



Australian  
Mining

New frontiers  
South and  
East Asia

# Indonesia



# 02

**TRADE AGENDA**

Minerals Council of Australia

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A guide for Australian  
trade negotiators and mining  
and METS businesses to  
leverage trade and investment  
opportunities in emerging  
markets across Asia

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## ABOUT NEW FRONTIERS

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**New frontiers: South and East Asia** is a research study by Mike Adams, Nicolas Brown and Ron Wickes, the partners of Trading Nation Consulting, for the Minerals Council of Australia.

The New Frontiers study will produce a series of reports identifying opportunities and setting out an agenda for Australian trade negotiators and mining and METS businesses to expand trade and investment links with emerging Asian economies.

The Trading Nation Consulting partners are former senior officials of the Department of Foreign Affairs and Trade and the authors of *Trading Nation: Advancing Australia's interests in world markets*, UNSW Press, 2013.

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# Indonesia

**NEW FRONTIERS: SOUTH AND EAST ASIA**

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## **Indonesia's growth will provide huge opportunities for Australia**

**Indonesia's development will have big trade implications for Australia.** On one measure, Indonesia is already the eighth largest economy in the world. International Monetary Fund (IMF) staff estimate that growth will be just under 5.5 per cent per annum out to 2022. There are some risks to this outlook, such as growing global protectionism, fluctuating commodity prices and inadequate infrastructure. The projected growth rate is also well short of the double-digit rates which China and the newly industrialised economies achieved during their high-growth periods and below the rates Indonesia itself seeks to achieve. But if realised, as is probable, it will lead to Indonesia's economy being more than a third larger by early in the next decade. Higher rates of growth are possible, but would require ongoing reform.

## **It is already a billion dollar plus market for mining goods**

**Indonesia is already a sizeable market for minerals and basic metal manufactures.** When estimates are included for products which are confidential in Australian Bureau of Statistics (ABS) data, Australian exports of these goods to Indonesia in 2016 were around \$1.1 billion. Four products – coal, iron ore, alumina and unwrought aluminium – make up over 70 per cent of this total and eight products (adding salt, unwrought zinc, refined copper and ferrous waste and scrap) almost 95 per cent. As Indonesia industrialises there will be opportunities to expand this trade. Indonesia's requirements for steel, copper, aluminium and other metals will increase and, with that, demand for the ores, processed minerals and metals that Australia can supply.

## **... and the biggest or second biggest market for METS**

**For Australia's mining equipment, technology and services (METS) industries, Indonesia is shown in industry surveys to be the top or second top market.** It is estimated that at least 140 Australian-based METS companies export equipment, products, services or technology to the market. METS firms doing business in, or with, Indonesia range from big contract miners such as Thiess that provide whole-of-mine services, to firms that provide highly specialised inputs such as fuel management equipment and services; fuel analysis; mine communications networks; hydraulic and drive products; and mining software.

## **AANZFTA has largely eliminated tariffs for mining and METS**

**Tariff barriers for Australian minerals and basic metal manufactures sold to Indonesia have been eliminated under the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA) with two exceptions.** These are copper cathodes and table salt, with scheduled tariffs of 5 per cent. However, some metal manufactures (such as some types of galvanised iron) are scheduled in AANZFTA at higher rates (in this case 15 per cent until 2025 when they decline to 5 per cent). Tariffs on mining equipment have also mostly gone to zero under AANZFTA, but there are important exceptions. For example, tariffs on motor vehicles for transporting goods in Indonesia's most recent, domestically-enacted AANZFTA schedule are up to 45 per cent in 2020. In some cases, Indonesia's only commitment in this schedule is to give Australia most-favoured-nation treatment.

## **But non-tariff measures affect almost two-thirds of all tariff lines**

**Non-tariff measures (NTMs) affect many products which Indonesia imports and most of those affected are subject to three or more measures.** A 2016 study showed that NTMs affected 6,466 tariff lines, or almost two-thirds of the total number of lines, with some 14 government agencies responsible for them. For minerals, 110 tariff lines were affected by three or more NTMs. Technical barriers to trade (those that stipulate such characteristics as size, labelling or performance, as well as conformity assessment procedures) are the most frequently applied NTMs.

A key issue is the degree to which NTMs have become non-tariff barriers (NTBs) which act as impediments to trade. There has been limited research on this issue. But it seems clear that Indonesia has sometimes used NTMs with the aim of limiting imports. As one example, in mid-2014, Indonesia's Ministry of Trade issued a decree requiring a licence to import steel alloy, with an additional requirement for technical inspection in the originating country. The procedures were eased in December 2016.

## **There are substantial barriers to services trade relevant to mining and METS**

**Barriers to services trade can be considerable. These include restrictions on delivering services via commercial presence and by the movement of personnel to Indonesia.** For the mining sector, construction and engineering services are crucial, but a wide range of other services (computing, legal, accounting and so on) are very important. For construction services, Indonesia is rated by the OECD as the second most restrictive among 44 countries. Under AANZFTA, firms providing these services in Indonesia can form a joint venture, but with not more than 55 per cent owned by foreign partners. There are also significant limits on services provided by the movement of directors, managers and technical experts.

For engineering services, the AANZFTA schedule stipulates that commercial presence can involve either a joint operation representative office or a joint venture no more than 49 per cent foreign owned, while consulting and design services delivered by commercial presence must be provided through a representative office with a local partner. Legal services are almost completely closed to outsiders, with Indonesia rated by the OECD as the second most restrictive country in Asia (after India). Overall, AANZFTA has made only limited progress in addressing services barriers.

## **Economic nationalism has driven changes in policy on mining investment**

**For the mining sector, the barriers to investment in Indonesia are generally the most serious impediment.** Restrictions have developed in a climate of growing economic and resources nationalism. This has deep historical roots stemming from Indonesia's struggle against colonialism. Economic nationalism is characterised by a strong belief in the central role of the state in promoting industrialisation and the need to avoid foreign control of resources; by a belief that manufacturing almost alone is a key driver of jobs and growth; and by a mercantilist approach to trade policy. There is also a widespread belief that Indonesia's large population (around 259 million) means that it can grow primarily through the domestic market – a belief that overlooks the benefits which flow from increased openness to both foreign investment and trade, along with greater involvement in global supply chains.

**... which now aims to achieve majority Indonesian ownership and a domestic refining capacity**

**Under Indonesia's mining laws and regulations, foreign mining companies are now required to divest to a minority equity position within 10 years.** They must also make special application to export unrefined ores and pay export duties that vary according to firms' progress in developing refining capacity. Firms operating under older 'contract of work' arrangements are required to convert them to mining permits that are subject to mining laws and regulations as a condition of approval to export unrefined ores. This has played havoc with some mining investments.

More broadly, Indonesia's underdevelopment means it is, and will long remain, a difficult place in which to invest and do business. In the recent World Bank Ease of Doing Business ranking, Indonesia is 90th out of 190 countries. Inadequate infrastructure, low education levels and poor workforce health, along with labour market rigidities, excessive red tape and problems in trading across borders or within Indonesia's sprawling archipelago are among barriers businesses face.

**Australia has opportunities to encourage reform**

**Three sets of negotiations – for a bilateral free trade agreement, the Regional Comprehensive Economic Partnership (RCEP) and the review of AANZFTA – provide Australia and other economies with opportunities to encourage domestic economic reform and address entrenched barriers.** Australia should promote economic and institutional reform through APEC, the Australian aid program and contacts with its own agencies (notably the Productivity Commission). It should encourage further advocacy of reform by international agencies like the OECD, the World Bank, the IMF and the Asian Development Bank.

**Non-tariff measures should be at the centre of work on merchandise trade**

**Non-tariff measures should be the central focus of work on merchandise trade.** It would be useful to establish a work program in this area in one or more of the ongoing negotiations to identify key barriers and assess their impact, with a view to eliminating or modifying those that distort trade. Further tariff liberalisation is a lower priority, but it would be useful to eliminate remaining barriers such as the 5 per cent tariff on copper cathodes and tariffs on mining equipment. In some cases, tariffs will remain at low levels and could more easily be removed.



