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DEFENCE AND TRADE

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JOINT COMMITTEE ON FOREIGN AFFAIRS, DEFENCE AND TRADE

Foreign Affairs Subcommittee

Monday, 13 October 2003

Members: Senator Ferguson (*Chair*), Mr Brereton (*Deputy Chair*), Senators Bolkus, Cook, Eggleston, Chris Evans, Harradine, Hutchins, Johnston, Sandy Macdonald, O'Brien, Payne and Stott Despoja and Mr Baird, Mr Baldwin, Mr Beazley, Mr Bevis, Mr Byrne, Mr Edwards, Mr Laurie Ferguson, Mrs Gash, Mr Hawker, Mr Jull, Mr Lindsay, Mrs Moylan, Mr Nairn, Mr Price, Mr Prosser, Mr Bruce Scott, Mr Snowdon, Mr Somlyay and Mr Cameron Thompson

Subcommittee members: Mr Jull (*Chair*), Mr Laurie Ferguson (*Deputy Chair*), Senators Bolkus, Cook, Eggleston, Chris Evans, Ferguson (*ex officio*), Hutchins, Sandy Macdonald, Payne and Stott Despoja and Mr Baldwin, Mr Beazley, Mr Bevis, Mr Brereton (*ex officio*), Mr Byrne, Mr Edwards, Mrs Gash, Mr Hawker, Mr Lindsay, Mr Nairn, Mr Price, Mr Prosser, Mr Bruce Scott, Mr Snowdon, Mr Somlyay and Mr Cameron Thompson

Senators and members in attendance: Senators Eggleston, Ferguson, Sandy Macdonald and Hutchins and Mr Beazley, Mr Brereton, Mr Jull and Mr Bruce Scott

Terms of reference for the inquiry:

To inquire into and report on:

Australia's relationship with the Republic of Indonesia, focusing in particular on building a relationship that is positive and mutually beneficial.

The Committee shall review the political, strategic, economic (including trade and investment), social and cultural aspects of the bilateral relationship, considering both the current nature of our relationship and opportunities for it to develop.

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Subcommittee met at 10.01 a.m.

BLAKE, Mr Peter, Chief Executive Officer, Department of Business, Industry and Resource Development, Northern Territory Government

KILLEN, Mr John, Senior Asian Relations Officer, Department of Business, Industry and Resource Development, Northern Territory Government

LAURIE, Mr Jeff, Director, International Business, Department of Business, Industry and Resource Development, Northern Territory Government

PRINCE, Mr Ian, Director, Policy Development, Department of Business, Industry and Resource Development, Northern Territory Government

CHAIR—I declare open this public hearing into Australia's relationship with Indonesia. We are pleased to have the opportunity to speak with the representatives from the Northern Territory government today by means of video conference. The terms of reference for this inquiry require us to examine the political, strategic, economic, social and cultural aspects of Australia's relationship with Indonesia. We have received a number of submissions from government departments detailing their engagement with their counterparts in Indonesia. The Northern Territory government describes it as having a unique relationship with Indonesia and has provided a submission that is full of detail of its current engagement as well as offering a number of suggestions for building relationships. These have been very useful and we look forward to being updated on developments since your submission was made and of discussing your very constructive ideas in more detail with you today.

On behalf of the subcommittee, I welcome your representatives to today's hearing. Although the subcommittee prefers that all evidence be given in public, should you at any stage wish to give any evidence in private, you may ask to do so and the subcommittee will give consideration to your request. Although the subcommittee does not require you to give evidence on oath, I should remind you that these hearings are legal proceedings of the parliament and therefore have the same standing as proceedings of the House itself. I now invite to you make a short opening statement before we proceed to questions.

Mr Blake—The Northern Territory government made a written submission signed by our acting Chief Minister back in January this year which was really to outline to you what the Northern Territory government has been doing over many years and including currently under the Labor government, which came to power in 2001. It was not a submission that attempted to put to the Commonwealth things that the Commonwealth government should be doing in relation to Indonesia. Rather, it was to position you in terms of just what the Northern Territory had been about.

I will keep it brief because I think it is more appropriate to go into questions. Generally, the Territory has been working hard on its relationship with Indonesia since self-government in 1978. In particular, the Northern Territory government entered into a memorandum of understanding with the Indonesian government, the national government, back in 1992 whereby we had an agreement of ways in which the Northern Territory and the eastern Indonesian islands

could work together for the benefit of both. That agreement is still current today and has been the foundation of our arrangement on the eastern islands area.

Our relationship, however, does not stop there. Our major trading activity relates to the live cattle export into Indonesia. That trade predominantly is further west in Sumatra and Java. Our relationships have been at a political level, with respective chief ministers over the years meeting with presidents of Indonesia and numerous relationships with the ministry of Indonesian government. That cascades down into a number of arrangements not only of a trade and investment nature but in terms of education, health, community related type activities and sport related activities, such as the Arafura Games, whereby over the period of 25 years of self-government we have built an exceptionally good relationship with the Indonesian government. Our industry and community groups in the Territory have built good relationships at the business and community level. Our local governments have participated into that by building sister city relationships into the eastern Indonesian areas.

I will touch on a couple of things that we are particularly interested in currently because our submission is a year old. The Northern Territory is now looking to build its Australasian trade route with the completion of the construction of the Alice Springs to Darwin railway and the completion of the second stage of our port developments. We are now entering the stage where in January the first freight trains will roll into Darwin. We are busily attempting to develop both the shipping connections that take us into Asia and obviously the commerce and trade that sits around that. Indonesia is an exceptionally important part of that. So that is a key objective we have in the Territory.

Another key objective is trying to link our involvement in the petroleum and mining industries with those in eastern Indonesian areas—in Papua and other eastern Indonesian provinces. There are developments existing in the stage of development or, in the case of Papua, like the Tangguh LNG proposals, major developments on the horizon. We are looking to build our relationship with Indonesia in order to build a capacity between our industries in the Territory and theirs in a service manner. I think I will leave it there rather than go on in detail. The submission gives ample detail of a number of other areas, but I think it is probably better done by discussion between us.

CHAIR—Thank you very much. While these programs and the relationship have been building up for 25 years, has there been any blockage or slowdown of any of the programs as a result of things like East Timor, Bali and SARS?

Mr Blake—I guess you could go back to the Asian meltdown of the economy. That caused quite a difficulty for our cattle trade for a period of time. It is now building up again. But it had its difficulties. Security issues, obviously, in terms of the visitation between the two areas, is impacting on things like tourism in a very significant way. More recently, SARS, for example, impacted on the May 2003 Arafura Games needing to be cancelled because of the difficulty of being able to provide the secure, healthy environment both at our end and for visitors. So they are examples of the types of things where recent events have caused us some difficulty.

CHAIR—Are all your air links back in place?

Mr Laurie—No. We are currently negotiating on a regular basis with Malaysian Airlines to get them to come back. We are also talking to Singapore Airlines, specifically Silk Air, to get them to resume flights. We do have good news with Royal Brunei Airlines. They have committed to increase the regularity of their flights between Darwin and Brunei from two to three services per week. We have also spoken to Cathay Pacific. They have not returned. It is fairly unlikely that they will return in the near future. So we continue to look for an increase in the international air routes servicing Darwin.

CHAIR—What about services into Indonesia? You have a pretty comprehensive network.

Mr Killen—I will comment on the services into Indonesia. Garuda Indonesia, first of all, have cut back their flights into Darwin. However, they are working very closely with the Northern Territory to maintain the links they have, even though they have been able to demonstrate on a number of occasions that maintaining the number of flights they have is not necessarily an economic proposition for them. Merpati Airlines suspended their flights between Kupang and Darwin in the aftermath of the East Timor independence. They have been trying at various times to re-establish that link. On 13 December this year and again on 3 January, they will run two trial flights, which we hope to support, and see that link open up again. Qantas has given undertakings to provide extra flights into Indonesia. Until now, it is not possible to make bookings on those flights because they have not been confirmed.

CHAIR—Thank you for that. You mentioned specifically the Adelaide-Darwin rail link and obviously a sense of excitement that surrounds it. Is there any hard evidence that Indonesia in particular or other countries in general are taking much notice of this event? If so, are things like air freight companies and the shipping companies physically putting new arrangements into place?

Mr Blake—We already have shipping arrangements through the Swires group, who are connecting us with eastern Indonesian areas and Singapore. They are very actively looking at how they can build on the rail connection when it comes into operation in January. Our Minister for Asian Relations and Trade recently did a visit to Singapore, Sabah, Brunei and Peninsula Malaysia. Unfortunately, he was not able to get to Indonesia. But the interest throughout that South-East Asian area is quite strong in relation to the completion of the rail and the things that might flow from it. We also had one of our officers by invitation attend a recent BIMP-EAGA meeting in the Philippines, which links Indonesia, Brunei, the Philippines and Malaysia together as a growth area. He was able to provide considerable information through that forum. Again, the interest was very strong. We have an international based major conference here in February, which will be attempting to put to the world this new trade route. There is quite a lot of interest from South-East Asia in attendance at that.

Senator FERGUSON—I want to follow up the question in relation to the rail link and trade opportunities. What do you think are the greatest areas of opportunity that the rail link might provide as far as trade with Indonesia is concerned?

Mr Blake—I guess our difficulty with Indonesia has been that our principal trade is live cattle. Live cattle does not go in general container ships; it goes in specialised shipping for that purpose. So our linkages through people like Swires have been of a gradual build-up nature. They carry both containers and freight bulk. So we are looking at things particularly like the

mining and petroleum developments in east Indonesia, where companies are looking for materials and inputs into their projects which have very high Australian standard type requirements. We are trying to build those types of projects in particular. Other items of food and food lines et cetera are more difficult, obviously, because of the cost differentials between our productions in Australia versus the productions in Indonesia. But getting into the creme of the market, looking at the hotel trades of Bali et cetera, has always been of interest. There is some build-up happening there. They are just a couple of comments. Jeff might want to add to them.

