at a lower cost and more quickly than manual systems. However, a number of conditions must be fulfilled for this potential to be realised. For example, systems to receive information are required, the identity and intentions of the sender of the information must be trustworthy, and nuisance, malicious and fraudulent uses of the systems need to be minimised.

Both Australia and Indonesia acknowledge the importance of implementing consistent e-commerce policy frameworks across the Asia-Pacific region, as is demonstrated by the commitments they undertook in AANZFTA. A bilateral FTA could help to further facilitate the effective and efficient operation of e-commerce platforms through cooperation in a number of areas:

- *Trade Administration Documents and Customs.* An FTA could add impetus to efforts to standardise customs data and encourage the creation and acceptance of electronic trade administration documents;
- *Customs duties moratorium.* An FTA could be used to agree to maintain the current practice of not imposing customs duties on electronic transmission, the subject of a rolling moratorium in the WTO;
- *Electronic Transactions: Basic Framework.* A bilateral agreement could help to remove existing legal impediments to the use of electronic communications between Australia and Indonesia. For example, an FTA could seek to explore the cross-jurisdictional relevance of electronic transactions across borders. It could also build on the work of the e-ASEAN strategy to harmonise and create frameworks for cross border government-to-government transactions;

- *Privacy and electronic data protection.* Guidelines for the collection, use, disclosure, quality and security of electronic transactions are needed to protect personal information and set out the requirements for access to this information. An FTA could contain a commitment to ensuring the privacy of information used in electronic transactions;
- *Consumer protection.* An FTA could facilitate cooperation on mechanisms to strengthen consumer protection to promote confidence in electronic transactions; and
- *Online Security.* An FTA could be a vehicle to promote cooperation on reducing spam and increasing online security.

5.4 Government Procurement

Both the Australian and Indonesian Governments are major purchasers of goods and services. Australia and Indonesia are also members of the APEC Government Procurement Experts' Group which promotes transparency, value for money, open and effective competition, fair dealing, accountability and due process, and non-discrimination in government procurement.

5.4.1 The Australian Government Procurement Framework

Since the mid 1990's, the Australian Government has implemented a number of broad ranging and integrated reforms to its resource management and governance arrangements with a view to improving the efficiency and responsiveness of Australian Government departments and agencies. A key component of the resource management framework is the devolved procurement framework first introduced in 1998.

Australian Government arrangements for the management and accountability of its entities distinguish between departments and agencies subject to the *Financial Management and Accountability Act 1997*²³ and independent government authorities and companies subject to the *Commonwealth Authorities and Companies Act 1997*.²⁴

The *Financial Management and Accountability Act* covers all Australian Government departments of state, including legal departments and departments supporting Parliament, and their agencies. The Act provides the framework for the proper management of public money and public property by the executive arm of the Australian Government. The Minister for Finance and Deregulation has the power to issue guidelines relating to procurement – the latest version of the Commonwealth Procurement Guidelines took effect from 1 December 2008. The procurement framework created by the Guidelines follows the devolved resource management model of the *Financial Management and Accountability Act*. That is, each Australian Government department or agency is responsible for managing their procurements, in terms of the processes and the outcomes, within a centrally prescribed framework of procurement policies as issued by the Minister for Finance and Deregulation.

²³ A list of departments and agencies subject to the Financial Management and Accountability Act can be obtained at <http://www.finance.gov.au/financial-framework/fma-legislation/fma-agencies.html>.

²⁴ A list of bodies subject to the Commonwealth Authorities and Companies Act can be obtained at <http://www.finance.gov.au/financial-framework/cac-legislation/cac-bodies.html>.

‘Value for money’ is the core principle governing Australian Commonwealth Government procurement, and is usually assessed on price and non-price criteria to ensure that the Government gets the best performance outcome for what it buys. Officials buying goods and services must be satisfied that the best possible outcome has been achieved after taking into account all relevant costs and benefits over the whole of the procurement cycle.

Consistent with the core principle of ‘value for money’, the Australian Government procurement framework is generally non-discriminatory between domestic and foreign suppliers. Exceptions to this non-discrimination are specific policies to ensure small and medium enterprises are not discriminated against in opportunities to participate in procurement process and, in limited circumstances, policies to assist indigenous Australians.

The Australian Government does not control or regulate resource management by State and Territory Governments or local governments. Each State and Territory Government independently manages its own arrangements and is responsible for ensuring compliance with any international agreements to which it has agreed to be bound. Local governments are regulated by their respective State and Territory but are not covered in any international agreement covering Government Procurement.

Australia has entered into four international agreements with provisions on government procurement but is not a signatory to the WTO Government Procurement Agreement (GPA).

5.4.2 The Indonesian Government Procurement Framework

The Government of Indonesia has introduced new procedures to improve the transparency and efficiency of procedures and to foster competition in bidding for government contracts (Presidential Decrees 80/2003 and 8/2006). The procedures covered by the decrees relate to transparency, efficiency and effectiveness, fairness and accountability, including by simplifying bid procedures and requirements and encouraging post qualification method for open tender.

The decrees obliged all government agencies to declare government project plans and announce the tender invitations and provide related information in one national newspaper. By 2008 the announcement of tenders were also required to be publicized on a national procurement website. Widespread procurement public notices are expected to increase the number of procurement participants, to enhance the quality of procurement process and to achieve more accountability and reliability of the process and simultaneously obtain government expenditure savings, as a result of more options to gain the best tender.