## **Services and investment are both high priorities**

**Services liberalisation should be a high priority, especially in areas particularly relevant to the mining and METS sectors.** These include services incidental to mining, engineering and construction. It should be possible to re-negotiate bindings on construction and engineering services where applied barriers are more liberal than those under AANZFTA. In the case of investment, it would be useful (though politically very difficult) to encourage changes in taxes on exports of mineral ores and the time over which refining capacity is to be installed and majority Indonesian ownership achieved.

It will be important for Australia to encourage dialogue between the Australian and Indonesian business communities. To the extent that this helps the Indonesian business community to develop a more international perspective, it could be influential in changing the Indonesian policy debate. Sharing Australia's experience with the Productivity Commission should remain a priority for Australia, as a way to encourage a rigorous and transparent assessment of the costs of protection.

## **Australia's aid program can help promote reform**

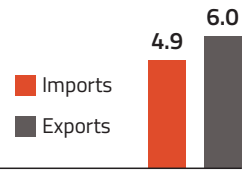
**Australia can also use its aid program to improve trading conditions in areas such as logistics and trade infrastructure.** This is recognised in the Australian Government's 'aid for trade' initiative that has set a target of up to 20 per cent of the aid program for this purpose by 2020. Indonesia is expected to receive a total of \$357 million in Australian official development assistance in 2017-18. By engaging with Indonesia in areas that help to promote development, Australia has its best chance to influence Indonesia's policies to the benefit of both countries.

# Indonesia

## ABOUT INDONESIA

|                |                  |
|----------------|------------------|
| Capital        | Jakarta          |
| Language       | Bahasa Indonesia |
| Population     | 258.7 million    |
| Currency       | Rupiah           |
| Land area      | 1,811,570 sq km  |
| Internet users | 29.5%            |

**\$15.4b**  
Australia/Indonesia  
goods & services  
trade 2016



Australian goods exports & imports to and from Indonesia  
(A\$ billion)



## ECONOMIC INDICATORS 2016

**\$932.4b**

Indonesia's GDP  
(US\$)

**\$3604**

GDP per capita  
(US\$)

**5.0%**

Real GDP growth  
(percentage change)

**-1.8%**

Current account balance  
(percentage of GDP)

**3.5%**

Inflation  
(percentage change)

**5.6%**

Unemployment  
(per cent of labour force)

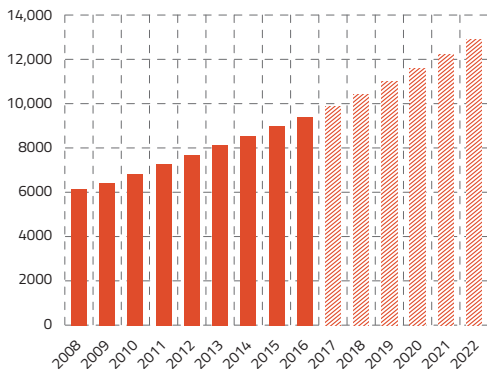
**18%**

Total imports  
(share of GDP)

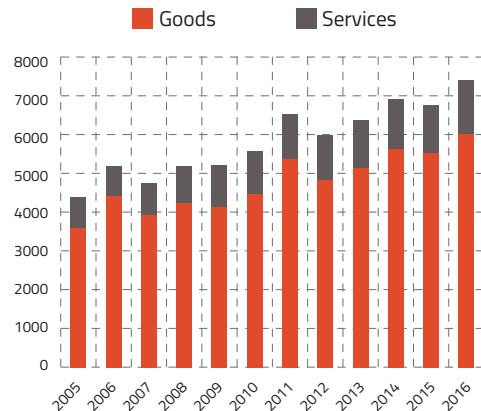
**19%**

Total exports  
(share of GDP)

Indonesia: GDP growth and forecast  
(Rp trillion, constant price, 2010)



Australia: Exports to Indonesia  
(A\$ million)



## AUSTRALIA-INDONESIA TRADE

### Major Australian exports to Indonesia

(A\$, 2016)



**Wheat**  
\$981 million



**Live animals**  
(*excl. seafood*)  
\$699 million



**Crude petroleum**  
\$616 million



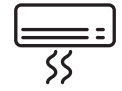
**Sugars, molasses & honey**  
\$528 million

### Major Australian imports from Indonesia

(A\$, 2016)



**Crude petroleum**  
\$886 million



**Heat/cooling equip & parts**  
\$379 million



**Specialised machinery & parts**  
\$296 million



**Refined petroleum**  
\$216 million

### Australia's trade in services with Indonesia

(A\$, 2016)

**\$1.4b**

Exports of services

**\$3.1b**

Import of services

### Key Australian services traded with Indonesia

(A\$, 2016)



**Personal travel** (*excl. education*)  
\$2426 million

Imports



Exports

**Education related travel**  
\$659 million

### Australia's investment relationship with Indonesia

(A\$, 2016)

**\$10.4b**

Total investment between Australia & Indonesia



AUSTRALIA

**\$6.2b**

Direct investment in Indonesia



INDONESIA

**\$1.2b**

Total investment in Australia

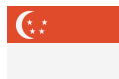
### Indonesia's goods imports: Top 5 source countries

(US\$, 2016)



\$30.8b

1. China



\$14.54b

2. Singapore



\$12.98b

3. Japan



\$8.67b

4. Thailand



\$7.32b

5. United States



\$5.26b

8. Australia

Australia provides 3.9% of Indonesia's annual goods imports



# Indonesia

Indonesia is undergoing a transformation which will have profound implications for the world and for Australia's own region. On one measure, Indonesia is already the eighth largest economy in the world – bigger than the United Kingdom and within striking distance of Germany by the early 2020s.<sup>1</sup>

As it develops, Indonesia, with a population of around 259 million – the fourth largest in the world – will become a major and prosperous economic power if it avoids the middle-income trap which has affected so many emerging economies. Building a more developed country will, however, require sound economic management and a willingness to embrace further reform.

If Indonesia does succeed, there will be huge opportunities for Australia. The experience of other emerging nations suggests that Indonesia's development will see a big expansion of physical infrastructure, a massive flow of people to the cities and very substantial growth in the middle class. These trends will benefit the mining and METS sectors despite – and in some ways because of – Indonesia's own substantial natural resource endowment. Realising these gains will, of course, depend on maintaining Australia's own

capacity to supply competitively. Policies which continue to build an open environment for trade and investment in both Indonesia and Australia will be important, as will close bilateral cooperation.

This report looks at the impediments which could limit the Australian minerals and METS sectors in contributing to, and benefiting from, Indonesia's transformation. It begins with a brief review of the economic context of Indonesia's growth and of Australia's current trading and investment ties with Indonesia. Subsequent sections look at tariff and non-tariff barriers to trade in minerals and mining equipment and at impediments to mining services trade and investment. The final two sections examine the opportunities for reform of trade and industry policies in Indonesia and offer recommendations which would assist Australia and Indonesia to expand trade and investment in the minerals and METS sectors.

## The economic environment

Indonesia's GDP, which is the main driver of import growth and investment opportunities, grew over 2006-16 at around 5.7 per cent annually. This is well below the double-digit rates achieved by China, the Republic of Korea and Taiwan during their peak periods of industrialisation, but it still represents quite rapid growth. Growth over the past three years has, however, been a full percentage point slower than the 6 per cent plus rates achieved over the period 2010 to 2012 and even further below the 7.4 per cent rate achieved in 2008 before the main impact of the Global Financial Crisis. An important objective for the Indonesian Government is to lift growth rates on a sustainable basis.

In some respects, macroeconomic fundamentals in Indonesia have improved in recent years, in large part because of action by the authorities. Inflation, which had been running at over 6 per cent annually over the period 2013 to 2015 (and at over 13 per cent in 2006), declined to about 3.5 per cent in 2016, close to the bottom of the 3-5 per cent official target band. The current account deficit was about 1.8 per cent of GDP in that year, down from over 3 per cent of GDP in 2013 (and 4.4 per cent in the second quarter of that year). A floating exchange rate has facilitated adjustments to changes in the international and domestic environment, including the sharp price changes for export commodities like coal and crude oil in recent years.<sup>2</sup> There is a statutory limit of 3 per cent of GDP for the budget deficit. Gross government debt was a mere 28 per cent of GDP in 2016 and all three major rating agencies now give Indonesia an investment grade sovereign credit rating.