Mr Laurie—When Minister Henderson, our Asian relations and trade minister, visited Jakarta in February this year, we spoke with a number of ministerial counterparts about the use of this new trade route for Indonesian exporters to Australia. A number of people in, for example, the clothing industry could use Darwin as a point for value adding clothing coming in for pre-sale tagging, pressing and ironing, so there is an opportunity for value added processing here in Darwin. There are a few interesting manufacturing operations in Indonesia that could well use this. One is a large factory established in Jakarta very recently by LG, the Korean white goods manufacturer. That factory targets Australia as its sole destination. We are looking at identifying companies like that which might use this Australasian trade route as a means of getting their product into Australia.

Senator FERGUSON—I understand, though, that when the proposal was put again to connect Adelaide and Darwin there was not only value for the Northern Territory as far as trade to Indonesia but the idea was that it would be used as a hub for getting goods from further south into Indonesia, which included perishables. Do you know whether any work has been done in Darwin or the Northern Territory trying to attract trade from the south to go out through Darwin to Indonesia?

Mr Laurie—Yes, very much so. Our Office of Territory Development has an ongoing program of identifying companies from southern states to work with Territory companies to both bring in goods to value add but also to hub and redistribute through Asia. There are a couple of confidential arrangements being discussed between Melbourne and Darwin firms at the moment. A Queensland provedore has recently officially undertaken to take over a Darwin provedore company to ship foodstuffs and perishables into Asia, again using this Darwin hub concept. So there are a number of commercial activities happening.

Senator FERGUSON—My final question at this stage is: how is your Indonesian customs facility trial going?

Mr Killen—The Indonesian customs trial is progressing quite well at the moment. It is progressing according to our plan. We are now into our second phase, which is the longest phase of the two-year trial. We are beginning to build up volume through Darwin at the moment. We have gone from a matter of a couple of hundred kilos of goods processed in the first six-month phase through to over 2,700 kilograms of goods processed to date in this six-month posting of Indonesian customs officers. We will move on to the final phase, which will start in March next year. During that period, we will determine a costings program to see how we will fund a formal implementation of a final program beyond the trial. We have had a large number of inquiries from exporters in the south wishing to use our facility. We also have a basic outline of an approach to Indonesia to see about direct shipping links into the eastern part of Indonesia both for exports and imports to and from the region and the rest of Australia.

Mr BEAZLEY—On the question of shipping, I take it most of the work that you have been doing with the Swires group would be direct shipping links between Darwin and Singapore and Hong Kong. I wonder what sorts of weaknesses or opportunities in terms of shipping capacity are spread throughout the Indonesian islands? Is there a problem with attracting the interest of shipping companies to operate from Darwin to the islands in Indonesia as opposed from Darwin to Singapore, Hong Kong and the usual hubs?

Mr Killen—Yes, there has been a problem to date. The problem is one of volume. Before the arrival of the railway and the ability to utilise the new port and rail link, there has not been the volume that would make it economical for direct shipping links to be established and sustained into the eastern part of Indonesia.

However, with the completion of the railway and the new port facilities, as I said before, we now have an outline of a plan to attract Indonesian shipping from the eastern islands into Darwin by linking them into what would be a round trip probably from Jakarta at Tanjung Priok or Surabaya throughout the eastern islands. We would link it into Darwin as part of that route rather than making it a one-off trip from, say, Surabaya to Darwin and back, which becomes very difficult to sustain with the current volumes. We would then hope to build upon those volumes by providing a shipping link which could be used both ways not only for Darwin freight but for freight to and from the rest of Australia.

Mr BEAZLEY—Have you identified particular companies in Indonesia or elsewhere who might be prepared to do that milk run type link?

Mr Killen—In relation to that program, we are currently setting up meetings with the Indonesian department of industry and trade. We should begin talks with them no later than December after the Ramadan period. We have already had agreement from them that they will provide figures on volumes to the rest of Australia out of the eastern part of Indonesia. As an extension of that, we will identify the shippers involved.

Mr BEAZLEY—I have one final question in that regard. You have a little piece in your submission here that was referred to by Senator Ferguson in relation to the operations of Indonesian customs officers. Have you identified what sort of customs support you need from the Commonwealth if you are going to be able to fully exploit the opportunities that you are seeking, like the ones you have just described?

Mr Blake—We have not specifically, but clearly the trade between Australia and Indonesia is only going to grow gradually, not by any major leaps and bounds. The customs facilities we have in Darwin from the Commonwealth are quite sophisticated customs arrangements and are probably quite capable of dealing with the requirements in the immediate future. But we would expect that as growth came gradually in relation to trade, so the customs facilities, immigration facilities and quarantine facilities et cetera would grow in relationship to that trade.

The other comment to make clearly is that the operators of the rail are quite clear in terms of their position that their first objective is to cover the costs of their operations by freight in and out of Darwin. They see the trade links as the add-on in relation to development which will then come progressively. So there is not an expectation on the operators that suddenly we are going to see a large volume of trade materialising. It will be gradual.

Mr Prince—I will add two quick points in relation to that. The Northern Territory government released an international trade strategy in October last year. Within that is encapsulated a target to grow the trade over the port of Darwin to 50,000 containers within the five-year span. It was envisaged that that would be a steady growth rather than an immediate spurt. Secondly, from a factual point of view, Northern Territory-Indonesia total trade has been increasing at about \$30 million to \$50 million a year for the last four years. At the moment, it is about \$236 million, whereas four years ago total trade was \$117 million. There is a very large slice of live animal exports, but it has been a steady growth. The two-way trade with Indonesia is our widest trading market. The largest number of customs categories are covered by the trade with Indonesia. So it is a very important trade for us and has a lot of capacity to grow.

CHAIR—This is a question out of left field but it is in conjunction with that. In terms of that report or in a separate situation, has the Northern Territory government ever given consideration to the possibility of a free trade arrangement with Indonesia? If so, has it got any interest?

Mr Blake—Historically, there was a look at that back in the early 1980s. The difficulties, of course, of putting up a free trade arrangement in Australia are extremely difficult given our constitutional position. As a consequence, instead of a free trade operation, what was established was a trade development zone, which provided an industrial estate to attract people that were dealing in imports and exports, and various concessions that were within the Territory government's powers as against the Commonwealth's powers to try to both attract them and keep them here. You would have to say it had very limited success over the years. In fact, this year, in the Territory government's budget deliberations, it has been replaced by a Northern Territory land corporation, which will be focusing on major developments in the East Arm port area and in some of our other industrial development areas similar to the land corp type operation in Western Australia. So we no longer have a trade development zone as of 1 July this year.

Senator HUTCHINS—This question might follow on from the chairman's question. You might be the only state or territory government in Australia that has a ministry of Asian affairs. Do any differences emerge in our relationship with Indonesia when comparing a Canberra perspective and a Darwin perspective? Would you like to comment on how we might see it down here as opposed to how you see it up there? It is a similar question to the one about the trade development zone and the free trade zone.

Mr Blake—Yes. I have been here for the entire period of self-government. I guess over the years our chief ministers and our ministers, particularly since we have had ministers for Asian relations, which was about 1992, have been able to develop relationships in a way that keeps away from a number of the major foreign affairs issues, defence issues and illegal fishing issues et cetera. So our relationships have been able to develop in a climate of mutual agreement. There are very few situations where there has been conflict between Indonesia or the respective governments and ourselves. So I guess we are different in the sense that the things that confront the federal government do not confront us. Even in troubled times over many years when there were difficulties between the Commonwealth government and the Indonesian government, our chief ministers and ministers were continuing to meet with their respective counterparts in Indonesia. But it is mainly because of the coverage. Our coverage was on the nice ground, not the difficult ground.

Mr BRUCE SCOTT—I note in your submission that you talk about the Australia-Asia trade route—it is an exciting time for us all—with the new railway line as it starts to develop trade opportunities into South-East Asia and, of course, anywhere to our north. In relation to the specifics here on Indonesia, is there something more that we should be doing in relation to market access to Indonesia with our products? We are going to have this opportunity presenting itself, but there may be barriers in relation to trade and in accessing markets in Indonesia and vice versa. I firmly believe the health of that line and your port are going to be very much determined by the capacity of accessing markets on a bilateral basis north and south of Darwin and into Indonesia in relation to the topic we are on today.

Mr Laurie—That is a great question. Thank you for that. From our small jurisdiction, we have been trying to promote the benefits to Australia of the Australasia trade route. Our Minister for Asian Relations and Trade was holding public functions in Indonesia earlier this year, and we will continue to do that. But if we could get support from the Commonwealth and other jurisdictions in Australia on this challenge to promote this new asset that Australia has to offer, we would welcome that gladly. I imagine that organisations like Austrade and perhaps Foreign Affairs and Trade could play a more significant role in promoting this Australian asset rather than just the Territory government taking the lead. We will continue to do that but, boy, we could certainly use some help.

Mr BRUCE SCOTT—Because the viability of the line will be very much dependent on access to markets off our shores. I think the only way we are going to really progress these in the short and medium term is going to be bilaterally to make the most of the opportunities. Our market access to Indonesia—and you spoke of it earlier—is very much focused around a few agricultural sectors like the live cattle trade. It is all very important. But, coming from southern Australia, to market in Indonesia and from Indonesia back into Australia is what, I guess, we are focusing on here today. How far do you see we have to go yet to be able to get a greater volume of products going in there? In other words, should we be opening up the discussion through our trade and foreign ministers to get greater access bilaterally, which is ultimately going to be to the benefit of the hub in Darwin and the railway line?

Mr Prince—The Northern Territory has been tracking the Commonwealth initiatives in relation to market liberalisation for trade generally. We have been closely involved with the Singapore-Australia free trade agreement, tracking the Thailand-Australia closer economic relations free trade agreement, watching the ASEAN agreements and the implementation of the Bogor goals under the APEC economic cooperation arrangements as well as, of course, the wider WTO initiatives. There are significant areas where the Indonesian market could be made more accessible for Australian exports of goods and services. Each of those steps—the ASEAN arrangements and the APEC arrangements—will assist that. It is not an area we have had a close look at, but there may be scope for a bilateral trade arrangement, if not a full free trade agreement—it may be a trade and economic facilitation agreement—with Indonesia to explore where those opportunities might be best achieved and what it might yield for Australia.