The Presidential Decrees also allow procurement participants to file complaints and/or claims if there is any indication of corruption, collusion, nepotism or violation of contracts. The decrees urge that moral integrity and responsibility along with technical qualifications and capability of procurement professionals are essential to conduct procurement operations, and this is enforced through a training and examination programme.

Establishment of a National Public Procurement office, professional certification and wider competition are key features of the updated decree. Furthermore, a draft new procurement law provides more clarity on procurement policies and procedures and stronger enforcement mechanisms. Procurement training modules for international and national competitive bidding procedures have been prepared by the Government to develop professional procurement expertise.

In addition, Indonesia's Government procurement continues to be used as an important instrument of industrial policy. Its main policy objective is to increase the use of domestic production, design, and engineering with the aim of expanding domestic employment and national industries. Some special preferences are granted to encourage domestic sourcing, and there are provisions on the maximization of local content in government projects, regardless of their source of funding.

Foreign participation in procurement contracts is subject to certain conditions, including the use of domestic goods and services. For example, under the 2003 decree, foreign companies are eligible to bid for government contracts as part of a joint partnership or as a subcontractor to a domestic firm. In addition, foreign participation is permitted for projects with a value of more than Rupiah 5 billion.

Indonesia is not a party to the WTO GPA but is an active participant in the Working Group on Transparency in Government Procurement.

5.4.3 Opportunities for Increased Cooperation

Issues which might be addressed in discussions on the nature and scope of any provisions on government procurement in a bilateral FTA could include:

- consultation mechanisms, for example, with regard to procurement laws, regulations, procedures and policies;
- suppliers' rights, for example, with regard to the protection of confidential information;
- principles of non-discrimination and their application, including the treatment of sensitive preference and offset policies;
- coverage of any agreement; and
- minimum procedure requirements in respect of procurement processes.

5.5 Intellectual Property

Intellectual property (IP) laws provide creators and inventors with certain exclusive economic rights, generally for a limited time, over their creative and innovative endeavours. Both Australia and Indonesia recognise that the effective protection, administration and enforcement of IP rights is a key element in fostering creativity, innovation and technological reform and thus facilitating trade and investment and promoting sound economic development. To this end, both countries have adopted international obligations towards each other with respect to the administration, and

protection of IP rights through multilateral and regional agreements. Both countries are party to the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) that underpins the international Intellectual Property regime, as well as to core WIPO Conventions.

Under AANZFTA both countries further committed to enhancing the administration and protection of IP rights, establishing an institutional framework for ongoing cooperative development of effective IP regimes in the region. A chapter on intellectual property in a bilateral FTA between Australia and Indonesia could further promote harmonisation around international standards and underpin an enhanced bilateral commercial relationship.

5.5.1. Australia's Intellectual Property Regime

Australia has specific laws covering patents, trade marks, designs, plant breeder's rights, geographical indications for wines and copyright and circuit layouts. Confidential information and trade secrets are protected through contract and the common law action for breach of confidence. Geographical indications can also be protected through certification trademarks. Business reputation and goodwill in unregistered trademarks or trade names may be protected by the common law action of passing off or an action for misleading or deceptive conduct under trade practices legislation. Therapeutic goods legislation prohibits the use, in the evaluation of therapeutic goods for registration, of information about other therapeutic goods that is protected information.

IP rights are enforced through a variety of criminal, civil and administrative mechanisms. Administrative authorities such as the Commissioner for Patents, the Registrar of Trade Marks and Registrar of Designs may make various decisions as to the granting of patents, trade marks and designs. The Copyright Tribunal is a specialist administrative body, which has jurisdiction to hear all copyright licensing disputes. There are criminal offences in the Copyright Act, Trade Marks Act and Plant Breeder's Rights Act. Courts determine substantive civil disputes and criminal actions regarding IP rights.

All Australian FTAs (except ANZCERTA, an older agreement) include a separate IP Chapter.

5.5.2 Indonesia's Intellectual Property Regime

Indonesia has made significant progress in improving its legal framework to improve enforcement of IP rights and reform its intellectual property laws. New laws on patents, trade marks, copyright and industrial designs provide for criminal penalties for some infringements and assign civil cases to the Commercial Court for prompt settlement, allowing for court-ordered injunctions against persons found to have infringed Indonesia's intellectual property laws. The laws also establish a mechanism for alternative settlement by arbitration.

Copyright. A new copyright law came into force in July 2003. The law establishes rights to license, produce, rent or broadcast audiovisual, cinematographic, and computer software. It also provides protection for neighbouring rights in sound

recordings and for the producers of phonograms. It stipulates a 50-year term of protection for many copyrighted works. The law contains a number of provisions to combat the widespread use of optical discs in copyright piracy.

In March 2006, the President of Indonesia issued a decree establishing the National Task Force for IPR Violation Prevention.²⁵ The Task Force takes a comprehensive approach to reducing IPR violations.

Despite an often limited capacity to undertake effective enforcement action against copyright infringers, under such laws and policies, the Government is making some progress in combating piracy, recognized in the United States Trade Representatives' (USTR) decision to lower Indonesia from its Priority Watch List to the Special 301 Watch List in November 2006.²⁶

Patents. Indonesia's Patent Law, enacted on 1 August 2001, increased fines for patent infringements and established an independent patent commission to rule on disputes and appeals. It includes compulsory licensing provisions and limits patent protection to products that are made in Indonesia. The importation of patented products or goods made under a patented process does not constitute infringement, nor does use of an invention by a third party before the granting of a patent, including the period during which an application is under review.

Trade marks. Indonesia's trade mark law, enacted on 1 August 2001, provides for the determination of trade mark rights by priority of registration rather than commercial use, for the protection of well-known marks and for increased penalties for infringements. There are no administrative procedures for cancellation of existing registrations which must be challenged through the Courts.