An IMF staff projection suggests that the economy will be more than one third larger than currently by 2022, with GDP growth running at just under 5.5 per cent per annum.<sup>3</sup> Growth over the coming decade will be assisted by several factors. Dependency ratios are not expected to rise: the United Nations Population Division expects the 15-64 age population to increase slightly from 67 per cent of the total in 2015 to 68.3 per cent in 2030.<sup>4</sup> Savings and investment are running at around one third of GDP, although the gross incremental capital-output ratio is quite high suggesting inefficient investment.<sup>5</sup> Indonesia does not score well on the quality of its primary education in international rankings, but the adult literacy rate in 2015 was 95 per cent, or about the same as the rates for Malaysia and the Philippines. Indonesia also is a relatively open economy. Imports plus exports of goods and services were around 36 per cent of GDP in 2016, approximately the same as for China, though well below the Republic of Korea. The simple average MFN applied tariff rate is 6.9 per cent (though the simple average WTO bound tariff is much higher at over 37 per cent).

There are some risks to the outlook for growth in the medium and long term. Like Australia, Indonesia relies significantly on commodity exports, for which prices are volatile. Between 2011 and 2016, merchandise exports fell by around 29 per cent in US dollar terms, from US\$203.5 billion to US\$144.5 billion. A fall of about 53 per cent in the value of exports of the five leading primary commodities – palm oil, coal, petroleum gases, crude oil and natural rubber – accounted for almost

all of this decline. According to Ginting and Aji, 55 per cent of holdings in the stock market and 38 per cent of the domestic bond market are attributable to foreign entities, making Indonesia somewhat vulnerable to changes in foreign investor sentiment, including those occurring because of changes in US monetary policy.<sup>6</sup> The possibility of increasing protectionism in major markets like the United States is a further risk in the medium and longer term.

There are also a number of impediments to growth which may have a substantial impact if not addressed, among them infrastructure, skills and labour market rigidities. Economic inequality could place a question mark over political stability in the longer term. Between 2000 and 2011 the Gini coefficient (a measure of inequality ranging from zero to 100) rose from 30 to 41 though by September 2016 it had dropped back to 39. The World Bank reports that the bottom 40 per cent of the population continues to lag behind. Much will depend on how rapidly employment grows.<sup>7</sup>

Imports of goods and services have increased in volume terms over the past decade at around the same rate as GDP, though they have shown much sharper fluctuations. The volume of imports fell by over 6 per cent in 2015 and then rose by 3 per cent in 2016. Fluctuations over 2008 to 2012 were much larger.<sup>8</sup> An IMF staff projection shows the volume to be around 30 per cent up on 2016 levels by 2022. This and rising per capita incomes will create strong opportunities for increased exports and investment by Australia across a number of sectors, including the minerals and METS sectors.

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## **Trade and investment links with Australia**

Australia's exports of goods and services to Indonesia were valued at around \$7.4 billion in 2016, making Indonesia Australia's eleventh most important market. In some respects, the value of this trade is disappointing. Indonesia ranks below New Zealand and Singapore, and is about on the same level as Malaysia as a goods and services market in spite of its proximity and sizeable GDP (which is about three quarters that of Australia at market exchange rates). But the value of trade is still well above – more than 2.5 times – what would be expected given Indonesia's share of world imports of goods and services.<sup>9</sup> It is also possible that some exports to Indonesia are recorded as exports to Singapore, given its role as an intermediary for trade in South-East Asia and more broadly.

Merchandise exports were around \$6 billion in 2016. The biggest merchandise exports in recent years have been wheat, live cattle (in spite of problems associated with this trade), sugar, crude petroleum and beef, but several minerals and basic metal manufactures were also important. Services exports were around \$1.4 billion in 2016. They have been dominated by education-related travel services and, to a lesser extent, other travel services. Around 14,000 Indonesian students were studying in Australia in 2015.

Australia's imports of goods and services from Indonesia were around \$8 billion in 2016. Merchandise imports in recent years have included crude petroleum (by far the biggest product), specialised machinery and parts, wood, gold and footwear. Personal travel services make up a very high

proportion of Australian services imports. Australians made over 1.2 million trips to Indonesia in 2016, mostly for holidays, reflecting the importance of tourism to Bali and elsewhere.

Australia's direct investment in Indonesia is substantial, though well under that with some other neighbouring countries with which Australia has cultural or historical ties, or where the climate for investment is better. Cumulative foreign direct investment (FDI) by Australia in Indonesia was some \$6.2 billion at the end of 2016, somewhat down on the peak of \$7.5 billion at the end of 2013. The 2016 level was less than 10 per cent of the stock of Australian FDI in New Zealand, well under half of that in Papua New Guinea and less than a third of the total for Singapore. Again, Australian direct investment is cast in a better light when it is compared with Indonesia's share of global inward direct investment. The share of cumulative Australian direct investment in Indonesia, at about 1.1 per cent of total Australian direct investment abroad, is a little higher than Indonesia's share of the stock of global inward foreign direct investment.

Data on the stock of inward direct investment from Indonesia are not published by the ABS, but the total is likely to be small. At the end of 2016, cumulative investment of all types by Indonesia in Australia (including portfolio investment) was only \$1.2 billion. Flows of inward direct investment appear to have been extremely small in recent years (although flows were not published in two of the past five years). This is consistent with Indonesia's small share of world outward direct investment, which in turn reflects its position as a lower middle-income economy.



Table 1

**Australian exports of minerals and basic metal manufactures to Indonesia in 2016**

Source: UN Comtrade Database

| <b>Product description</b>  | <b>Exports<br/>A\$m</b> |
|---|-------------------------|
| Coal; briquettes, ovoids, similar solid fuels manufactured from coal  | 291.9                   |
| Iron ore and concentrates   | 224.9                   |
| Non-ferrous metal ores  | 4.9                     |
| Non-metallic and other minerals                                       | 8.1                     |
| Basic iron and steel manufacturing, of which:                         | 34.0                    |
| – ferrous waste and scrap, remelting scrap ingots                     | (30.5)                  |
| Basic non-ferrous metal manufacturing, of which:                      | 259.3                   |
| – refined copper and copper alloys, unwrought                         | (32.4)                  |
| – unwrought aluminium   | (121.1)                 |
| – unwrought zinc  | (73.5)                  |
| <b>Total published data for minerals and basic metal manufactures</b> | <b>823.1</b>            |
| Confidential items estimated from Indonesian data:                    |                         |
| – aluminium oxide (excluding artificial corundum)                     | 160.1                   |
| – salt and related products   | 89.6                    |
| – other confidential items  | 9.5                     |
| <b>Total including estimated confidential items</b>                   | <b>1082.3</b>           |

**Note:** Australian export data for confidential items are estimated at 95 per cent of c.i.f. imports for Indonesia.

**Trade links in the mining sector**

Export statistics for Australia show minerals and basic metal manufactures to Indonesia to be worth around \$823 million in 2016 (Table 1). However, this figure excludes a very substantial trade in alumina (aluminium oxide) and in salt (other than table salt), where the relevant ABS data are confidential. Indonesia's import statistics suggest that Australia's exports of alumina and salt in

2016 were worth \$160 million and \$90 million respectively, while exports of other confidential items were around \$10 million. Total Australian exports of minerals and basic metal manufactures are estimated at around \$1,082 million – under one fifth of Australia's merchandise exports to Indonesia in 2016.<sup>10</sup>

This is a relatively low proportion compared to that for some other regional economies,

reflecting Indonesia's comparatively early stage of industrialisation and significant mineral resources. Trade is highly concentrated. In 2016, just four products – coal, iron ore, alumina and unwrought aluminium – constituted over 70 per cent of Australian exports of minerals and basic metal manufactures, while eight (adding salt, unwrought zinc, refined copper and ferrous waste and scrap) made up almost 95 per cent.

Australia's imports of minerals and basic metal manufactures from Indonesia are limited. As noted already, the biggest import was crude oil, but this falls outside the definition used in this research (see the Technical Annex in the first report in this series), as does oil other than crude and copper wire, which were other significant items.<sup>11</sup> The biggest mineral and basic metal manufacture appears to be gold, with imports valued at \$73 million in 2016. Cement (mostly in the form of cement clinkers) was another sizeable item, with imports valued at around \$25 million.