In relation to our own efforts, we have used our relationship with the Indonesian government and, in particular, the customs facility in Darwin to overcome some of the practical non-tariff related barriers that sometimes impede trade into particularly eastern Indonesia. So in a very practical sense we have endeavoured to use that facility and the relationship to overcome those sorts of problems. But there may well be scope to improve market liberalisation into Indonesia

which would expand the capacity of the Northern Territory and the export of goods and services from elsewhere in Australia.

Mr BRUCE SCOTT—Thank you for that.

Mr Blake—If I could add to that, in terms of market development our experience with things like live cattle is that it is not just a matter of securing the trade; it is a matter of the aftercare and service. For example, with the live cattle industry, our success there has been underpinned by the fact that we have put our veterinarians into our markets—into Indonesia and the Philippines et cetera—to assist at their end to enable their part of the operation to work properly with the right technical inputs. We have assisted with their meat industries in taking the processing of this meat beyond the normal wet market type operations into a far better processing of the product at the other end. It is this support mechanism we are putting at the other end that helps to secure and keep the trade as against it just being a trade that is there for a period until somebody else knocks us off in the process.

Similarly, we are trying to build some relationships with horticulture. We have in fact the director-general of horticulture from Indonesia visiting us tomorrow—he is coming here and to North Queensland—looking at the technologies of our horticulture industry in terms of how cooperative arrangements can be in place between Indonesia and Australia. This is for them to develop not just their technologies of growing but all the post-harvesting and marketing end of the horticultural industries. It relates to the development of two-way trade in terms of products that they in time will want to try to get into Australian markets and our products, be they temperate or tropical ones, getting into Indonesia. So that aftercare and other services are very important if we are going to continue to develop these markets.

Mr BRUCE SCOTT—So we are really saying that we need to focus on our bilateral trade relations between Australia and Indonesia which obviously, from Australia's point of view, is going to benefit the new rail corridor and, of course, the port of Darwin. Thank you very much for that. I think there is a lot going on at APEC and multilaterally in the region or the ASEAN area. As we are focusing today on Indonesia, I think it is interesting to hear your comments as to whether there needs to be more effort put into the bilateral arrangements or at least identifying the opportunities that will emerge over time for trade between Australia and Indonesia.

CHAIR—You have a number of sister state relationships with Indonesia. How effective are they? What do you use them for—principally trade? Are there any cultural exchanges? Do you have any programs for people-to-people contact?

Mr Killen—We do have two sister state relationships with Indonesia. One is with the province of Bali and the other is with the province of East Kalimantan. We have a number of local government arrangements. Darwin City Council has a sister city relationship with Ambon. The city of Palmerston has a sister city relationship with Kupang in the western part of Timor. With the difficulties that have been experienced with security and transport connections into Indonesia, these relationships have not been particularly well serviced in the past two or three years and perhaps even up to four years. Prior to that, they were used for the promotion of department-to-department relationships. They were very productive in being able to promote those relationships. The memorandum of understanding with Indonesia itself was the catalyst for

developing the customs facility which we are now trialling in Darwin. We could use that as an example of how useful those relationships have been.

Mr Prince—Could I add to that answer. Each of the relationships has an economic development, a social development and a cultural development aspect. In each of them, there has been some aspect of each of those elements that has been active within them over the period they have been in place, whether it is teacher exchanges, information visits or study tours as well as the development of trade and facilities to help trade grow, like the customs facility.

CHAIR—I think the Northern Territory government was given responsibility for the development of Indonesian language in Australia. How has that developed? Has the ending of the NALSAS program had much effect on what you have been doing?

Mr Killen—The Indonesian language program was fairly popular Australia-wide at the time the Northern Territory gained control. I think there was a project to develop the national curriculum for Indonesia. That project was concluded back in the early- to mid-1990s. I believe that there is now a national Indonesian curriculum in place. However, the conclusion of the NALSAS program has not had a big impact on the immediate implementation of the Indonesian programs in the Northern Territory in particular because most of the impetus for those programs came from the Northern Territory department of education and what is now known as the Department of Employment, Education and Training and from promotion with the communities involved with schools that teach the language. So, while there has been a financial burden imposed on schools through not having access to the funding from the Commonwealth program, the program seemed to be continuing.

CHAIR—Thanks for that. The only other thing I was going to ask you to comment on is the Australia-Indonesia Ministerial Forum. Is that effective? Can it be improved? Overall, are there any specific initiatives you would like to see to strengthen the relationships between the federal and state governments and the Indonesians?

Mr Killen—From a Northern Territory perspective, the Australia-Indonesia Ministerial Forum is a very effective way for us to maintain our links into the region. In particular, we are very interested in the Australia-Indonesia development area programs, the AIDA programs, that operate under the umbrella of the Australia-Indonesia Ministerial Forum. The Northern Territory would probably benefit from support from the federal government in relation to AIDA, although our sector group, the working group for animal husbandry, agriculture and fisheries, is the only remaining active group, I believe. We have seen that as a very good vehicle for the Northern Territory to have a formal introduction into the provinces of the eastern part of Indonesia, where we can best promote our agricultural advantages.

CHAIR—Have you any idea why those other groups folded?

Mr Killen—The other groups were chaired by other states. I am not aware why they folded, but I think the history would show that many of them folded within the first 12 months of operation.

CHAIR—We are just about out of time. Thank you very much indeed for being with us today. If there are any other matters on which we might need additional information, our secretary will

be in contact with you. She will also send you a copy of the transcript of your evidence, to which you can make any necessary corrections to errors of transcription. Thank you very much indeed. That has been very useful.

Mr Blake—Thank you very much for giving us the opportunity to appear.

[10.45 a.m.]

HILL, Professor Hal Christopher, Deputy Convenor and H.W. Arndt Professor of Pacific and Asian Studies, Indonesia Project, Research School of Pacific and Asian Studies, Australian National University

MANNING, Dr Chris, Head, Indonesia Project, Economics Division, Research School of Pacific and Asian Studies, Australian National University

McLEOD, Dr Ross, Fellow; Editor of Bulletin of Indonesian Economic Studies, Indonesia Project, Research School of Pacific and Asian Studies, Australian National University

CHAIR—On behalf of the subcommittee, I welcome representatives of the Australian National University. Although the subcommittee prefers that all evidence be given in public, should you at any stage wish to give any evidence in private, you may ask to do so and the subcommittee will give consideration to your request. Although the subcommittee does not require you to give evidence on oath, I should remind you that these hearings are legal proceedings of the parliament and therefore have the same standing as proceedings of the House itself. I understand that you would like to make some opening statements before we proceed to questions.

Dr Manning—I will coordinate the addresses of my colleagues. We thought we would speak, if you agree, for about five minutes each on different topics. I want to talk generally about the Indonesia Project. Of my two colleagues, Ross will speak on the recent parting of the ways with the IMF and developments in international relations and Hal Hill will talk on trade and bilateral relations and related matters. I will open. We are all members of the Indonesia Project at the ANU. This project has been going now for nigh on 40 years, so we have accumulated some knowledge over time on the Indonesian economy. We want to record that.

Turning to the Indonesian economy and what has been happening, basically there has been a fundamental shift in recent years in the long-term growth trajectory from something around seven or eight per cent, an east Asian model, to something closer to what we might call a south Asian model of three to four per cent. Indonesia has really turned around since the crisis and the political changes after Suharto, so it is looking a bit more like the Philippines than, say, Thailand or Malaysia. Hal Hill will talk a little about that. In the context of the change in the growth trajectory, the demographics are not as hard for Indonesia these days. The population growth is about half as fast as it was before, so that gives it a bit of a breathing space. A period of accumulated rapid economic growth and improvements in infrastructure, human capital and so on under Suharto give it a bit of a breathing place. But it is a different place from that which it was in the Suharto era in terms of economic opportunities.

The immediate situation is not too bad actually in the immediate period after breaking with the IMF. The macro-economic situation has been pretty stable. The debt situation has improved substantially to a situation that is considered pretty well viable in the long term. Inflation is way down to about six per cent, which is about half what it was. It can go down a lot more, but it is

much better. The budget is pretty much in balance. They are running a very small deficit. Exports are up a bit, partly related to the SARS issues.

The economy was not greatly disturbed by the Bali affair or the Marriott. In a sense, that is a function of the fact that foreigners are not that interested in Indonesia. It is also a function of the fact that the economy is being driven by domestic forces, such as domestic investment, to a considerable extent. If we look at what is driving growth, it has really been consumption in the recent time. The real problem is to get some investment back. Fixed investment is still negative, although there is a lot of short-term capital going into Indonesia.

Small and medium industries seem to be driving growth rather than foreign capital. That looks like it is going to be a pattern for some time to come. It is going to be a much more domestic driven economy. There will perhaps be much less dependence on international forces. The policy has moved considerably towards a more protectionist regime in a way that it was not planned in the future.

What are the implications? There is going to be less money around for investment in education and health. It is certainly not going to be like PNG, but it is going to be closer to the Philippines than, say, Thailand, where they will have more money from growth, taxes and public revenue to invest. There is going to be slower poverty decline and fewer major shocks in growing cities like Jakarta, which grew in the last 30 years, and some of the other centres. But at the same time there will be fewer improvements in living standards. We do not think this is going to feed into political and social tensions substantially. We do not see major disruptions as a result of very slow economic growth, the sort of thing that perhaps we are seeing in parts of the Pacific where you have very unstable economic growth.