5.5.3 Opportunities for an enhanced bilateral IP environment

Indonesia and Australia have a strong IP relationship, which could be reinforced and extended through an IP Chapter in a bilateral FTA.

Both countries are committed to implementing the WTO's TRIPS Agreement. Both participate actively in the World Intellectual Property Organization, a specialised UN agency with important normative and development agendas.

Australian and Indonesia participated actively and constructively in negotiating new IP commitments to each other through AANZFTA. AANZFTA contains provisions on copyright, enforcement, patent, traditional knowledge/cultural heritage, geographical indications and trademark, envisages a significant cooperation program around IP issues and establishes a plurilateral sub-committee on IP to ensure the continued strength of the IP relationship among the parties.

The overall objective for an intellectual property chapter in a bilateral FTA would be to support increased trade and investment between the parties. Provisions in a bilateral

²⁵ Presidential Decree No. 4/2006, 27 March 2006.

²⁶ USTR cites bolstered implementation efforts as well as numerous raids on retail outlets selling pirated goods. International Intellectual Property Alliance Press release of 8 November 2006. Viewed at <http://www.iipa.com>.

agreement can be tailored closely to the bilateral relationship and so usefully build on commitments in AANZFTA and in the multilateral arena. Provisions that aim to promote harmonisation around international standards, and to strengthen administration of IP systems and enforcement of IP rights can facilitate IP-related trade and investment. Both parties recognise that an FTA would present an opportunity to strengthen the institutional foundations of the excellent and longstanding record of cooperation between the parties on IP issues.

During the public consultations process for this study, business consistently identified IP systems as an influence on business decisions. Strengthening bilateral commitments on IP would allow businesses in both countries to better register, use and enforce their IP rights in each other's markets and deliver real outcomes of lasting benefit to both economies.

5.6 Competition Policy

A sound competition regime can ensure that the benefits derived from market liberalisation mechanisms such as FTAs are not undermined or frustrated by anticompetitive and unfair practices within a domestic economy. There are also structural arrangements that can provide opportunities for anti-competitive conduct and the maintenance of government enterprises or entities that are immune from pro-competitive laws.

Competition policy can contribute to the sound economic development of an economy by putting in place mechanisms that promote independent rivalry, lead to more product research and innovation, ensure truthfulness of product claims, improve price and quality of products and services and enhance the efficiency of distribution systems, with the associated benefits flowing to consumers. An effective competition policy can also contribute to more favourable perceptions on the part of international investors and thus promote increased foreign direct investment.

5.6.1 Australia's Competition Regime

Competition reforms have delivered significant benefits for Australia. Lower domestic production costs arising from competition policy reforms enhance Australia's export competitiveness. Competition policy has contributed to Australia's strong economic performance and the delivery of direct price benefits.

Australia's competition policy was the subject of comprehensive reforms during the 1990s. In 1995 the Council of Australian Governments established a comprehensive national framework, the National Competition Policy. The framework includes applying the Trade Practices Act 1974 to all business activities, a review of all legislation that restricts competition and providing for third party access to nationally significant infrastructure.

The aim of the National Competition Policy was to promote competition to encourage businesses to use resources more effectively, reduce prices and respond better to consumer needs. National Competition Policy programs comprised a mix of policy, initiatives and measures to advance social and environmental needs. In February 2006,

the Council of Australian Governments announced its commitment to a new national reform agenda building on the initial National Competition Policy framework.

The Australian Competition and Consumer Commission (ACCC) is an independent regulator, the ACCC is charged with enforcing the Trade Practices Act, and is also involved in compliance and educational activities. Private actions under the Trade Practices Act are also available. The Trade Practices Act covers all business activity in the Australian economy, including government business activity, and prohibits the following anti-competitive practices:

- anti-competitive agreements (for example, price fixing);
- misuse of market power;
- exclusive dealing;
- resale price maintenance; and
- anti-competitive mergers and acquisitions.

Australia has included competition policy chapters in its FTAs with Singapore, Thailand, the United States and Chile. Australia favours a principle-based approach for competition chapters in FTAs, reflecting shared and overarching policy principles.

5.6.2 Indonesia's Competition Regime

Over several years Indonesia had relied on economic deregulations and liberalisations as a method to urge competitive behaviour of domestic firms. The Anti-Monopoly and Unfair Competition Law (No. 5/1999) seeks to maintain a competitive environment that benefits consumers and ensures equal opportunity for businesses.

The law covers a wide spectrum of anti-competitive behaviour, including prohibited business activities, and agreements to abuse a dominant position, as well as the competitive consequences of mergers and acquisitions. There are various exemptions from the law; these include small enterprises, certain activities by cooperatives and state-owned companies (acting lawfully) as well as the production and marketing of goods and services deemed vital to public welfare.

The Commission for Supervision of Business Competition (Komisi Pengawas Persaingan Usaha - KPPU) is Indonesia's independent regulatory agency to enforce competition law. KPPU has made a number of important recent rulings which seek to uphold competition within the Indonesian economy. In addition to key enforcement action and decisions, KPPU has a central role in making proposals to Government for policy initiatives to focus on the promotion of competition principles and, where appropriate, the removal of any anti-competitive aspects of policy.

KPPU continues to focus on its primary function, which is competition law enforcement and correcting policy to promote the competitive business environment.