The prospects for expanding Australia's mining exports to Indonesia depend on three critical variables: trends in Indonesia's demand; the supply response from Indonesian miners and manufacturers; and Australia's competitiveness with respect to suppliers in other countries. Looking at the first of these variables, demand seems certain to rise considerably in the long term. Indonesia's position as a lower middle-income economy means that its use of resources has only just begun a period of rapid expansion. As it industrialises, it will require significant investment in physical infrastructure – in turn requiring substantial quantities of steel and, with that, iron ore and coking coal. Indonesia's use of steel per

capita in 2015, at around 62 kilograms, was just a fraction of the level in Malaysia (354 kilograms) and Thailand (229 kilograms), and even further below that of China (479 kilograms) and South Korea (785 kilograms).<sup>12</sup>

Demand for metals like copper and aluminium is similarly likely to increase substantially. Copper has a myriad of uses in a modern industrial economy, ranging from construction to industrial machinery to automobiles and electronic and electrical components. Aluminium is widely used in transport equipment (ranging from automobiles to aircraft), packaging and construction. Indonesia's consumption of both metals in 2013 was less than Thailand's, in spite of its much larger population.<sup>13</sup> Demand for a host of other minerals and basic metal manufactures could be expected to grow as Indonesia's economy expands.

Indonesia's supply response is likely to vary a good deal and will depend on its resource endowments for various minerals and on whether government policies work to facilitate production. In relation to the former, Indonesia has proven coal reserves of 25.6 billion tonnes, or almost 60 times annual production. But Indonesia's coal is typically of low quality and, although it is the leading exporter of steaming coal, import demand for coking coal is expected to increase. Indonesia also has reserves of iron ore, but it is not a significant producer. It has considerable reserves of bauxite, copper, nickel and gold and is the world's leading exporter of tin. Regarding policy issues, there is a question mark over Indonesia's approach to the mining industry, with the government attempting to have further processing of minerals carried out in Indonesia and to ensure that

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**Expanding Australia's mining exports to Indonesia depends on three critical variables: trends in Indonesia's demand; the supply response from Indonesian miners and manufacturers; and Australia's competitiveness with respect to suppliers in other countries.**

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Indonesians have majority ownership of mines. These policies are discussed further below (pp. 39-42), but they are likely to impede growth in production.

Australia's own competitiveness will also vary with each commodity. Australia has high quality reserves of many minerals, but much will depend on government policies towards the industry and on developments in rival exporters. Currently, Brazil is a significant competitor in the iron ore trade and, in spite of distance, accounted for around a quarter of Indonesia's imports of this commodity in 2016. Australia held three quarters of Indonesia's import market for coal in 2016, but still faced competition from the Russian Federation and China. Australia shared around 80 per cent of Indonesia's import market for alumina in 2016, with India the only other big supplier. For unwrought aluminium – the fourth big ticket item in Australia's exports to Indonesia – Australia held little more than one sixth of the import market in 2016, with competition from a range of exporters, principally the United Arab Emirates, Malaysia, the Russian Federation, Qatar, Oman and India.

Neither the ABS nor BKPM (the Indonesian government authority which issues business licenses to firms operating in Indonesia) provide detail of mining industry investment by country. However, it is likely that investment in mining constitutes a significant part of the stock of Australian investment in Indonesia. Box 1 gives several examples of different types of investment/joint ventures involving firms based in Australia or listed on the Australian Securities Exchange.



# Investment in Indonesian mining

## Rio Tinto

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Rio Tinto Ltd ranks second (after BHP) on the PwC top 40 list of global mining companies and has dual listing on Australian and UK stock exchanges. Rio Tinto gives its non-current Indonesian assets as US\$1.48 billion in 2016.

Rio Tinto's main current interest in Indonesia is the Grasberg mine in Papua, which is one of the largest copper and gold mines in the world. The mine is owned by PT Freeport Indonesia, a subsidiary of Freeport-McMoRan. Rio Tinto does not operate the mine, but under terms of its joint venture is entitled to a 40 per cent share of production in excess of certain levels until the end of 2021 and 40 per cent of all production after 2021.

The mine has had a troubled history and Rio Tinto received no output from it in 2015 or 2016 because specified production was not met.<sup>14</sup> Some issues concerning the mine are discussed on pages 41–42.

## Newcrest

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Newcrest Mining Ltd, which ranks 20th on the PwC list, is an example of an Australian-based firm investing in Indonesia. Its main interest in Indonesia is the Gosowong gold and silver mine, which has produced more than 4 million ounces of gold since mining began in 1999.

Newcrest has a 75 per cent stake in the Indonesian company, PT Nusa Halmahera Minerals, which owns and operates the mine. In 2016, Newcrest entered into an alliance to explore for gold and copper ores in several parts of Indonesia with the state-owned mining company PT Antam, its Indonesian partner in Gosowong. Newcrest sees this alliance as an important opportunity to grow its business in Indonesia.<sup>15</sup>

## EMR Capital

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EMR Capital is a Melbourne-based private equity firm specialising in mining investment.

EMR secured a major stake in the Martabe gold and silver mine when the group of buyers it led purchased the mine from Hong Kong listed G-Resources for US\$775 million in 2016. EMR's equity constituted 61.4 per cent of the group purchasing the mine, the other partners being a US investment fund and two wealthy Indonesian families.

Martabe is located in North Sumatra and is one of the largest gold mines in the world. As a private equity firm, EMR has raised capital for its investments through equity funds: many investors are believed to be from the United States.<sup>16</sup>

## Trade links in the METS sector

Indonesia is a major market for the Australian METS sector. It is estimated at least 140 METS firms export equipment, products, services or technology there. Indonesia's importance is clear from the Austmine surveys released in 2013 and 2015.<sup>17</sup> It is also reflected in the annual Australian International Business Surveys (AIBS) carried out by the University of Sydney for the Export Council of Australia and partner institutions, published in 2014, 2015 and 2016.<sup>18</sup> The questions asked in these surveys differ, but there is substantial agreement among them. The 2015 Austmine survey found 49 per cent of exporting METS firms exported to Indonesia – more than to any other country.<sup>19</sup> The 2016 AIBS survey found 8 per cent of respondents described Indonesia as one of their top two markets – second only to the United States (13 per cent). Prior surveys by Austmine and the AIBS also ranked Indonesia as the top or second most important market.

The surveys differ on the most prospective future markets. The Austmine 2015 survey found Indonesia was seen as a key market for future growth – a finding consistent with each of the AIBS surveys for 2014 and 2015. However, the AIBS 2016 survey does not list Indonesia among the top ten countries seen by respondents as the most important new source of revenue over the next two years. This may reflect the small number of METS firms in the survey.

The surveys do not give a breakdown by country of how firms do business with their markets – the numbers of respondents are, in any case, too small to do that effectively. For the whole METS group in the AIBS 2016 survey, about 60 per cent of firms mainly supply their

markets from Australia. About a fifth mainly use a foreign sales branch or subsidiary, while around 15 per cent work principally through an agent or distributor. A high proportion of firms – 45 per cent according to the Austmine survey – collaborate internationally. Key research and development partners include other suppliers, mining companies and universities. The importance of collaboration reflects the fact that METS firms are generally highly innovative.

Australian-based METS firms doing business with or in Indonesia range very broadly in terms of their size and the services, technologies and equipment they provide. At one end of the spectrum is contract-mining giant Thiess, which provides total mine services for several big coal projects in Indonesia. At the other is an award-winning small/medium enterprise, Hy-Performance Fluid Power, which supplies a range of hydraulic and drive products, as well as blast hole drill and other mining equipment.

Other examples of firms operating in, or exporting to, Indonesia, are Macmahon Holdings Ltd (another contract miner); Technomics (which tests fuels and lubricants and which has laboratories in Australia, Indonesia and Thailand); Banlaw (which provides fuel management services); RUC Cementation Mining (which provides a range of equipment and services focussing on underground mining); MST Global (which specialises in mine communications networks); RPM Global (whose Indonesian subsidiary focusses mainly on advisory services, though the parent firm also provides mining software, training and gas testing); and Micromine (a mining software provider with an Indonesian subsidiary). Box 2 provides additional details on some of these firms.



# Providing mining equipment and services

## Thiess

Thiess became the biggest contract miner in the world in 2015 and has been operating in Indonesia since the 1980s.