There will be greater inequality across regions as they have undertaken a major fiscal decentralisation program. But there is no sign that outside the two extremities—Aceh and Papua—that that is going to be politically destabilising in a major way. We do not see that. Politics can, of course, feed into economics more than perhaps economics is going to feed into politics. There is less certainty in governance as a result of the political reforms. Building the domestic political polity, as recent submissions made before you suggest, is going to take considerable time.

Indonesia is going to be less important in international forums. I think we are seeing that both in APEC and, to some extent, in ASEAN. There is less commitment to international arrangements.

To sum up, the economy is growing. It is growing at a relatively low rate. It can live off a lot of the infrastructure and investments of the past. But at the same time Indonesia is going to be a more closed economy and one where social capital is growing much less rapidly.

Dr McLeod—I have decided to restrict my comments to, as Chris put it, the parting of the ways between Indonesia and the IMF. That is perhaps a bit of a strong way to put it. Indonesia invited the IMF to come in and assist it with managing the crisis that began to emerge in mid-1997. It has within the last few weeks decided officially to terminate that program as of the end of this year. The loans that it had obtained from the IMF already will continue to be repaid over

the next several years. It is not really a parting of the ways because the IMF will actually stay on more or less as an advisor to the government in what is known as post-program monitoring.

Looking back on the IMF program over the last six years, I think you could say that the IMF was actually welcome in Indonesia during the early months but it became much less welcome over these six years. I think that is not too surprising because its efforts to help Indonesia I would rate as largely ineffective at best and somewhat counterproductive at worst. I actually wrote a report on this for AusAID, which I entitled *Dead on arrival: A post mortem of the IMF program of assistance to Indonesia*, mainly to prevent my colleagues from falling asleep in my seminar. But that pretty much sums up what I thought of the program. If members of the subcommittee are interested to see that, I am sure AusAID would be able to make a copy available.

I think the IMF's presence came to be seen as more and more highly intrusive, especially after Suharto fell from office in May 1998, even though there was considerable support for the IMF, especially amongst the intelligentsia in Jakarta in the early months. At that time, it was effectively attacking the Suharto regime, and so everybody was glad to have it around, but as subsequent presidents have come and gone there was this feeling of great intrusiveness.

It appears that the markets have taken the departure of the IMF in their stride. They have not really reacted perceptibly to the announcement of the cessation of the program. In fact, at the moment, share prices are up in Jakarta and the exchange rate is quite steady, which indicates that there is no great capital flight as a result of the announcement. I think the financial markets are mainly concerned with macro-economic stability. That has been by and large achieved. It is not difficult to continue to maintain macro-economic stability if sensible policies are followed.

It seems to me that it was the reform part of the IMF program that was difficult to implement. It will continue to be difficult in the future. But this is not of such great concern to the financial markets in the sense that this is simply a reflection of ongoing problems, not new shocks to the system which would cause capital to run away again from Indonesia.

Presumably, the markets expect that much the same policies will be followed in the future as have been followed in the past. That said, I think much depends on who becomes the finance minister and/or the coordinating minister for economic affairs following the election of a new President next year. There are in fact significant differences of opinion on what constitutes good economic policy amongst the economics ministers in the cabinet. At the time the government announced its cessation of the IMF program, it produced what has now become known as a white paper. Formally it is presidential instruction No. 5 of 2003. It is a very long statement—it is over 90 pages—and it is basically filled with lots of good intentions as the various letters of intent to the IMF have been over the last six years. But what matters, of course, is what is achieved rather than promises as to what is going to be done.

When I looked at that document, I felt there was a failure to focus on what really matters. I had the feeling that, by listing everything as important, nothing becomes important in practice. There is in the document a very heavy reliance on writing new laws and new regulations rather than implementing existing ones, which I see as a continuing reluctance to take tough decisions and push them through to their conclusion. I would also characterise the document as displaying a lack of a clear conception of the relative roles, the complementary roles, of the public and the

private sectors. I can see the public sector becoming more intrusive in some fields in which it does not really need to do anything much.

I think it is very likely that many of the deadlines that have been set in that presidential instruction will be missed, just as many of the deadlines in the letters of intent to the IMF have been missed over the years. I think it is important to note, just in concluding, that some of the policies set out very, very briefly in this document seem to me to be counter to good economic sense. In particular, I think there is in it a suggestion that, in the setting of tariffs, they should be based on or fixed in accordance of the ability of the sector in question to compete, which to me is exactly the reverse of the way it should happen. A sector which is not able to compete on world markets should not be given tariff protection because to do so simply means that resources will be devoted to that sector when they would be better employed in other sectors where Indonesia does have the ability to compete on world markets.

The second area where I think there is a lack of good economic sense is in relation to the labour market. There is a lot of lip service paid to the importance of generating job opportunities because this is really the only way that poverty can be overcome in the long run; you have to increase the demand for labour. I can see in this document there are several pages of opportunities for new regulation of the labour market which seem much more likely to me to constrain job opportunities than generate them. I think I will leave it there. I am very happy to answer questions on that or to talk about other aspects of the financial sector.

Prof. Hill—I will talk briefly about three issues, if I may. One is trade and investment issues in Indonesia. The second one is a bit on future scenarios. The third one is a couple of suggestions, maybe even a bit of advocacy, if I am allowed to. On the first point of trade and investment, I have just very brief points which may be of interest to the subcommittee. On trade, Indonesia is a very open economy. It got to this point by instituting sweeping reforms in the 1980s pretty much as we did and at about the same time. In addition, of course, for Indonesia the IMF mandated reforms in 1997-98.

I think that openness is very much in our interest as a neighbour and a trading partner. It has to be said that Indonesia's current openness is somewhat precarious, although there is unlikely to be major backtracking. In the wake of the crisis and the perceived rough treatment by the West, especially the IMF, as Dr McLeod referred to, there has been a resurgence of nationalist sentiment. It is also the case that, with this sudden transition to democracy from an authoritarian regime, political parties do need funding—something I am sure subcommittee members here would be totally unfamiliar with.

Like the entire east Asian region and Australia, Indonesia became more open over time because of unilateral reform—that is, it reformed because it saw the benefits of reform in doing so. I believe this forward momentum—that is, unilateral liberalisation—is now endangered by the push to bilateralism and free trade agreements. I think Australia would be doing a major disservice to Indonesia to encourage it to go down this track. It would complicate life for reforms at home and in Indonesia. It would be administratively not practical. Incidentally, the major line departments of agriculture, trade and industry in Indonesia are dominated by protectionist sentiment. Empowering them, which an NFTA negotiation would do, I think would be counterproductive.

As my colleague Dr Manning mentioned, foreign investment continues to be negative six years after the crisis. Indonesia is a real outlier in this respect in east Asia, where the other crisis economies have got foreign investment back in fairly quickly. I think the key point is that while Indonesia has now achieved macroeconomic stabilisation, as my colleagues have mentioned, thanks mainly by the way to the finance minister, Dr Boediono, one of Australia's finest products, the macroeconomic stabilisation is not yet enough to ensure a return to rapid economic growth. Investors are still holding back long term because of the micro-uncertainties and the political uncertainties. So the world has to be patient, I think, in looking at Indonesia on these issues.

Thirdly, within this trade and investment area, Australia-Indonesia relations—obviously a vast topic—I think the key point to make is that we are naturally complementary economies. So complementarity plus proximity is really important. It is of great potential in a conducive business environment. For example, Australia is now the major supplier of offshore tertiary education for Indonesia, which is a phenomenon of immense long-term significance if we capitalise on it and use it productively.

It is also important to emphasise that trade obviously has to be a two-way street. We in Australia still have trade problems with our neighbours in a number of areas, including tropical agricultural products and some of the labour intensive manufactures, such as textiles, clothing and footwear. The obvious point is that governments can help things along with trade promotion and trade shows and so on, but generally this is best left to the private sector. I think the major government role here is to actually reduce the barriers to trade and certainly involve free trade agreements. It is worth noting, although you would not recommend this as a recipe for future success, that in two recent periods of friction between the two countries—that is, the mid-1980s in the wake of the David Jenkins article and other things and then the late 1990s—the commercial relations between the two countries proceeded more or less uninterrupted and in fact grew on both occasions.

Let me say a little about future scenarios. The obvious and key point is that Indonesia was very badly affected by the 1997-98 crisis. There was an economic contraction of 14 per cent. It is an order of magnitude that we in Australia are not normally accustomed to. It was combined with a massive reworking of political institutional arrangements. The outside world has to understand that there is this muddle through period which is inevitable.

If we are looking at crystal ball gazing, which of course is very hazardous, one possible source of guidance might be to look at what happened in the Philippines post Marcos. Post Marcos Philippines and post Suharto Indonesia—there are differences—are remarkably similar. The economic decline in both cases—that is, the Philippines in 1985-86 and Indonesia in 1997-98—was about the same. In both cases, there were protracted, complex debt workouts. In both cases, there was a very awkward, tense relationship with the IMF. In both cases, there was extremely rapid, arguably too rapid, decentralisation of power away from the centre. In both cases, populism in the labour market complicated the recovery. In both cases, there was a major reworking of the relationship between the bureaucracy, the executive and the legislature.

Colleagues in the Philippines have recently completed a book, funded by AusAID, incidentally, on the Philippines economy. It is instructive to remember that the Philippines economy is now in its per capita income about where it was in 1980. In other words, it has lost

one quarter of a century of development with no net growth. It went down and then came up back to where it was. The question, I guess, is whether Indonesia is going to be in the same position. That is, is Indonesia going to lose effectively a quarter of a century and be back where it was in the mid-1990s in about the year 2020? It seems to me that this is one of the key questions for the subcommittee to contemplate, especially I guess because, if Indonesia is economically somewhat incapacitated, it is arguably much more important in the region than the Philippines both because of its geographic location and because of its size.

Finally, I will make a couple of suggestions on economic issues. If you will excuse me, I am getting a bit towards the area of advocacy. We have to be very cautious in dealing with Indonesia. Indonesia is in no mood to be lectured to, as it has shown with the IMF experience, as Dr McLeod referred to. I will make two concrete suggestions in the area of economic policy making, where I think we could make a contribution.