5.6.3 Opportunities for Increased Cooperation

Cooperation and exchange of information between competition authorities assists in the prevention of anti-competitive conduct, and helps increase the detection and

prosecution of anti-competitive conduct. Transparency, and a consistent decision making process by competition authorities, assist in providing certainty to businesses and consumers. Bilateral cooperation on competition policy between Australia and Indonesia under an FTA can build on the existing cooperation between the respective competition authorities.

The ACCC and the KPPU have developed a strong and cooperative working relationship with extensive information exchange focusing on strengthening Indonesia's competition policy framework. The ACCC and KPPU are in the process of establishing mechanisms for increased cooperation across a range of areas including the detection of abuse of market power, development of internal training and recruitment processes and competition assessment processes.

The ACCC and KPPU officials are active members of the International Competition Network, the OECD Committee on Competition and the APEC Competition Policy Deregulation Group. Through these forums both agencies are committed to the development of best practice competition enforcement and policy development.

The judicial system also plays an important role in ensuring the enforcement of competition law. Competition law is an inherently complex field and a bilateral FTA may also provide additional opportunities to strengthen judicial capacity in the area of competition law.

Under AANZFTA, Australia and Indonesia agreed to mechanisms under which there would be increased cooperation on the implementation and development of competition policy. ASEAN members would also be able to receive technical assistance for the implementation of effective competition policy initiatives, including enforcement, policy development and advocacy.

5.7 Economic Cooperation and Capacity Building

5.7.1 Current Capacity Building Links

Australia and Indonesia have a strong capacity building relationship. The goal of Australia's assistance is to work in partnership with the Government of Indonesia to achieve a more prosperous, democratic and secure Indonesia. Australian aid to Indonesia is untied and guided by the Australia Indonesia Partnership (AIP) Country Strategy 2008-13, which is aligned to Indonesia's National Medium Term Development Plan. Pillar 1 of the AIP Country Strategy states that Australia will work with Indonesian stakeholders to deliver sustainable growth and economic management. The target outcomes under this Pillar are improved natural management and responses to climate change, improved economic policy and strengthened economic management at the central level and reduced constraints to infrastructure and productivity growth.

Australia's trade and economic development assistance to Indonesia is provided through both bilateral and regional programs. Through the five-year, A\$29 million Technical Assistance Management Facility for Economic Governance (TAMF), Australia is supporting public sector policy-making and management in key Indonesian Government agencies, with a particular focus on economic reform. Through TAMF, a

technical advisor has been placed in the Indonesian Ministry of Trade since 2005 to facilitate capacity building and provide technical assistance, with a current focus on trade in services policy and trade negotiations. TAMF advisors have also assisted Indonesia on a range of other economic governance issues. Australia is currently finalising a successor to TAMF, to be called the Australia Indonesia Partnership for Economic Governance (AIPEG). AIPEG aims to expand Australia's support for international trade policy, tax administration reform, debt management, financial system stability, economic policy coordination and public financial management in Indonesia.

Under the Government Partnerships Fund (GPF), thirteen Australian Government agencies have established programs with Indonesian counterparts — including the Ministry of Finance, Statistics Indonesia (BPS), the Cabinet Secretariat, the Audit Board, the National Civil Service Agency, the National Ombudsman Commission and Bank Indonesia — and are reviewing opportunities to expand the number of Indonesian agency relationships. These programs aim to strengthen Indonesia's core economic and financial governance and public sector management capabilities through the exchange of skills, knowledge and expertise. Activities are delivered primarily in the form of technical assistance and training and include: institutional strengthening and/or capacity-building for counterpart organisations in Indonesia; training for counterpart organisation staff in either Indonesia or Australia; secondments and work attachments for Indonesian organisation staff with their Australian counterpart organisation; secondment of Australian staff to advise or work in their counterpart organisation in Indonesia; and technical assistance and applied policy research. Currently eight Australian Government officials are undertaking long-term placements in the Indonesian Ministry of Finance and other civil service agencies in Indonesia. The GPF also involves an annual High Level Policy Dialogue, where Australian researchers and Treasury officials exchange perspectives on economic policy with senior Government of Indonesia officials and advisors.

The provision of scholarships for postgraduate study in Australia equips recipients with the technical and analytical skills to support economic growth. The Indonesian Ministries of Trade, Foreign Affairs and Finance are all targeted organisations under the Australian Development Scholarships program, with officials from these agencies receiving 51 scholarships in 2008. In addition to these, eight Australian Leadership Awards were awarded to officials from the Ministry of Finance, Coordinating Ministry for Economic Affairs and the Ministry of Foreign Affairs. Overall, 41 per cent of scholarships administered under the AIP in 2008 were awarded to applicants whose proposed studies concerned sustainable growth and economic management.

Australia has directed assistance towards promoting a more competitive, vibrant and robust small and medium enterprise (SME) sector in Indonesia. The Indonesia Australia Specialised (short course) Training Project (IASTP), for example, has delivered trade-related training to the Indonesian Ministry of Cooperatives and SMEs, the Ministry of Trade, provincial and district officials and to SME owners and managers. These courses include 'The A-Z of Exporting', 'Small Trade and Export Promotion' and 'Developing Proposals for Foreign Assistance'. This assistance complements initiatives such as the Australia Nusa Tenggara Assistance for Regional Autonomy (ANTARA) project, a A\$30 million program facility in Nusa Tenggara

Timur, which aims to improve peri-urban and rural income through strategic investment in local and international initiatives.