A Brisbane based firm, Thiess is part of the Australian Securities Exchange-listed CIMIC Group. CIMIC is majority-owned by a German firm, which in turn has, as its biggest shareholder, a Spanish-based construction company.<sup>20</sup> At present, Thiess provides total mine services for several major

coal projects. These include the Banyan Group's Melak mine in East Kalimantan, which Thiess has developed and operated since 2008 and which produces over 2 million tonnes per annum. Its contract to operate this mine was initially extended for three years in 2016 and subsequently further broadened and extended to run until March 2022.

Thiess also has a life-of-mine contract to operate

the Senakin coal mine in South Kalimantan, including the transfer to barges of the annual output of 5 million tonnes.

A third project is the KPC Sangatta coal mine, where Thiess provides services ranging from planning, to blasting, to removing overburden, with annual production at 11 million tonnes.<sup>21</sup>

## Macmahon

Perth-based Macmahon Holdings Ltd is listed on the Australian Securities Exchange and had a market capitalisation of around \$485 million at the end of September 2017. It is closely involved in providing mining services in Indonesia.

At the Lhoknga project in Aceh, Sumatra, it carries out drilling, blasting and mining of limestone for cement manufacture, together with haul road construction under

a contract valued at US\$60 million. Another project involves providing a wide range of on-site services with an Indonesian joint venture partner at the Martabe gold mine in Sumatra, under a five-year contract valued at around US\$170 million.

More recently, Macmahon has signed an agreement to provide life-of-mine services for the Indonesian miner PT Amman Mineral Nusa Tenggara's

(AMNT's) Batu Hijau copper-gold mine in Indonesia.

Under the agreement, Macmahon acquired equipment from the Indonesian firm valued at US\$146 million and, in return, has issued shares giving a subsidiary of AMNT a 44.3 per cent stake in Macmahon. Macmahon's directors see the agreement as likely to improve its prospects for further growth in Indonesia.<sup>22</sup>

**Australian-based METS firms doing business with or in Indonesia range very broadly in terms of size and the services, technologies and equipment they provide.**

## **Banlaw**

Banlaw, which is based in the Hunter Valley, specialises in fuel management for a range of vehicles, including haul trucks, bulldozers and heavy trucks.

It has been involved in several major mining projects in Indonesia. One example is an MTU Indonesia project

which required the installation of special fuel tank vents that incorporated ultra-fine filters suitable for mining trucks.

After initial tests with two vehicles – results were verified in MTU’s German head office – Banlaw installed the filter across the mine’s entire fleet. Another example is Banlaw’s

work to install its FuelTrack system to monitor fuel use in a tripartite partnership with miner KPC and local firm Atlas Copco Nusantara. Banlaw subsequently continued to assist with hardware and site audits and in implementing more efficient processes for fuel management.<sup>23</sup>

## **Technomics**

Technomics has specialised in distributing lubricants to the mining industry for more than two decades and has operated in the Indonesian market for many years. Its current focus is analysing fuels and lubricants to identify problems that could

lead to breakdowns or loss of machine efficiency.

Technomics also distributes nano-additives that reduce mechanical wear and prolong the life of engine oils. It operates testing laboratories in Australia, Indonesia and

Thailand. Tests aim to identify the chemical and physical properties of oil and fluids, to assess whether contaminants are present and to detect the presence of debris arising from wear and tear.<sup>24</sup>

## The climate for business in Indonesia

Indonesia is perceived as a difficult place in which to do business. In the case of the METS sector, 15 per cent of respondents in Australia's 2015 International Business Survey ranked Indonesia as their most difficult market after China (23 per cent).<sup>25</sup>

Large mining companies might also be expected to rate Indonesia as challenging. The difficulties are captured in several different measures, based on international business surveys or other data, which rank Indonesia against other economies. While each has its limitations, together they provide a good overview of business conditions facing companies operating in Indonesia or trading with it.

The first measure is the World Bank's Ease of Doing Business ranking, covering 190 economies. This indicator seeks to examine the conditions facing a local firm operating, in Indonesia's case, in Jakarta or Surabaya. Table 2 provides Indonesia's ranking, both overall and on selected indicators. As the table shows, Indonesia ranked 91, above India but significantly below China. Indonesia's performance is dragged down by poor scores on enforcing contracts (specifically time taken and cost of procedures) and trading across borders (considered further in the discussion below on non-tariff barriers). However, it performs surprisingly well (49/190) on obtaining electricity, scoring well compared with economies with best international practice on the reliability of supply and the transparency of the electricity tariff.<sup>26</sup>

Table 2

### Ease of doing business, selected measures, 2016

Source: World Bank, *Doing business 2017: Equal opportunities for all*, Washington D.C., 2017

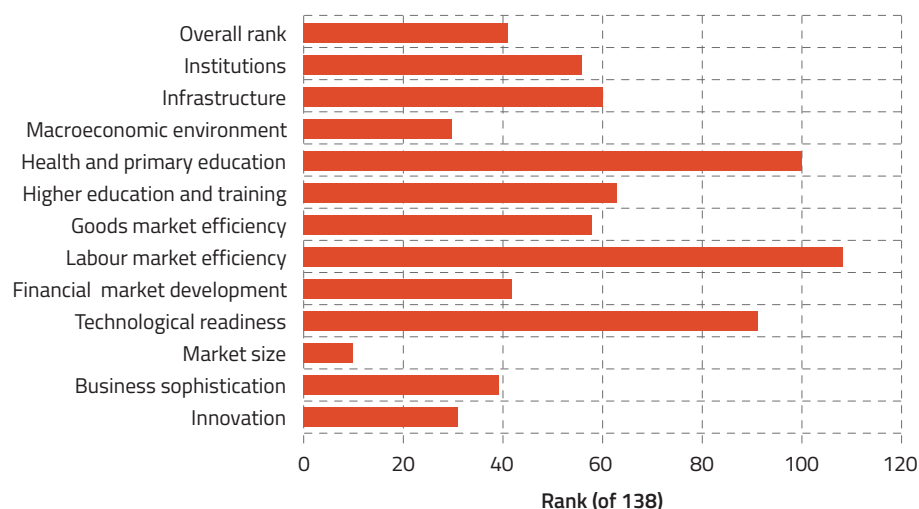
|              | Ease<br>of doing<br>business<br>rank<br>(1-190) | Starting<br>business<br>rank<br>(1-190) | Dealing<br>with<br>construct.<br>permits<br>(1-190) | Getting<br>electricity<br>rank<br>(1-190) | Regist.<br>property<br>rank<br>(1-190) | Getting<br>credit<br>rank<br>(1-189) | Paying<br>taxes<br>rank<br>(1-190) | Trading<br>across<br>borders<br>(1-190) | Enforcing<br>contracts<br>(1-190) |
|--------------|---|---|---|---|--|--------------------------------------|------------------------------------|---|-----------------------------------|
| Australia    | 15  | 7                                       | 2   | 41  | 45                                     | 5                                    | 25                                 | 91                                      | 3                                 |
| Brazil       | 123   | 175                                     | 172   | 47  | 128                                    | 101                                  | 181                                | 149                                     | 37                                |
| China        | 78  | 127                                     | 177   | 97  | 42                                     | 62                                   | 131                                | 96                                      | 5                                 |
| India        | 130   | 155                                     | 185   | 26  | 138                                    | 44                                   | 143                                | 172                                     | 136                               |
| Indonesia    | 91  | 151                                     | 116   | 49  | 118                                    | 62                                   | 104                                | 108                                     | 165                               |
| Russian Fed. | 40  | 26                                      | 115   | 30  | 9                                      | 44                                   | 45                                 | 140                                     | 12                                |
| South Africa | 74  | 131                                     | 99  | 111                                       | 105                                    | 62                                   | 51                                 | 139                                     | 113                               |



Chart 1

**World Economic Forum rankings for Indonesia**

Source: World Economic Forum



The second set of measures is from the World Economic Forum's 2016-17 Global Competitiveness Report. This gives Indonesia a ranking of 41 out of 138 countries. The index is made up of 12 pillars, each based on a number of different indicators. Some of these indicators (such as exports as a share of GDP and the size of the domestic market) would not strictly be included in a measure on the climate for business, but many are relevant. Chart 1 shows the ranking Indonesia obtained on each of the 12 pillars. Indonesia does badly on labour market efficiency, where its ranking reflects extremely poor scores for redundancy costs (the World Economic Forum notes that redundancy costs typically amount to more than a year's salary); health

and primary education (where Indonesia ranks poorly on a number of health indicators, as well as on primary education enrolment); and technological readiness. On the other hand, Indonesia scores well on business sophistication and innovation, which are more relevant to economies at a higher level of per capita income.<sup>27</sup>

A third measure, again from the World Bank, is the International Logistics Performance Index. This focusses on cross-border trade and is based on information provided by logistics professionals on six dimensions of trade. Indonesia ranks 63 out of 160 countries.<sup>28</sup> Components which determine this ranking are discussed below (p. 32).