The first point is that obviously improving economic policy making is the key to getting the economy back to the seven per cent growth that Dr Manning referred to. It is the only sure way of overcoming poverty. How this is done, of course, is a matter for the Indonesian people. One idea I would like to commend to the subcommittee is the following.

If we think about the current discussions and debates on Indonesian economic policy making, they are characterised by four key features. First, it is highly fluid and changes quickly. Secondly, it is highly variable in its quality, but mostly rather poor quality and very populist. Thirdly, it is increasing anti globalisation and anti IMF in character. Fourthly, it is highly dependent on one key and very successful minister, Minister Boediono, to whom I referred. I think this trend will continue with the IMF exit.

At the moment, this means that the proponents of sensible economic ideas are constantly on the back foot. Most of the debate is occurring in an analytical and empirical vacuum. I believe there is a great need for better informed discussion. One possible mechanism for addressing these problems would be the establishment of an independent authority answerable to the finance minister to undertake high quality policy research in important areas and feed them into the public domain, where we now have a very lively and pretty open press. In some ways, it could be akin to something like our Productivity Commission, which in its former guises played such an important role in Australia in providing the ammunition for the Australian reform process from the 1980s onwards. I think there would be a very high pay-off for Indonesia. It is being talked about in circles in Indonesia that know a bit about our Productivity Commission.

On the specifics—it is a big and detailed question, but just a few points I think are important. It would obviously have to be an Indonesian institution with Indonesian ownership. We would need to think long time—five to seven years at least in the first instance—in proposing it. We would need a major commitment to it, something of the order, I imagine, of about \$5 million a year. It might sound a lot, but that is less than three per cent of the current AusAID budget for the Indonesia program.

The second point is that I think it is still the case that Australia has a greater stock of expertise on the Indonesian economy than any other country outside Indonesia. Thanks for that go primarily to the late Professor Heinz Arndt, who set up the ANU Indonesia project in the mid-1960s. I have to report, as will be strikingly obvious in the sample of people before you, that the

pool is ageing and it is not being replaced. There is a danger that in about 10 years the pool will disappear altogether. I guess the context in universities is that area studies specialists are not the flavour of the month. I think something modestly significant needs to be done to address this problem. I would like to propose for the subcommittee's consideration a recommendation that the government grant two PhD scholarships a year in Australia for work on the Indonesian economy. I also suggest they be called the HW Arndt scholarships. Perhaps there would be one each for an Australian and Indonesian citizen tenable at any Australian university with a demonstrated interest in work on the Indonesian economy. Thank you.

CHAIR—Thank you very much. Just before we proceed to questions, we have a delegation from Indonesia who is visiting our inquiry this morning. They are a delegation of high-level officials led by Mrs Iga Tarsini. We bid you a very special welcome to this most important inquiry.

Mr BEAZLEY—I would like to start with where you concluded, Professor, because we have had a bit of evidence along these lines in the course of our considerations. The question is about developing expertise in this country. Do you have an impression, either boosted by statistics or just anecdotally, of why it is that there is such a reluctance on the part of students to enter into studies of not just Indonesia but South-East Asian politics and economics generally? Have you got a view of at what level this problem has to be addressed?

Prof. Hill—It is a really complex issue, Mr Beazley, and I do not have a simple answer. There was a golden era, in a sense, in the 1960s and 1970s, which is the part that you know about. Since then, I think a number of factors have conspired to make Indonesia less attractive as an area of study. One is, I guess, the friction in the bilateral relationship from time to time. The Timor issue has complicated things. Another issue, I guess, is that other countries have become, in a sense, more attractive, China in particular, especially for those students with a business career in mind. They think of the high-growth economies as being important. Within universities in general, the disciplines are now emphasised more than area studies, so area studies are sometimes seen as a bit of a backwater in the academic community. I think there have been a number of factors at work. It is hard to put your finger on a particular point.

I think the key point is that from time to time if there is a national problem, there probably is a case for some sort of national solution to it. That is, initiatives, modest in nature, can make a bit of difference in turning things around and changing the perception. At the moment, you would have to say that almost all the key experts on Indonesia across disciplines are in their 50s plus, and it is a worry. The other point is that Australian universities used to be able to recruit on international markets from anywhere. The salaries were attractive. That is no longer the case. We cannot compete internationally the way we used to be able to.

Mr BEAZLEY—I wanted to give you a bit of an opportunity to advertise there, but I will go over to one or two of the other matters that you raised. I think in different ways all three of you raised the issue of protectionism developing in Indonesia, the ideological underpinnings of it and the economic rationales for it. In practical terms, against whom have protectionist measures so far in reality been directed? Has it been to Western product or has it basically been to the neighbourhood?

Prof. Hill—At the moment, it is more a sentiment and less a reality. But the sentiment is really gathering strength and it is becoming more powerful. At the moment, it is predominantly in a range of agricultural products. That is partly because—it is a complex issue—with agricultural products it is easier to circumvent WTO requirements or there are non-commercial interests like quarantine which you can invoke. It is partly because as Indonesia is rapidly democratised, there are votes outside the cities and agricultural protection is a means of doing it. It is underpinned moreover by the fact that anti-globalisation sentiments do give you a free kick. Indonesia has been through a really rough time with the perceived heavy-handed intervention of the West and the IMF. Therefore, there are votes in a popular sense in protection.

It is worth pointing out that Indonesia at the moment is somewhat hemmed in by AFTA, the ASEAN free trade agreement. At the moment, it is not yet serious. But the way the sentiment is gathering and with the current ministry for trade and industry being implemented, it could become pretty serious in the next three to five years, depending crucially, as Dr McLeod mentioned, on who is the next finance minister.

Mr BEAZLEY—You link it to the growing popularity of bilateral type trade agreements. Are they actually pursuing any that are likely to come to a serious conclusion at the moment?

Prof. Hill—At the moment, Indonesia is only a signatory to AFTA, which of course is regional rather than bilateral, and APEC, which is non-binding. However, a couple of months ago, the minister for trade and industry announced the intention of the government to pursue FTAs with five countries, one of which is Australia. Two points are very clear about that. One is that Indonesia feels under pressure to do it because other countries are doing it in the region—Singapore, Australia, Thailand and others—so it feels as though it is missing the boat if it does not do it. Secondly, it is very clear that, although this minister is talking about FTAs, the reality is the other way. That is, it is going towards a protectionist sort of direction. So if the FTAs were to ever get off the ground, it would be in a highly regulated sense. It would be very dangerous for Indonesia because it would sidetrack the reformers, who are trying to push ahead with reform. They would have to then fight bushfires elsewhere. So it would be regrettable, but it looks like it is on the horizon.

Senator FERGUSON—Dr Manning, I do not want to misquote you, but I think you said in your opening remarks that Indonesia is a different place for investment opportunities since Suharto. Could you expand on that a bit? Why is it so different? I know the political situation has changed. I think it needs a bit of expansion.

Dr Manning—Sure. Incidentally, I think I made an incorrect statement. I think I said gross domestic investment is negative. What I meant to say was foreign domestic investment, or FDI, is negative. Why is Indonesia a different place? There are a host of reasons, I think. The overall democratisation process has brought many voices into the political scene combined with decentralisation, which has contributed to erratic political stances on a range of issues. Local politics often leads to actions against foreign investors that are not supported at the centre—land claims, squatting on investment sites and local regulations which prohibit transactions by a large corporation. So there is a general aura of policy uncertainty, both centrally and regionally, and particularly regionally with decentralisation.

In specific areas, such as mining, there is a very, very great uncertainty. We have seen it in some of the big mining corporations right across the country. In Kalimantan, in the big coal investment, there is a huge dispute going on with the provincial government over the sale of part of that company by the foreign company. As I have mentioned, there have been land disputes and so on in other areas, such as north Sulawesi, on a range of issues. So there is certainly a real problem with the large-scale mining corporations in Indonesia.

At the other extreme you have many of the labour intensive industries—garments, footwear and textiles—where foreign capital, particularly from Korea, Taiwan and other South-East Asian countries, has been important. These investments have been hit by a range of regulations, some of them tax related. Labour regulations are very rapidly increasing minimum wages. There is an extraordinarily extensive labour law, which is probably the most restrictive of any law anywhere in East Asia that I know of. Indonesia has always been restrictive on labour grounds but never implemented it. It now has an active trade union movement. It is a combination of those things.

Senator FERGUSON—Is it a deliberate discouragement of foreign investment by the Indonesians or is there a reluctance from foreign investors to go in because of the impediments that are currently in place? Which is it?

Dr Manning—It is more the latter. It is not an explicit policy of the government.

Senator FERGUSON—But they are aware of the effect of their actions.

Dr Manning—As I am sure you are aware, there has been a major decentralisation so that the policies of the central government are not always reflected in the policies of provincial governments. Some of these provincial governments have considerable bargaining power. Look, for example, at places like East Kalimantan. It has very substantial revenue from mining as a result of the decentralisation of finances. It is there often following policies that are at odds with the central government policies. So it is by default, in a sense, that this is occurring.

Senator EGGLESTON—I was interested in education. You mentioned that we are the largest provider of education services to Indonesia. I have heard that we have about 18,000 or thereabouts Indonesian students in Australia. I wonder what the scope for expansion of our educational services to Indonesia is in terms of perhaps the location of Australian university campuses in Indonesia or with facilities like e-education and the Internet. Who are our major competitors for the Indonesian market?

Prof. Hill—Just to make a point on your comment, we are the largest offshore tertiary education provider. Obviously, we play a very small role in primary and secondary and onshore tertiary, where Singapore is the major provider. It is a very important story and one that is little commented upon. It has occurred not because Indonesia necessarily loves us. It is because it is a pragmatic decision. We are close by. We are perceived as being reliable and fairly safe. Of course, we are cheaper than the alternatives—the US, the UK and Canada. But I think it is a very important long-term phenomenon. It will mean that in the future much of the Indonesian elite in business, politics and civil society in general will have an Australian education. With the spin-offs of family and parents coming to visit them, I think it is a very important development, perhaps one of the most important developments, in the commercial area between the two countries.