The Smallholder Agribusiness Development Initiative (SADI) is a A\$38 million program which aims to improve rural growth and household incomes in four target provinces: Nusa Tenggara Timur, Nusa Tenggara Barat, South and South-East Sulawesi. The program assists Indonesian policymakers, industry and smallholder farmers to identify and address constraints in the supply chain, such as market access, finance and infrastructure. The program improves smallholder farmers' access to markets by linking them with large national firms. SADI is increasing rural productivity and quality of commodities through improved access to agricultural research and technologies. It is also strengthening the capacity of Indonesian organisations to undertake research activities that better address farmers' needs.

Infrastructure support is another major focus of the AIP. The A\$328 million Eastern Indonesia National Road Improvement Project (EINRIP), which represents a combination of grants and concessional loans to Indonesia, aims to rehabilitate approximately 550 kilometres of the national road network and to replace 1,000 metres of steel-truss bridges. National roads in eastern Indonesia mainly serve coastal corridors and their improvement will promote economic growth in the region by reducing transport costs and improving access to regional centres, national level public services, markets and terminals. For example, it is expected that major improvements will be made to a substantial proportion of the coastal corridor around the south and east of South Sulawesi, providing considerable benefits to the region. Other activities under EINRIP are proposed for coastal corridors in Bali, Southeast Sulawesi, Central Sulawesi, North Sulawesi, Gorontalo, Papua, West Papua, Maluku, North Maluku and Nusa Tenggara Timur. In addition to EINRIP, Australia is also contributing A\$64.8 to the Indonesia Infrastructure Initiative, which aims to help Indonesia to reduce regulatory and policy constraints that deter private investment in areas such as transport, water and renewable energy.

Australia provides regional assistance to Indonesia through the ASEAN Secretariat. The main instrument for advancing ASEAN economic integration is the ASEAN-Australia Development Cooperation Program (AADCP), through which Australia has provided A\$50 million in economic cooperation from 2002-08 (including A\$5 million for the East Asia Summit Research Initiative). A second phase of AADCP is currently being planned and is expected to involve an increase in funding and a focus on strengthening the ASEAN Secretariat's institutional capacity, providing high quality economic research and policy advice on priority regional economic integration issues and supporting regional mechanisms for the implementation of selected high priority activities under the ASEAN Economic Community Blueprint. This initiative will complement planned Australian assistance to the Economic Cooperation Work Program (ECWP) under AANZFTA, a five-year technical assistance program to assist ASEAN member countries to implement AANZFTA.

Australia also provides regional assistance to Indonesia through APEC. As part of Australia's broader APEC reform agenda, this assistance is focused on improving the quality of APEC's economic and technical cooperation activities. For example, Australia allocates A\$3 million annually to the APEC Public Sector Linkages Program (PSLP) to support the transfer of expertise from Australian universities and federal,

state and territory Governments to public sector counterpart organizations in the Asia Pacific region. The PSLP covers issues such as competition law, trade liberalization and structural reform, and Indonesia obtains a significant portion of funding under this program each year. Australia is also contributing a total of A\$4.5 million to the APEC Support Fund, a flexible funding mechanism for capacity building projects to support the overarching goals of APEC.

Australia's development assistance to Indonesia is becoming more strategic in content as well as in its administration. Particularly in the area of economic cooperation, Australia is leading other donors on aligning the goals of its assistance with those of the Government of Indonesia. The development cooperation relationship is increasingly based on partnership rather than a traditional donor-recipient model, which in turn means that it is well placed to support mutual gains from trade and investment.

5.7.2 Potential Future Capacity Building

Importantly, AANZFTA also includes a comprehensive chapter on Economic Cooperation which provides a framework for additional economic cooperation projects under the auspices of that FTA. Keeping these diverse economic cooperation activities in mind, there may be scope for discussing the possibility of additional economic cooperation and capacity building projects (including investment promotion and technology transfer) under a bilateral FTA.

A bilateral FTA could provide an avenue to further enhance links between agencies in Indonesia and Australia to assist Indonesia to develop world's best practice in areas such as human resource capability as well as institutional management. Technology transfer and skills training in various sectors (for example, agriculture and fisheries, manufacturing, mining and energy and services) would allow Indonesian firms to benefit fully from the bilateral FTA. An FTA could strengthen capacity building between Australia and Indonesia in the following areas:

Sanitary and Phytosanitary Measures: Australia, like many developed countries, has very high processed food standards. Indonesia would benefit from technical assistance related to applied technology on cultivation and processing, and marketing. This could be achieved through projects for the provision of specific skills training to Indonesians in these areas. In particular, the FTA could include projects designed to assist Indonesian producers to improve the standards of agricultural products to make them readily acceptable in Australia and other developed markets.

Services: There are considerable opportunities to further promote bilateral services trade and investment to the benefit of both countries. Among the most important areas to further strengthen under a bilateral FTA is human resource capacity. Improvement in skills and ability in different fields of production and management through short term training could enhance bilateral trade and investment links. For example, training in tourism and hospitality management could further develop Indonesia's services exports.

Investment: Likewise, a bilateral FTA could include a framework through which investment, especially in the form of joint ventures between Australia and Indonesia, in

the agriculture and fisheries sector could be encouraged. Such new investment would inject fresh capital and with it capital equipment and technology transfer, and application of best-practice methods leading to increased output and quality. Moreover, joint ventures between Australia and Indonesia could lead to the development of new products not just for the domestic markets, but for export to other countries. With Australia's high-quality production methods and fresh Indonesian agricultural inputs, new products could be developed. This could be a win-win outcome for both countries.

Standards and Technical Regulations: Australian technical assistance could assist to enable Indonesian exporters to comply with Australia's technical standards and regulations on industrial goods and agricultural products. An FTA could develop measures that facilitate cooperation and provide a mechanism for addressing issues on standards certification and technical regulation thereby facilitating bilateral trade in industrial goods and agricultural products.