The fourth measure, from the World Economic Forum, is a survey of business executives on problems in doing business in their own economy, taken from a list of 16 possibilities given to them. Indonesian executives listed corruption, inefficient government bureaucracy and inadequate infrastructure as the three biggest problems in doing business in their country. Restrictive labour regulations ranked last in this survey, and an inadequately educated workforce had a middle ranking. These results differ somewhat from the World Economic Forum findings above.<sup>29</sup>

Despite their differences, these measures suggest that Indonesia is somewhere in the middle group of economies in terms of the climate for doing business. Taken together they also suggest that there are several areas where business may encounter difficulties in Indonesia, among them:

- The educational level and health of the workforce, including the business impact of diseases such as tuberculosis and HIV/AIDS
- The quality of government institutions, including excessive red tape and irregular payments, bribes and other forms of corruption
- Trading across borders, including problems with customs and international shipments (pp. 32-33)
- Inadequate infrastructure, including the quality of port and airline infrastructure
- Labour market rigidities, including the level of redundancy payments, relatively inflexible wage determination and lack of female participation in the workforce.

These problems are unlikely to be fixed quickly.

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## Tariff Barriers

Tariff barriers for Australian products exported to Indonesia have been mostly eliminated under the ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA). According to 2009 analysis prepared by the Department of Foreign Affairs and Trade, the percentage of tariff lines with tariff-free treatment in Indonesia was scheduled to rise from around 21 per cent in 2005 to 85 per cent by 2013 and to around 93 per cent by 2025. Tariffs in the range 0-5 per cent were expected, under the scheduled reductions, to make up 96 per cent of the total by 2017. This represents a very significant achievement in improving Australia's market access. The agreement is also of considerable value in binding tariff levels at much lower rates than in the WTO. This holds even where the tariffs were zero in the first place, or where they have not gone to zero.

### Tariffs on minerals and basic metal manufactures

For minerals and basic metal manufactures as defined in this research (see the Technical Annex in the first report), Indonesia's tariffs under AANZFTA (as set out in its domestically-enacted HS 2012 schedule) have already gone to zero with two exceptions.<sup>30</sup> These are table salt and copper cathodes (and sections of them), where the tariff remains at 5 per cent.<sup>31</sup> There is no tariff on other kinds of salt, which make up almost all of Australia's exports. As already noted, salt is a significant item in Australia's trade with Indonesia, while exports of copper cathodes to that country were valued at around \$31 million in 2016. Eliminating the tariff on copper cathodes, and

possibly salt, either in the review of AANZFTA or in negotiations within the framework of the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), would be useful.

A possible remaining problem is tariff escalation – that is the imposition of higher duties on more elaborately transformed products into which minerals and simple metal manufactures are inputs. This can confer significant protection and constitute a barrier to sales of manufactures from other countries, including Australia. In the case of iron and steel products, this issue could potentially be of some significance. Although a range of products ranging from pig iron, to iron and steel ingots, to semi-finished products have zero tariffs for exports to Indonesia under its domestically-enacted AANZFTA schedule, some manufactured items using these products can have tariffs of up to 20 per cent, with tariffs remaining at this level to 2020. These tariffs are not necessarily applied in practice, but the possibility that Indonesia might do so remains a source of concern.

For example, some types of large tubes and pipes made from iron or stainless steel have tariffs in Indonesia's schedule of 20 per cent out to 2020 (under Indonesia's schedule using the 2007 Harmonized System, they are to fall to 5 per cent in 2025).<sup>32</sup> Applied MFN tariffs are currently at 5 or 7.5 per cent according to the WTO's tariff database. Australia's exports of these items to the world are very small, and there are no exports to Indonesia, suggesting that accelerating a reduction in these tariffs is not a priority. Flat-rolled products of iron and steel such as some types of galvanised iron

are another example of high scheduled tariffs, in this case 15 per cent (tariffs are scheduled to go to 5 per cent in 2025 under Indonesia's HS 2007 schedule for AANZFTA).<sup>33</sup> The MFN applied tariff is lower at 12.5 per cent. There was no Australian export trade recorded for these products in 2016 with Indonesia, but Australia did export small amounts to countries other than Indonesia, with total global exports of around \$32 million, about half going to the United States. There might therefore be some minor benefit in seeking to accelerate tariff reduction in this area.

For some other metals, there appears to be no great problem with tariff escalation. With copper, for example, more sophisticated manufactures such as tubes and pipes and household articles of copper all have zero tariffs in Indonesia's schedule. The same is true of nickel, aluminium, lead and zinc.

Obtaining reduced tariffs available under AANZFTA is dependent on meeting the relevant rules of origin. These rules were amended (principally with regard to the way the requirements for meeting origin were presented) in the First Protocol to AANZFTA, which entered into force for most parties to the agreement in October 2015. At the time of writing, however, Indonesia had not completed all of the necessary domestic procedures for it to enter into force for its own trade, so that provisions in the original agreement continue to hold in its case. Either under the new or old arrangements, there are very flexible rules of origin, allowing in most cases a choice between a regional value-added rule (typically requiring 40 per cent of the value to be added within AANZFTA) and a change of classification approach of the Harmonized System applying to the materials

used and the final product. Goods which are wholly produced or obtained from a party, of which minerals are typically examples, are conferred origin without the requirement to undergo these tests.

As already noted, part of the value of AANZFTA lies in binding tariffs at much lower levels than WTO bound rates. For many mining products, bound rates are extremely high. Table 3 gives bound most-favoured-nation (MFN) rates for Indonesia for various mining products. Clearly, there is an enormous gap between the applied and bound rates, underlining the importance of AANZFTA in binding rates within the free trade agreement.

Although tariffs on many products (and almost all minerals and basic metal manufactures) have gone to zero, there can still be various charges levied on imported goods. Under Indonesian tax law, a withholding tax is applied to imports of many goods, levied on the c.i.f. value of imports (that is, the value including insurance and freight) as a pre-payment of income tax. The rate varies but for most goods other than consumer goods is 2.5 per cent (and 7.5 per cent if the importer does not have an Importer Identification Number). Taxpayers without a tax file number pay double the relevant rate, so that an import tax of this kind can go up to 15 per cent. A value-added tax (VAT), usually 10 per cent, applies to many goods and is also levied on imports. But a range of minerals including coal (prior to being processed into briquettes), iron ore, bauxite and ores of tin, copper, gold and silver are non-taxable goods under the VAT. A luxury goods sales tax can also apply to imports, though this is not relevant to mining goods.<sup>34</sup>

Table 3

**WTO bindings for minerals and basic metal manufactures**

Source: WTO Tariff Download Facility

| Product group                         | WTO bindings  |
|---------------------------------------|---|
| Coal and coke                         | All lines bound at 40 per cent.   |
| Iron ore                              | All lines bound at 40 per cent.   |
| Non-ferrous metal ores                | All lines bound at 40 per cent.   |
| Non-metallic and other minerals       | Rates bound at 40 per cent, except for bentonite and asbestos, which are bound at 30 per cent.  |
| Basic iron and steel manufacturing    | All lines bound at 40 per cent.   |
| Basic non-ferrous metal manufacturing | Six HS sub-headings are unbound. Five are for metals from the platinum group (other than platinum itself) and their basic manufactures (e.g. palladium in semi-manufactured form). The other is for waste and scrap of silver. All bindings on the remaining items are at 40 per cent, except for unwrought lead and lead waste and scrap, and unwrought zinc and zinc waste and scrap, which are bound at 30 per cent. |

**Note:** The WTO bindings are in terms of HS1996 while the product groups above are defined in terms of HS 2012. There is not an exact concordance between these two classifications for some sub-headings (that is 6-digit items) in minerals and basic metal manufacturing. But the differences are not ones which affect the statements made in column 2 of the table.