What can be done? I think the main thing is that it is essentially driven by competitiveness plus quality. I think it is important that we maintain quality. There are some sharks in the field. I think there is a case for maintaining the regulatory environment, which ensures that quality and integrity is preserved. I think a very important issue is to follow up with this rapidly growing alumni population in Indonesia to keep them in contact with Australia. I think there is scope there for the embassy to do a lot more.

On e-education, I am not really an expert in the area. My impression is that it is growing very quickly. A couple of Australian universities have got in on the ground floor, capitalising on the fact that students have come here to study. So I think it is an area with a very bright future. It is almost as though the Indonesian upper middle class has taken the decision that it is just not going to be possible for the Indonesian education system to provide an international quality tertiary education system in English. Therefore, you have to go abroad. As long as that political economy dynamic prevails, I think it will continue to be large. We are also No. 1 for Thailand now, which is a recent development, and I think we are either No. 1 or No. 2 in Malaysia, so this is a really important story, not just for Indonesia.

Senator EGGLESTON—Yes, it is. What is the value of that education sector to the Australian economy?

Prof. Hill—Of the overseas students?

Senator EGGLESTON—Yes.

Prof. Hill—I have not seen recent estimates. Perhaps my colleagues from the Department of Foreign Affairs and Trade will provide you with them. The figures are very large, but just as to what they are I will defer to the specialists. It is not just the direct effects too; it is also the indirect effects of tourism related things and so on.

Senator SANDY MACDONALD—I want to follow on from that. You say that we are the largest supplier of tertiary education to Indonesia and that Indonesians come here for all the obvious reasons—that it is close and safe and things like that. You say it is not because they like us. Do they like us more after they have been here, do you think?

Prof. Hill—I honestly do not know. I hope so. I have not really seen any systematic surveys undertaken, Senator Macdonald. It is a very important point, actually.

Senator SANDY MACDONALD—It is such an important alumni grouping, isn't it? These are powerful people.

Prof. Hill—Yes, that is right.

Senator SANDY MACDONALD—I wonder if there is anything we should do from a governance point of view to make sure that their stay here is as positive as it can possibly be.

Dr Manning—I will add to that. I think it is the post study period that is most important. It seems to me rather difficult to affect the nature of the study period in Australia. It is limited. We can do some things to improve conditions. But we do not have any integrated program of

supporting Indonesians when they go back, or any foreign students in fact, and I think that is a problem. My experience over a long period of time is that the association with Australia does dissipate quite significantly over time. So by the time these guys get into important positions, their Australian experience often is not particularly significant to them. That may be five to 10 years afterwards.

Senator SANDY MACDONALD—Do you have any suggestions as to how we might counter that?

Dr Manning—Looking at the Japanese experience, the Japanese have very solid alumni organisations. They are strongly supported by their foreign affairs ministry. They allocate money to support alumni relationships and provide practical follow-up at particular institutions or provide information in certain fields and so on.

Senator SANDY MACDONALD—You can only reinforce something that has been a particularly positive experience. You cannot create in retrospect something that perhaps has been two years of hell. I do not know the answer. I am just wondering whether there are any thoughts about how you might reinforce that really positive experience. We are very privileged to have those students here. As a means of building a stronger relationship with Indonesia, I cannot think of a more powerful force. We always say it. You are not the first people who have said it, of course. Other people have said it as well.

The other question I have revolves around the question of investment, which you have discussed again in questions. You said that net foreign investment is negative. I have a couple of questions on that. How long has that been the case? Secondly, where have been the withdrawals of foreign capital? Has it been, for instance, in Taiwan? Has the withdrawal of Taiwanese capital been of benefit to Australia? Perhaps it has come here.

Dr McLeod—I am not sure that I know the answers to all of those questions. I think foreign direct investment has probably been negative ever since the crisis began. I think at that time investors, not only foreign but also domestic, got cold feet about Indonesia and decided their wealth would be safer and more productively used elsewhere. I think it has just never come back as far as the foreigners are concerned.

Senator SANDY MACDONALD—Since 1997?

Dr McLeod—The crisis began in the middle of 1997. Capital outflow really began to be quite large in the second semester of 1997. I imagine that most of that outflow tends to be concentrated more on the European economies and America and perhaps less so amongst the Asian investors, but my colleagues might like to add to that.

Senator SANDY MACDONALD—Do you think the anti-Chinese nature of those riots must have impacted certainly on the Chinese community? That is why I mention Taiwan.

Dr Manning—Yes. I think that is correct.

Dr McLeod—I think a lot of the outflow is in the form of domestic capital outflow, where ethnic Chinese Indonesians undoubtedly decided to do some of their investing in countries like China, Taiwan or Singapore and so on.

Senator SANDY MACDONALD—Or the Gold Coast.

Dr McLeod—Or the Gold Coast, indeed, in a small way.

Prof. Hill—I will add a very small point. I want to also emphasise that the major long-term foreign investor has been Japan for the last 30 years. Unfortunately, the Indonesian crisis of 1997-98 coincided with this long-term recession in Japan. So Japan, which was also once the driver, sort of dropped off the scene. So in addition to these other problems that my colleague mentioned, there is a special Japanese part of the story

Senator SANDY MACDONALD—Thank you. I will not ask you about travel advisories; that would be not fair. The general nature of travel advisories is that non-essential travel be postponed or not taken. How does the ANU regard that advice? Does it prevent you travelling? Have you taken the bull by the horns?

Dr Manning—There are a thousand different voices, I think, on that issue. Generally, most academics at the ANU feel that the travel advisory is somewhat extreme in its nature and that domestic conditions in Indonesia have not changed very much. That has been most of our experience. I think all of us have travelled many times to Indonesia since the Bali bombings. I was in Indonesia a week or so after the Marriott bombings. Within Indonesia there is absolutely no perception of fear related to those particular events and nor is there a sense that Australians are being targeted or that in any way there is a specific problem for Australians. But this is a little beyond our portfolio.

Senator SANDY MACDONALD—I know. I was not asking you. I was just wondering whether you are travelling there. The last question is this: within the Research School of Pacific and Asian Studies, do you have somebody who is an Indonesian Muslim expert or an Islamic expert on Indonesia?

Dr Manning—Actually, we have a considerable number. Dr Greg Fealy is an expert on Islam and, in particular, Nahdlatul Ulama, the conservative Muslim party that saw Abdurrahman Wahid come to power. Professor Jim Fox has a number of Muslim students. Professor Virginia Hooker works on Islam and her husband, Professor Barry Hooker, works on Islamic law. So we have at least four experts on various aspects of Islam working at the Australian National University.

CHAIR—We are well over time. There being no further questions, I thank you for your attendance today. If there are any matters on which we might need additional information, the secretary will write to you. She will also send you a copy of the transcript of your evidence to which you can make any necessary corrections to errors of transcription. Once again, thank you very much indeed.

[11.35 a.m.]

CHITTICK, Mr Craig Ian, Director, Indonesia Section, South and South-East Asia Division, Department of Foreign Affairs and Trade

CLOGSTOUN, Mr Royden, Executive Officer, Services Trade Negotiations Section, Office of Trade Negotiations, Department of Foreign Affairs and Trade

GIBBONS, Mr Paul Anthony, Executive Officer, Indonesian Section, Maritime South-East Asia Branch, Department of Foreign Affairs and Trade

GLASGOW, Ms Julie, Executive Officer, Regional Trade Policy Section, Department of Foreign Affairs and Trade

PATERSON, Mr Bill, First Assistant Secretary, South and South-East Asia Division, Department of Foreign Affairs and Trade

CHAIR—On behalf of the subcommittee, I welcome representatives of DFAT. Although the subcommittee prefers that all evidence be given in public, should you at any stage wish to give any evidence in private, you may ask to do so and the subcommittee will give consideration to your request. Although the subcommittee does not require you to give evidence on oath, I should remind you that these hearings are legal proceedings of the parliament and therefore have the same standing as proceedings of the House itself. I invite you to make a short opening statement, if you wish, and then we can proceed to questions.

Mr Paterson—Thanks, Mr Chairman. I thought it might be useful, without really quite knowing the testimony you have had from our ANU colleagues and others, if I gave you a quick overview, as we see it, of the Indonesian economy and the economic aspects of the bilateral relationship. My colleague Mr Gibbons has circulated or is circulating to you a series of graphs of economic statistics which will accompany my presentation. I will say at the outset that Indonesia is continuing to show signs of faster economic growth this year. They have forecast GDP growth of four per cent this year and five per cent for 2004-05. Growth has been underpinned largely by consumption expenditure and net exports. You have already heard, I think, from our previous speakers that there are some other weaknesses. I will come to them.

GDP until now has been below pre Asian financial crisis levels. In the third quarter of this year, some new preliminary statistics suggest it may finally have just exceeded those levels. Fiscal consolidation has continued. The deficit for 2003 is on track. Government debt as a proportion of GDP has fallen from 100 per cent in early 2002 to less than 70 per cent now. Inflation, which was very high in 1998 and 1999, has moderated, but prices are now over 2½ times higher than they were in 1997. Interest rates have fallen in line with lower inflation. The rupiah has appreciated. The Indonesian government forecasts an average of 8,500 rupiah to the US dollar this year. So it is more stable but significantly lower than pre-crisis levels.

Indonesia has decided to graduate from its IMF program at the end of this year. In an effort to promote confidence, the government has released a white paper detailing measures to maintain

economic stability and to continue with restructuring after the graduation from the IMF program. This has been reasonably well received in financial markets. It is based on the formula used in the letter of intent submitted during the IMF program. The IMF will continue to have a presence in Indonesia by way of post program monitoring.