Australia and Indonesia have already established an extensive network of cooperation that spans regulatory, technical and economic issues. The many and varied cooperation projects already in place, together with the commitments each country has already undertaken in other agreements, provide a solid foundation upon which the economic relationship between the two countries will continue to thrive and grow. An FTA would offer the opportunity to build on established cooperation and potentially broaden the range of areas in which the two countries cooperate.

Chapter 6. Architecture of a Bilateral FTA

The economic and trade impact of FTAs depends on their scope and coverage, as well as the timetable for liberalisation. This chapter examines the FTA architecture needed to strengthen the Indonesia-Australia relationship and increase economic growth and welfare in both countries.

A number of factors need to be taken into account in considering the architecture of a bilateral FTA. As members of the WTO, both Australia and Indonesia have obligations in relation to a bilateral FTA. As APEC members, both economies have welcomed the *APEC Best Practice Guide for FTAs*, which sets out principles which support the achievement of free and open trade and investment in the region. And, as parties to AANZFTA, both economies will make commitments to each other that need to be taken into account in determining the architecture of a bilateral FTA.

6.1 Objectives and Principles of a bilateral FTA between Australia and Indonesia

If Australia and Indonesia were to agree to enter into negotiations for a bilateral FTA, its primary objective should be to raise the rate of economic growth and increase living standards in the two countries by:

- liberalising bilateral trade and investment to encourage greater trade and investment flows bilaterally and with third countries;
- creating a larger economic market, thereby promoting productivity through greater competition, innovation and economies of scale;
- building on the multilateral, regional and bilateral frameworks for economic cooperation that already exist, and addressing trade problems and barriers, including through appropriate commitments on transparency;
- taking advantage of the synergies and complementarity of both economies to mutual advantage; and
- adding momentum to regional and multilateral trade liberalisation efforts.

Australia and Indonesia are strong supporters and active members of the multilateral trading system and have common interests in many areas of the Doha Round where ambitious outcomes are sought (including, in the case of agriculture, through common membership of the Cairns Group). Both are also active members of APEC. Both therefore have a stake in ensuring an FTA complements and supports their wider multilateral interests. It would be important for any FTA to seek to build on Australia's and Indonesia's commitments in the WTO (that is, it should be "WTO-plus"). This should include addressing issues such as investment liberalisation and protection, which are only partly covered by WTO disciplines and which have the potential to deliver substantial benefits to both parties.

Australia and Indonesia are also both parties to AANZFTA. This FTA, when it enters into force, will make a significant contribution to the process of economic integration

in the ASEAN region and between ASEAN, Australia and New Zealand. It will also have a significant impact on the bilateral trade relationship between Indonesia and Australia. It would be important for any FTA to build on Australia's and Indonesia's AANZFTA commitments.

In formulating the architecture of an FTA between Australia and Indonesia that advances these objectives, the two sides should take into account that Australia and Indonesia are at different stages of economic development, would bear different adjustment costs and gain different benefits from an FTA. However, it should also be noted that the gains from an FTA are typically greater when liberalisation proceeds more quickly. A bilateral FTA would provide an opportunity to accelerate AANZFTA commitments in key sectors of interest to both countries, and to add to those commitments in other sectors where the bilateral negotiations could yield more than was possible in a plurilateral context.

6.2 Relationship to AANZFTA

The relationship between a bilateral FTA and AANZFTA has been raised on a number of occasions in consultations for this study. Naturally, this would be an important issue for negotiators. The commitments under AANZFTA will clearly provide for significant liberalisation of trade between Australia and Indonesia, and do so as part of a wider regional arrangement (e.g. through the support of supply chains through its regional ROO). AANZFTA commitments should, therefore, provide the natural starting point for the negotiators to look at ways in which a bilateral FTA could build on the commitments and further enhance the bilateral trade and investment relationship. Careful consideration will also need to be given to issues of consistency between AANZFTA and a bilateral FTA, to minimise unnecessary duplication and complexity.

6.3 Scope and Coverage

Article XXIV of GATT and Article V of GATS provide minimum requirements that FTAs must meet to ensure WTO consistency. However, it is for the FTA partners to decide on the content of their agreements beyond meeting these WTO requirements, including the scope for negotiating in areas of economic activity not well covered in WTO obligations.

Generally, the more comprehensive the liberalisation under an FTA, the greater the gains that can be expected to flow from it. The independent modelling provided by the CIE suggests a bilateral FTA would bring worthwhile economic benefits for both countries beyond those accrued under AANZFTA. Maximum benefits are based on the assumption of an immediate liberalisation of all barriers. Narrowing the scope, be it coverage or timing, would reduce the outcomes and could limit the value of a bilateral FTA to businesses in both countries. FTAs provide an important opportunity to secure increased or improved market access but also are important tools in fostering greater integration of the economies party to them.

Outlined below are a range of issues which would be addressed in the FTA, likely in specific chapters. The discussion below is not intended to be comprehensive. There

may be other issues which emerge as significant during the course of the negotiation which would also contribute to enhancement of the bilateral economic relationship. Naturally these should also be addressed.

6.3.1 Trade in Goods

A bilateral FTA would feature tariff reduction and elimination commitments on the broadest possible basis under a Trade in Goods chapter, building on what has been achieved in AANZFTA negotiations. The elimination of tariffs under a bilateral FTA would need to be accompanied by appropriate ROO.