Although tariffs on many products (and almost all minerals and basic metal manufactures) have gone to zero, there can still be various charges levied on imported goods.

Table 4

**Tariffs on products which may include mining equipment**

Source: Indonesian 'Legal enactment of tariff commitments under AANZFTA', HS 2012 format

| HS   | Product   | 2020 tariff<br>per cent          | X-Indon<br>\$m | X-World<br>\$m |
|--|---|----------------------------------|----------------|----------------|
| 730422<br>730423<br>730424<br>730512<br>730520<br>730621<br>730629 | Various tubes, pipes, hollow profiles of a kind used for drilling for oil and gas | 0, 5, 20                         | 0.01           | 9.26           |
| 841360<br>841381   | Various pumps for liquids   | 0, 2, MFN                        | 10.94          | 68.44          |
| 841382   | Liquid elevators  | 0, 4                             | 0.00           | 0.38           |
| 8426   | Ships' derricks, cranes, works trucks fitted with a crane, etc.                   | 0, 2.5, MFN                      | 0.10           | 178.38         |
| 8427   | Fork lift trucks, other trucks for lifting, handling                              | 4, MFN                           | 0.26           | 64.09          |
| 8429   | Self-propelled bulldozers, graders, etc.  | 0, 5                             | 0.82           | 175.55         |
| 843049   | Boring or sinking machinery, not self-propelled                                   | 0, MFN                           | 0.10           | 16.44          |
| 843139   | Parts of machinery for lifting, handling or loading equipment                     | 0, 1, 5                          | 10.29          | 47.49          |
| 8501   | Electric motors and generators  | 0, 1, 2, 4, 5                    | 2.09           | 58.30          |
| 8704   | Motor vehicles for the transport of goods   | 0, 10, 11, 13, 33.33, 20, 40, 45 | 6.93           | 129.87         |

**Note:** The products above have been chosen on the basis that at least some lines for the product have non-zero tariffs by 2020. X-Indon. refers to Australian exports to Indonesia in 2016, while X-World is Australia's exports to all countries.

**Tariffs on mining equipment**

Mining equipment is difficult to define and many products have multiple uses. But it is clear most of the tariffs on METS products are zero in Indonesia's domestically-enacted HS 2012 AANZFTA schedule. A number of other tariffs are scheduled to fall to zero on or before 2020. There are some items, however, where this is not the case.

Table 4 lists some product groups that include one or more lines where scheduled tariffs will not be zero by 2020, or where Indonesia's only commitment is to give MFN treatment.

Exports to the world are included to provide an indication of whether Australia can supply those products competitively. The table includes broadly defined groups of products and is indicative only. But it suggests these items would warrant closer examination.

As with minerals and basic metal manufactures, bound tariffs on mining equipment are high. Table 5 illustrates this by giving the WTO bindings on selected products where tariffs are zero under the AANZFTA schedule. This again underlines the importance of AANZFTA in giving added certainty to Australian exporters.

Table 5

**WTO bound rates on selected products which may include mining equipment (per cent)**

Source: WTO Tariff Download Facility

|            | Prepared<br>explosives | Safety<br>fuses,<br>detonators,<br>etc. | Radio<br>remote<br>control<br>apparatus | Safety<br>headgear | Rock<br>drilling &<br>earth boring<br>equipment | Coal or rock<br>cutters &<br>tunnelling<br>machinery | Shovels,<br>buckets for<br>machinery,<br>etc. |
|------------|------------------------|---|---|--------------------|---|--|---|
| HS         | 3602                   | 3603                                    | 852692                                  | 650610             | 820713,<br>820719                               | 843031,<br>843039                                    | 843141  |
| Bound rate | Unbound                | 40                                      | 30                                      | 40                 | 30  | 30   | 40  |

**Non-tariff barriers**

Indonesia makes extensive use of non-tariff measures (NTMs). Munadi, in a 2016 study, finds a total of 199 NTM-related regulations in force, affecting 6,466 tariff lines, or almost two thirds of the total number of lines. Most of the affected products were subject to more than one NTM. Table 6 shows the result of Munadi's analysis for mineral products, metals and machinery and electrical goods, with the last sector being relevant to some mining equipment. Some 14 government agencies were responsible for these regulations, with the Ministry of Trade or the Ministry of Industry and Trade together responsible for about 40 per cent. Munadi finds that technical barriers to trade are the most frequently applied NTM in Indonesia.<sup>35</sup> Sanitary and phytosanitary measures, export-related measures and pre-shipment inspection are also important.<sup>36</sup> Import

licensing is one important method of implementing NTMs. According to the WTO Secretariat, over 2,000 items were subject to measures of this type when it carried out Indonesia's trade policy review in 2013. Export-related measures are particularly important for the minerals sector, and are considered below under barriers to investment.

Based on the measures reported by the Global Trade Alert since early 2009, it is difficult to avoid the conclusion that Indonesia has used NTMs to raise or liberalise import barriers as circumstances appear to require. One concrete example concerns iron and steel products. With the onset of the Global Financial Crisis, Indonesia's Ministry of Trade announced that new procedures would govern imports of these products, with imports of affected items only by Registered Importers or

Table 6

**Tariff lines subject to NTMs**

Source: E Munadi, 'Indonesia's Non-Tariff Measures: An Overview,' Non-Tariff Measures in ASEAN, ERIA Research Project Report 2015-1, Jakarta.

| HS chapter                          | Product group        | 1 NTM      | 2 NTMs     | 3 or more NTMs |
|-------------------------------------|----------------------|------------|------------|----------------|
| 25-27                               | Mineral products     | 46         | 34         | 110            |
| 72-83                               | Metals               | 17         | 15         | 370            |
| 84-85                               | Machinery/electrical | 98         | 286        | 491            |
| <b>All products subject to NTMs</b> |                      | <b>650</b> | <b>968</b> | <b>4848</b>    |

Producer Importers; with pre-shipment technical verification by a state-appointed company (known as 'surveyors') at the loading port; and with the submission of quarterly reports on import volumes. In June 2014, the Ministry of Trade issued a decree requiring a license to import steel alloy, with a further requirement for technical inspection in the originating country, evidently with the aim of limiting imports.

In December 2016, the Ministry of Trade announced new procedures – this time liberalising imports for steel and iron products by removing the requirement to restrict importers to Registered Importers or Producer Importers, allowing importers to use the more general import licenses API-U (for importers bringing in goods for further distribution) and API-P (import for input into manufacturing).<sup>37</sup> While none of the products affected by these regulations falls within the categories of mining or METS equipment as defined in this research, they are certainly of interest to the mining sector.

Leaving aside NTMs introduced or relaxed by the authorities, it is clear that there is a range of impediments other than tariffs that affect trade. Chart 2 illustrates this by looking at scores in the World Bank's International Logistics Performance Index for Indonesia (which, as noted earlier, ranked 63rd in the world on this index in 2016) and Singapore (which ranked fifth). Not surprisingly, Indonesia scores well below Singapore on each sub-component of the index, including the efficiency of customs and border management; transport and trade infrastructure; ease of arranging international shipments; the quality of logistics services; ease with which consignments can be traced; and the timeliness of shipments. The relatively low score on customs is in spite of reforms to this area, including the introduction of a National Single Window in 2007 and its extension to the major ports and airports used for trade. Indonesia's overall ranking has actually deteriorated, from 43rd in 2007, suggesting that at least some other economies have been reforming faster than Indonesia.