The Indonesian government is confident it can meet the funding gap in the absence of an IMF program and, therefore, Paris Club rescheduling. The Indonesian economy has benefited from a benign international economic environment. But a higher growth rate—a growth rate up to six to seven per cent, which, quite frankly, Indonesia needs to absorb new entrants to the labour force—will only be possible once foreign direct investment returns to Indonesia. In order to promote such investment, Indonesia needs to do a number of things. It needs to move decisively, I think, with reform of the legal system, which is probably the largest single disincentive for investors. There needs, for instance, to be a lot more confidence in the operation of Indonesian commercial courts. They need to address the confusion caused by the implementation of regional autonomy, which is something that Professor Manning just mentioned. They need to strengthen the banking sector, obviously, to improve corporate governance. There is the whole spectrum of issues related to transparency and accountability. They need to improve the quality and quantity of public infrastructure and, of course, to strengthen counterterrorism in an effort to improve the actuality as well as perceptions of the security environment.

I guess it is the lack of real reform and the security situation that we see as having had the most dampening effect on investment. Domestic and foreign direct investment has really not picked up since the Asian financial crisis. In fact, there has been a process, arguably, of disinvestment. Again, our previous speakers referred to that. Portfolio investment has recently returned. The stock market in Jakarta is quite buoyant, but, of course, that money can flow in and flow out overnight.

According to Indonesian statistics, Australia was the 10th largest foreign investor last year. Investment approvals have averaged \$US544 million over the past six years, but the figure is expected to be significantly higher once Australian investment channelled through foreign subsidiaries is taken into account. We consider that around 400 Australian companies currently operate in Indonesia. We have quite a big presence, of course, in mining, in banks, some consumer services, insurance and tourism et cetera. Of course, there is, as you were recently hearing, the education trade. Those companies that have been there long term and with existing operations are cautiously investing. Those without, I think, are continuing to wait for a clearer perspective on regulatory and security issues.

Our bilateral trade relationship remains robust, reflecting complementarity between the two economies. In the financial year 2002-03, merchandise trade at \$7.51 billion is a record. Indonesia currently enjoys a significant merchandise trade surplus of about \$1.7 billion. As you recently heard, education services are the highest export earner for Australia. Our statistics show about 17,000 Indonesians studying in Australia.

Australian exports to Indonesia have weakened recently, largely as a result of the Australian drought and, of course, the Australian exchange rate appreciation. There have also been other factors. The previous speakers referred to the growth in wage rates in the textile, clothing and footwear sector. That has led to a decline in cotton exports from Australia, as an example.

The architecture of the bilateral economic relationship is well developed. It is basically as well developed as with any of the other countries in South-East Asia. The Australia-Indonesia Ministerial Forum is the peak bilateral meeting on economic and trade issues. The last meeting of the forum was held in Jakarta in March this year. Seven Australian ministers and 10 Indonesian ministers participated. There are 11 working groups under this forum on issues as diverse as education, agriculture and transport.

I might leave it at that as an opening statement. The macro economy is stable to positive. Growth is increasing, based in part on political stability. I think Indonesia has enjoyed a period of relative political stability under the current Megawati administration. Domestic consumption is the driver; that remains very strong. Net exports are strong. Of course, interest rates have moved down. So all those have been positives. But we would be very willing to take your questions, Mr Chairman.

CHAIR—Thanks very much indeed. You have given us those statistics. There are just a couple more. Where do we fit in in the scheme of things in terms of our debt relief programs, our aid programs and our cooperative programs? Would we be considered major players in Indonesia with them?

Mr Paterson—You would want to separate each of them out. Our standing is probably different in each of those areas. Mr Chittick might have a more accurate readout of that. If we do not have it, we could probably provide it to you on notice.

Mr Chittick—Certainly in terms of aid, the Japanese, the Americans and the World Bank are the major donors. Australia is a very significant donor. An increase in the aid budget in the last budget has certainly consolidated that. So we are a very significant player but certainly not the biggest aid donor. In terms of our assistance on debt, as a member of the Paris Club, we have been providing debt rescheduling to the Indonesian government. Again, we are certainly not the country with the largest exposure of public debt to Indonesia but it is certainly a significant national interest of ours. Our policy is that any assistance on debt would come through the Paris Club rather than through bilateral arrangements. As the Indonesian government has decided not to renew its IMF program next year, that precludes them from receiving assistance from Paris Club countries.

CHAIR—With respect to the emergence of the Gulf states, and in particular the Saudis, showing very great interest in investment, did that come out of the blue? Did it surprise you? Can you give us any background on that?

Mr Paterson—Do you mean Saudi and Gulf state investment in Indonesia?

CHAIR—Yes.

Mr Chittick—There have been cultural and social links between Indonesia and the Middle East for a long time. There certainly are commercial interests there as well. I am certainly not aware of any significant increase in foreign direct investment from the Middle East, certainly not to the types of levels that we are seeing coming in from China or the existing levels of Japan, Korea and Taiwan.

Mr BEAZLEY—A lot of the material we see on it now is partly propagandist, for whatever set of purposes, from the people who are delivering it—the Saudis and the other Gulf states—to the Indonesians. I think it is there for political effect more than any real effect.

Mr Chittick—I am really not sure of that.

Mr Gibbons—According to Indonesian statistics, the Saudis have not made it into the top 20 approvals for the last few years whereas we have. We rate No. 10. Singapore, Hong Kong, Mauritius, the United Kingdom, Japan, the US, South Korea, France and, of course, the Netherlands are also in that top 10.

Mr BEAZLEY—Do you have a profile of Saudi or Gulf state investment in the Indonesian education system?

Mr Chittick—We certainly do not on hand. We can certainly take that on notice.

Mr BEAZLEY—On notice, could you give us, insofar as you have it, a bit of a chart of support out of the Middle East for the education system in Indonesia?

Mr Paterson—I think a number of those flows will be difficult to pin down. In the past, a number of them have come from Islamic charities in Saudi Arabia in particular. Some of those flows have until recent times been hard to track. Saudi Arabia has now brought in much stricter regulations on unofficial flows. That should be easy to track in the period ahead. But I suspect the statistics will not be particularly revealing on that because in many cases they will be unofficial flows between charities and Muslim organisations rather than government to government movements.

Mr BRERETON—I have a couple of questions about the security relationship. Can DFAT confirm the media reports that the planned Kopassus training in Australia that was due to commence later this year has now been put on hold? Arising from that, I want to ask whether it is really the case that Australia can pick and choose individual Indonesian officers when it is really Kopassus itself that has had such a track record of human rights abuses in East Timor and elsewhere?

Mr Paterson—Thank you, Mr Brereton, for your question. I think it is fair to say that the Australian government's policy is one of taking a gradual and step by step approach towards practical defence cooperation with Indonesia in areas of mutual interest and moving at a pace and in a direction with which both sides are comfortable. As you know, the government has been taking steps to develop very limited links with Indonesia's special forces, the Kopassus, specifically in the area of hostage recovery and counterhijack operations. We have done that specifically because we see that it is in our national interest to do so in terms of an overall counterterrorist strategy.

But there is no training program like you mentioned. There is no formal program. We really are at a much more exploratory stage than that. We are continuing to engage in discussions with the Indonesian armed forces on what might be done, a program that meets our interests and Indonesian interests. It will be done against the background of Kopassus's historic human rights record. It is obviously a balancing act. The government has decided, however, that it needs to be

examined because the government has, of course, a serious responsibility for the safety of Australians overseas, including in Indonesia.

Mr BRERETON—But was there not a meeting set down last week for Perth which Kopassus officers were due to attend? Was that meeting not cancelled, a meeting that had been set up to discuss the training of Kopassus members in Australia?

Mr Paterson—I am going to have to say that the specifics of that question are best addressed to the Department of Defence. I should add that, to the best of my knowledge, there was no such meeting planned to take place in Perth.

Mr BRERETON—Can you give us a heads-up on Aceh at the moment?

Mr Paterson—Only in very general terms. We were expecting the questioning this morning to be related to Indonesia's economy. I brought my—

Mr BRERETON—I will pass on that to a more appropriate time.

Mr Paterson—But we would be happy to do that. Mr Chittick has recently returned from Indonesia. He might be able to offer a general comment. I think our focus this morning was specifically to brief you on the economy.

Mr BRERETON—I am happy to pass on that if there is a more appropriate opportunity in the inquiry to deal with these issues.

CHAIR—Do you want to make any comment?

Mr Chittick—No, not at this stage. I was the economic counsellor in Jakarta, so while I have a general understanding of these issues, I certainly would not be able to provide any more detail than Mr Paterson.

CHAIR—I will bring it back to the area of moving out of the IMF. The IMF still have all the programs in place for this year. I was going through them. I think there was some bank privatisation, the establishment of anti-corruption commissions and goodness knows what else. Will those programs still go ahead?

Mr Chittick—Certainly the IMF program is very detailed and contains a lot of measures that the IMF and a number of other countries have been urging the Indonesian government to take. At the end of the IMF program, the government has recently released a white paper on economic policy which is at least as detailed as the IMF's letter of intent. It includes very detailed implementation programs and includes dates by which the implementation of particular measures is supposed to be finished. The reaction of business in Indonesia and the financial markets is that they see that plan as credible. We should emphasise that it is a plan. As with everything, it is the implementation of that plan that will be the proof of the pudding, so to speak. We will certainly be encouraging the Indonesian government to stick by its plan. We believe that it is certainly a very credible approach to resolving Indonesia's economic problems.

Mr BEAZLEY—You have emphasised the possibility of returning to a better performance on FDI in Indonesia over the next few years. Can you paint us a picture, because you have just come back, of the actual power centres now in the Indonesian economy? I have the impression that there has been a massive shift over the last five years. Most economic activity being generated involves people devising more and more interesting ways of value adding their local product, be it in the provision of services or what they do with their agricultural products, the development of a small-scale manufacturing industry and the like. In fact, it has become a much more internalised country and quite cheerful and happy about it. The FDI issue is related to the big projects that dominated the Suharto era. I do not know what reserve capacity there is left from construction, be it mining or manufacturing, from the Suharto era—whether it is all sitting and rusting at the gate or whether it is still quite viable, even if it is not being added to. It seems to me that it has shifted to one side and that, following that change to a more robust view of their own domestic economy, politics is going to be built on that change. It will be much more localised. There will be less big money politics. It will be much more related to people who are actually delivering economic outcomes in a particular area and enhancing their political power through that process. That is a big mandate but, you know, get on with it.