As outlined in Chapter Five, a comprehensive bilateral FTA could also address elements that go beyond tariff liberalisation, such as customs procedures, tariff quotas, and non-tariff border measures like non-automatic import licensing. In relation to each of these issues a bilateral FTA would likely include a mix of commitments as well as provisions for enhanced cooperation. The balance of this mix would be determined with careful reference to progress already made via AANZFTA. Other measures which could be impediments to trade, such as sanitary and phytosanitary measures and technical barriers to trade, could also be subject of further cooperation on regulatory issues.

6.3.2 Trade in Services

A bilateral FTA would include a chapter on Trade in Services. Under such a chapter, Indonesia and Australia would undertake comprehensive market access and national treatment commitments and also agree a range of disciplines in the services field. Major service sectors, such as education, professional services, telecommunications, financial services and tourism, could benefit from additional sector-specific commitments and disciplines, covering regulatory matters as well as market access.

6.3.3 Investment

Inclusion of an investment chapter incorporating strong market access commitments and a robust regime of investment protections that builds on those agreed under AANZFTA and the Investment Promotion and Protection Agreement in force between Australia and Indonesia would have the potential to deliver very significant gains to both the Australian and Indonesian economies.

6.3.4 Movement of Natural Persons

A separate chapter on the Movement of Natural Persons would provide an opportunity to build on the commitments made by Indonesia and Australian under AANZFTA, in relation to the terms and conditions of temporary entry for business people, investors and service suppliers.

6.3.5 Other Issues

As discussed in Chapter Five, Government Procurement provisions would be an important feature of a comprehensive bilateral FTA. Commitments in this area would be a strong signal of governmental commitment to bilateral trade and would recognise

the vital role of the Indonesian and Australian Governments as purchasers of goods and services.

A modern comprehensive bilateral FTA would also usefully include provisions on e-commerce. As discussed in Chapter Five, these provisions would seek to enhance the growth of electronic commerce in goods and services in ways that promote the use of electronic commerce globally and would seek not to apply additional barriers to electronic transmissions.

A chapter on intellectual property that seeks to enhance the protection and enforcement of the rights of Australian and Indonesian intellectual property holders would be a vital component of a bilateral FTA. Such a chapter could address specific bilateral intellectual property issues and could build on commitments in other international agreements in order to deliver efficiency gains to business. It could also serve as a platform for ongoing bilateral engagement and information exchange on these issues.

A potential bilateral FTA would include a chapter addressing competition policy. This would address mutual commitment to the development, implementation and enforcement of policies that promote a pro-competitive environment. Competition policy provisions in a bilateral FTA would also have a significant cooperation element, building on existing mechanisms and frameworks.

As discussed in Chapter Five, economic cooperation and capacity building could be an important element of a bilateral FTA. The specific projects or programs would be a matter for negotiation but an FTA could usefully include a framework for consideration of economic cooperation and capacity building issues.

The negotiations themselves may highlight other areas which could usefully be incorporated into the bilateral FTA which would assist in increasing economic integration between the two countries or improve welfare gains. Nothing should be left off the table which has the potential to improve outcomes from a bilateral FTA.

6.3.6 Institutional and Framework Chapters

A potential bilateral FTA would include a chapter on consultations and dispute settlement which would establish fair, transparent, timely, and effective procedures to settle disputes arising under the Agreement. A robust dispute settlement mechanism could borrow from the WTO dispute settlement architecture and may incorporate other “best practice” elements.

An institutional structure that reflects the strong relationship between Australia and Indonesia would also be a key feature of a bilateral FTA. For example, consideration could be given to a joint committee which reports – with some measure of flexibility – to a meeting of Trade Ministers. An appropriate institutional structure would recognise that an FTA was a platform for ongoing and increasing bilateral interaction in the economic field.

Chapter 7. Conclusions and Recommendations

Australia and Indonesia already enjoy a wide-ranging economic relationship that could be strengthened and further developed through a bilateral FTA. This study shows that an ambitious FTA, encompassing goods, services and investment, and that is consistent with WTO rules and APEC goals and principles for liberalising regional trade and investment, would deliver real trade and economic benefits to both countries. It would support bilateral trade and investment linkages, and play an important role in integrating the two economies over the long term. An FTA would build on the gains made under AANZFTA, thereby facilitating faster regional economic integration, which is one of the main goals of AANZFTA. In addition, an FTA would provide a solid platform for strengthened engagement and cooperation across a range of non-economic issues.

Assuming the immediate and comprehensive removal of tariff and non-tariff barriers to bilateral trade and investment as at 2010, independent modelling finds that an FTA would have a positive impact on Australia's real GDP. Indonesia's liberalisation accounts for the majority of the projected economic benefits for Australia. For Indonesia, the magnitude of projected real GDP gains arising from trade and investment liberalisation are greater in both absolute and relative terms. Indonesia's gains primarily arise from its own liberalisation, reflecting Australia's already low barriers to trade and investment following AANZFTA. The projected impact of trade and investment liberalisation on bilateral trade flows between Australia and Indonesia is also positive.

If liberalisation is slowed, or its scope is curtailed the economic benefits of an FTA would be reduced for both countries, but particularly for Indonesia, as it would not maximise the resulting direct investment and dynamic productivity gains. It would be safe to assume that the benefits for both countries would be reduced by the exclusion of certain sectors from liberalisation.