Mr Chittick—I would agree with that. Indonesia is currently undergoing three very significant and very challenging reform processes. It is undergoing a political transition to democracy. It is undergoing a decentralisation process. It is also undergoing an economic reform process. They are changes that in the Australian economy took decades, even centuries. Indonesia is attempting that in a very short period of time. So there has been a diffusion, I guess, of both political and economic power down to the regions and the provinces. The informal economy in Indonesia, which is that part of the economy that the taxation department or their version of the Bureau of Statistics does not quite capture, is very important. It provides a very important stabilising force in Indonesia. It is very difficult to calculate how big it is and how it is going. It is really only through partial indicators like cement sales and electricity consumption that you can get an understanding of that. Certainly the Indonesian government places a very important emphasis on small and medium size enterprise. Like in Australia, SMEs provide a very significant share of employment and a very significant share of income. The Indonesian government has a quite detailed program to promote SMEs.

One of the problems with the informal economy is that, precisely because it cannot be measured or in many ways captured, growth in that economy does not make its way through into taxation receipts, which can then drive further development spending. It is important that both parts of the Indonesian economy—the formal sector and informal sector—grow very strongly. Certainly in terms of foreign direct investment, there has been a very significant outflow of FDI since the crisis. It has had a practical effect of reducing the quality and quantity of the capital stock in Indonesia.

Mr BEAZLEY—Is that outflow more representative of Indonesian nationals putting their money outside or foreign nationals withdrawing their resources?

Mr Chittick—It is difficult to discern between the two because of accounting problems. Sometimes the transactions are undertaken by a Singaporean or Hong Kong company which is in fact controlled by Indonesians. So it is difficult. The anecdotal evidence suggests that there was a lot of capital removed by Indonesians and placed offshore. Again, anecdotal evidence suggests that some of that is starting to come back in. As Mr Paterson mentioned earlier, political stability

is a key factor in that. People are more confident to go to the malls to do shopping. They are more confident to engage in purchases of consumer durables like motorbikes. Certainly the elites are now starting to spend more money on property investment and consumption.

Senator EGGLESTON—You may have covered this because I left the room briefly. What are the implications for foreign direct investment and confidence in the Indonesian economy with their decision not to continue with the IMF program? I was there a year ago with a group and we met some ministers who obviously found the IMF program rather onerous and they said they were going to not continue with it. Indonesia has large debts and fairly high levels of corruption and unemployment. Obviously, if they pull out of the IMF program, there must be a growth in a lack of confidence in their ability to manage their economy and have a reliable investment climate, I would have thought.

Mr Chittick—Certainly the government's adherence to the IMF program and the detail in the IMF program provided a lot of international confidence in the Indonesian government's economic policy. In their transition from the IMF program, they have recently released a government white paper on economic policy which has used, I think, the IMF program as a model for their own economic policy. Certainly one of the significant benefits in releasing that paper is that the Indonesian government now has a much better ownership of its economic policy commitments. I know from my discussions in Jakarta that the officials were very keen to have a sense of ownership rather than having at least a perception of economic policy being determined at least partially by other countries.

Senator EGGLESTON—Was there some advantage in terms of foreign direct investment or some confidence in the fact the IMF would monitor the progress of the management? Under their proposed self-management, if you like, or their own program, the monitoring will not be there and perhaps there will be less confidence in the reported outcomes.

Mr Chittick—I understand that part of the normal transition process from an IMF program is that the IMF will play a post-program-monitoring role in Indonesia. I think that takes place until Indonesia has repaid its loans to the IMF. Until Indonesia repays its loans fully, as Thailand recently did, the IMF will retain a post-program-monitoring role in Indonesia. Even after that, the IMF will still maintain a monitoring role in Indonesia, as it does in Australia.

Mr BRERETON—Following the earlier question I asked about Kopassus, I noted Mr Paterson's answer that he was unaware of any meeting that had been cancelled in Perth. I refreshed my memory as to the press reports on this, which indicate that there was a visit planned by 10 Kopassus officers to the Australian Special Air Services regiment in Swanbourne in Perth last week. The Indonesian army cancelled the visit after the Australian Defence Force objected to it being led by Major General Sriyanto. The report went on to state:

...a spokesman for the Indonesian armed forces, General Syamsuddin, confirming that a preliminary trip of Kopassus officers planned for last week had been cancelled and the training of Kopassus members in Australia due to begin later this year had been put on hold.

I ask the department to get back to us in respect of that.

CHAIR—This is scheduled to be our last public hearing. Does anybody else have any questions on notice that they want to put? They probably should put them in today.

Mr BRERETON—Perhaps I can finish by asking Mr Paterson for his view. Do you really think we can in practice choose between good Kopassus and bad Kopassus? Might it not have been better for Australia to have maintained the policy of no exercises with Kopassus and concentrated all our antiterrorist efforts with Indonesia through the Indonesian police?

Mr Paterson—I think the answer is that we are putting in a very big effort with the police. I think everybody is familiar with that, so I will not go over the detail of it, except to say that we have embarked on a \$4.75 million four-year capacity-building program with the Indonesian police specifically to help them build their capacity to deal with terrorism. Several other countries are also helping them with capacity building—the United States, the UK and others. We will look potentially to do some more work in that area in the context of the planned regional meeting, which Mr Downer and Hassan Wirajuda will co-host in Bali in February next year. I want to be absolutely clear about that. The government will continue to give a lot of attention to assisting what so far has been a very successful pattern of cooperation with the Indonesian National Police.

On Kopassus, the government made a difficult judgment, I think, trying to balance our concerns about Kopassus's human rights record with a need to engage with what is at this point still the only effective counterhijack, counterhostage force in Indonesia. The government has made it clear that such cooperation as might take place would be restricted to those areas and that, essentially, in dealing with particular individuals, the government would take account of their past human rights record. Nobody is suggesting this is easy or straightforward. The implementation of this will obviously be a very complex thing. I think at this point it is very largely untested because we have not yet embarked on any programs of renewed cooperation with Kopassus.

Mr BEAZLEY—Perhaps you could give some indication, when you give a considered reply to Mr Brereton's question on notice in this regard, of the department's view as to whether pursuing particular elements of the defence cooperation program, which might produce this agreement between Australia and Indonesia on a more or less routine basis—for example, the exclusion of particular officers from Kopassus—will not in fact seriously damage the relationship between Australia and the Indonesian armed forces by constantly provoking argument and whether it would not be better, if you had an element of the defence cooperation program that constantly provokes argument, to eliminate it from the process rather than suffer disadvantage in relations between our two countries and our two defence forces by pursuing it.

Mr Paterson—In essence, Mr Beazley, you will appreciate that that will be essentially a judgment by ministers, but we will draw your comments to their attention.

CHAIR—We are running out of time. I was wondering whether I could go back to the talks of the last few weeks regarding the ASEAN free trade agreement. What sort of effect do you think that is going to have on the Indonesian-Australian relationship? What updates can you give us on that?

Mr Paterson—I will ask Mr Gibbons to speak to the AFTA CER developments.

Mr Gibbons—As I am sure you are aware, AFTA had a meeting last week of leaders where they announced, to quote Dr Mahathir, a 2020 vision for an ASEAN economic community. 2020 is a long time away. Under the AFTA CEPT, the common effective preferential tariff, while they have come a long way, they have now got to a point where getting further liberalisation is particularly difficult.

In the case of Indonesia, they have met their AFTA commitments up to date. They are falling a bit behind on their commitment to have zero tariffs. They will not meet their commitment until next year, where 60 per cent of its CEPT tariffs in the inclusion list will be at zero. It is currently about 56 per cent, so there has been a bit of slippage. In Indonesia there have been—I do not want to call it backsliding—tendencies towards increased protection. There are concerns about the pace of AFTA in Indonesia. But the Indonesian government has agreed that it will continue to follow its ASEAN member countries, its neighbours, and continue with the program.

How will this affect Australia? At the moment, the average MFN tariff, or most favoured nation tariff, in Indonesia is about 7.2 per cent. Its CEPT tariff, or its common effective preferential tariff, is 2.2 per cent. So there is a five percentage point difference. On a lot of the products that Australia sells, there are zero tariffs already, such as on livestock and meat, which is a fairly large proportion of our trade with Indonesia. Services trade, as Bill said in his opening statement, is our No. 1 export to Indonesia, with education services, at about \$A349 million a year. At least they are the latest statistics which we have. That will continue.

Indonesia's trade with ASEAN members compared to other ASEAN countries is quite low. It is only about 20 per cent of their total exports. Close to 50 per cent of Indonesia's exports go to four non-ASEAN countries, being Japan, the US, Korea and China. As in most other ASEAN countries, as their CEPT rates fall, the MFN rates also fall as they find out they are able to compete within their region and more widely. So the effect will not be as great as we thought.

A five percentage point difference is not that great between tariffs when you consider the Australian dollar since December last year has risen by 25 per cent. That is more an important indicator of competitiveness. That is what it is about. We will have an export market in Indonesia and we will have our share as long as we are competitive. We are competitive in the areas in which we export, such as livestock and meat and a lot of agricultural products. We are competitive despite that 25 per cent increase in the Australian dollar since the end of last year.

CHAIR—There being no further questions, thank you very much indeed for your attendance here today. If there are any matters on which we might need additional information, the secretary will write to you. She will also send you a copy of the transcript of your evidence to which you can make any necessary corrections to errors of transcription. Thank you very much indeed.

Resolved (on motion by **Mr Brereton**):

That this subcommittee authorises publication of the proof transcript of the evidence given before it at public hearing this day.

Subcommittee adjourned at 12.17 p.m.