In addition to the expected economic benefits, enhanced bilateral cooperation between the Australian and Indonesian Governments arising from an ambitious FTA would provide an opportunity to minimise transaction costs associated with bilateral trade and investment. In particular, an FTA would be expected to strengthen cooperation in a variety of trade related areas, including in the areas of customs procedures, sanitary and phytosanitary measures, technical regulations and standards, intellectual property rights and electronic commerce. Other areas where benefits may present themselves are in government procurement and competition policy. It would be important to ensure that bilateral commitments in these areas build upon commitments Australia and Indonesia have already undertaken in other fora, particularly AANZFTA.

A bilateral FTA would be consistent with broader foreign policy objectives being pursued by both countries. A robust and ambitious FTA that saw the elimination of tariff and non-tariff impediments to bilateral trade (goods and services) and investment would provide immediate opportunities for exporters and investors in Australia and Indonesia as well as boosting productivity in both countries through greater competition, innovation and economies of scale. An FTA would facilitate a more rapid integration of the Australian and Indonesian economies, and in so doing supplement regional efforts to promote economic integration.

An FTA would send a signal that both countries remain committed to open trading relationships – an important message during these current uncertain times. It could also encourage investment from third countries. It would serve as a vital symbol of the importance that Australia and Indonesia place on our bilateral relations. An FTA would provide a solid foundation for future cooperation and engagement on a broad swathe of issues including in bilateral, regional and multilateral fora.

The study finds that a bilateral FTA ought to include provisions that deal with tariff and non-tariff impediments to trade and investment, trade-related domestic regulation, cooperation to expand and enhance trade as well as institutional arrangements that would facilitate implementation of the FTA. The architecture of a bilateral FTA between Australia and Indonesia would be the subject of negotiation between Australia and Indonesia. A number of key factors will influence the outcome of those negotiations, including the scope and content of the international agreements and arrangements to which each country is already party, and the objectives that Australia and Indonesia share for a bilateral FTA.

This study has demonstrated that a bilateral FTA between Australia and Indonesia would provide worthwhile benefits to both Australia and Indonesia in the short and long term. Should both governments decide to enter into FTA negotiations covering goods, services, investment and capacity building it is recommended that negotiations commence as soon as practicable.

Glossary of Acronyms and Abbreviations

AADCP	- ASEAN-Australia Development Cooperation Program
AANZFTA	- ASEAN-Australia-New Zealand Free Trade Agreement
ABARE	- Australian Bureau of Agricultural and Research Economics
ACCC	- Australian Competition and Consumer Commission
ACFTA	- ASEAN-China Free Trade Agreement
AFAS	- ASEAN Framework Agreement on Services
AFTA	- ASEAN Free Trade Area
AIA	- ASEAN Investment Area
AIDA	- Australia-Indonesia Development Area
AIP	- Australia-Indonesia Partnership
AIPEG	- Australia-Indonesia Partnership on Economic Governance
AIPRD	- Australia-Indonesia Partnership for Reconstruction and Development
AKFTA	- ASEAN-Korea Free Trade Agreement
ANTARA	- Australia Nusa Tenggara Assistance for Regional Autonomy
ANZCERTA	- Australia New Zealand Closer Economic Relationship Trade Agreement
APEC	- Asia Pacific Economic Community
ASEAN	- Association of South East Asian Nations
AUSFTA	- Australia-United States Free Trade Agreement
BIT	- Bilateral Investment Treaty
BKPM	- Indonesia Investment Coordinating Board (Badan Koordinasi Penanaman Modal)
BPS	- Statistics Indonesia of the Republic of Indonesia (Badan Pusat Statistik)
BSN	- National Standardisation Agency of Indonesia (Badan Standardisasi Nasional)

CIE	- Centre for International Economics
CTC	- Change in Tariff Classification
DFAT	- Department of Foreign Affairs and Trade
DGCE	- Director General of Customs and Excise
EINRIP	- Eastern Indonesia National Road Improvement Project
ETMs	- Elaborately Transformed Manufactures
FATA	- Foreign Acquisition and Takeovers Act
FDI	- Foreign Direct Investment
FMA	- Finance Management and Accountability Act
FTA	- Free Trade Agreement
GDP	- Gross Domestic Product
GPF	- Government Partnership Fund
HS	- Harmonized Commodity Description and Coding System
IASTP	- The Indonesia Australia Specialised Training Program
ICT	- Information Communication Technologies
IJEPA	- Indonesia-Japan Economic Partnership Agreement
IMF	- International Monetary Fund
IP	- Intellectual Property
IT	- Information Technology
JSG	- Joint Study Group
KAN	- National Accreditation Committee (Komite Akreditasi Nasional)
KPPU	- The Commission for Supervision of Business Competition (Komisi Pengawas Persaingan Usaha)
MFN	- Most Favoured Nation
MOU	- Memorandum of Understanding

NSW	- National Single Window
OECD	- Organisation for Economic Cooperation and Development
PD	- Presidential Decree
PMV	- Passenger Motor Vehicles
PSLP	- Public Sector Linkages Program
ROO	- Rules of Origin
RVC	- Regional Value Content
SADI	- Small Agribusiness Development Initiative
SMEs	- Small and Medium Size Enterprises
SNI	- Indonesia National Standard (Standar Nasional Indonesia)
STMs	- Simply Transformed Manufactures
STSF	- Special Travel Security Fund
TAFTA	- Thailand-Australia Free Trade Agreement
TAMF	- Technical Assistance Management Facility for Economic Governance
TBT	- Technical Barriers to Trade
TCF	- Textiles, Clothing and Footwear
TIF	- Trade and Investment Framework
TPP	- Trans-Pacific Partnership Agreement
TRIPs	- Trade Related Intellectual Property Rights
USTR	- United States Trade Representative
WTO	- World Trade Organization