Chart 2

**World Bank International Logistics Index: Indonesia and Singapore**

Source: World Bank International Logistics Index, 2016

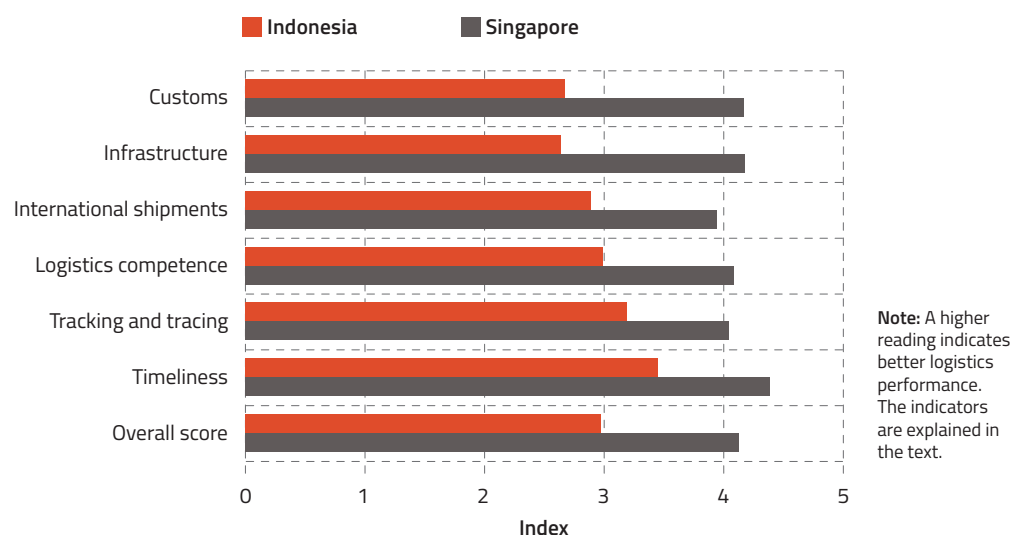
**Barriers to services trade**

Table 7 looks at barriers to services trade for Indonesia using the OECD's Services Trade Restrictiveness Index. As the table shows, Indonesia has a relatively high index (indicating significant restrictions) in sectors which are important to the mining and METS sectors. The table provides a decomposition of the OECD services trade restrictiveness indices (STRIs) into their constituent parts, covering restrictions on foreign entry, impediments to people movement, other discriminatory measures, barriers to competition and limits on regulatory

transparency. The table also gives Indonesia's rank out of the total of 44 countries for which data are available. In general, Indonesia ranks among the most restrictive of countries. Across all 22 sectors covered by the OECD's work, Indonesia has an STRI higher than the average.<sup>38</sup> Sometimes it is much higher.

Construction is an example of significant restrictions, with Indonesia the second most restrictive of the sample of 44 countries. Foreign firms providing construction services can only work in the market through a joint venture or a representative office. Foreign equity is capped at 67 per cent for work on

Table 7

**Indonesia: Services Trade Restrictiveness Index**

Source: OECD Services Trade Restrictiveness Index

|                                    | Account. | Engineer. | Legal | Computer | Construct. |
|------------------------------------|----------|-----------|-------|----------|------------|
| Indonesia, of which:               | 0.424    | 0.286     | 0.879 | 0.291    | 0.386      |
| a. Restrictions on foreign entry   | 0.264    | 0.094     | 0.447 | 0.086    | 0.145      |
| b. Restrictions on people movement | 0.102    | 0.113     | 0.306 | 0.103    | 0.089      |
| c. Other discriminatory measures   | 0.022    | 0.028     | 0.045 | 0.044    | 0.073      |
| d. Barriers to competition         | 0.008    | 0.009     | 0.040 | 0        | 0.037      |
| e. Regulatory transparency         | 0.028    | 0.041     | 0.041 | 0.059    | 0.041      |
| Indonesia's rank (out of 44)       | 6        | 7         | 4     | 9        | 2          |
| Minimum value                      | 0.081    | 0.113     | 0.078 | 0.100    | 0.101      |
| Maximum value                      | 1.000    | 0.488     | 1.000 | 0.442    | 0.476      |

**Note:** The restrictiveness index runs from a theoretical zero (completely open) to 1 (completely closed). The figures in items (a) to (e) sum (with small rounding errors) to the total restrictiveness index for Indonesia. The rank runs from the most restrictive country or countries with, for example, Indonesia the second most restrictive country of the 44 for construction services.

large construction projects (defined as projects of Rp 50 billion or more, or about \$4.8 million at the current exchange rate). Projects below this amount, or which are low risk or do not involve advanced technology, are reserved for local small and medium enterprises. A lower equity limit of 49 per cent applies to investments in state-owned enterprises (SOEs). In some cases such investment is prohibited.

Engineering services are more open than either legal or construction services according to the OECD index. Yet there are also significant barriers here. The principal restriction is on movement of people. A

Temporary Stay Permit Visa is required and is subject to a labour market test. It is only possible to stay for two years in the first instance, though this can be extended. There are also licensing requirements for engineering services. Restrictions on foreign entry include a 67 per cent equity limit for engineering service firms (up from 55 per cent in 2014). Construction supervisors and technical workers need to have a certificate of skill and expertise.

In the case of legal services, Table 7 shows that Indonesia's score is close to the theoretical maximum of one which

indicates a completely closed market. It is, in fact, the fourth most restrictive country for legal services of the 44 for which data are available and the second most restrictive in Asia (after India). Barriers to foreign entry and to people movement explain most of the high score on legal services restrictions. Thus, foreign lawyers cannot set up a practice in Indonesia and can only work in Indonesia as advisers on foreign law. A foreign advocate can stay for only 12 months initially (with the possibility of annual renewal thereafter) and there are limits on the number of foreign advocates who can be employed (they can only be employed if there are at least four local advocates in the firm for each foreign lawyer and it is not possible to hire more than five foreign lawyers in total for any one firm). Cross-border services are only possible if the lawyer or law firm is in Indonesian territory.<sup>39</sup>

The STRI index only covers restrictions which apply on a most-favoured-nation basis. It does not take into account more liberal arrangements which may apply under a free trade agreement – in the Australia-Indonesia case, AANZFTA. However, a number of studies have indicated that free trade agreements mostly bind the levels of openness on services which existed when the agreements were negotiated.<sup>40</sup> As with the General Agreement on Trade in Services (GATS), there can also be ‘water’ in agreements: that is a gap between the bound level and those which are actually applied.<sup>41</sup> The assessment in this report is that the OECD’s STRI still conveys useful information in gauging the level and kind of barriers which Australian firms face in Indonesia.

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## Indonesia’s commitments in AANZFTA are likely to form a basis for future negotiations on services in the Review and bilaterally.

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The bound levels in free trade agreements like AANZFTA are still important for firms given that they can provide some certainty of access to the Indonesian market. In addition, Indonesia’s AANZFTA commitments in its schedule on services and the movement of people are likely to form the basis of any negotiations with Indonesia under the review of AANZFTA or under the negotiations for IA-CEPA. Tables 8 and 9 give a summary, for the same five sectors above, as well as for services incidental to mining and for energy services, of Indonesia’s limits on market access and national treatment. Table 8 deals with Mode 1 (cross-border supply, for example over the Internet), Mode 2 (in which the service is provided by travel to Australia by the Indonesian recipient) and Mode 3 (where the service is delivered by commercial presence in Indonesia). Table 9 gives similar information for services provided through Mode 4 (that is, by the movement of Australian suppliers to Indonesia).

Like the most-favoured-nation applied data collected by the OECD, the AANZFTA schedules for Indonesia present a picture of a highly restrictive services regime.

Table 8

**Indonesia: AANZFTA commitments on services provided by Modes 1, 2 and 3 (select examples)**

Source: AANZFTA schedules for Indonesia

| Service  | Limits on market access and national treatment  |
|--|---|
| All services sectors for which commitments are made (that is, horizontal commitments), unless otherwise provided | Commercial presence must take the form of a representative office or limited liability enterprise, which may, in the latter case, be no more than 49 per cent foreign owned. Foreigners cannot own land, but through a joint venture can lease/rent land or property. Persons (including juridical) must comply with professional qualification requirements.   |
| Accounting services  | No commitments made.  |
| Engineering services   | Commercial presence for many engineering services can involve either a joint operation representative office (a three-year licence is provided for, with fees and the possibility of renewal), or a joint venture meeting the general requirements for all services and the Foreign Capital Investment Law. There are registration/qualification requirements for the local partners in the joint operation. In the specific case of engineering consulting and design services, commercial presence requires a joint operation through a representative office and the Indonesian participant must be a member of the Indonesian Consultant Association. |
| Legal services   | Commercial presence is specified as unbound (that is, regulation is not limited by any commitments).  |
| Computer services  | Consultancy services and software implementation must involve a joint operation via a representative office, with the local partner a member of the Indonesian Consultant Association. No commitments have been made in relation to data processing and database services and other computer services.  |
| Services incidental to mining  | No commitments made.  |
| Construction and related engineering services  | Commercial presence requires a joint operation via a representative office in Indonesia, or a limited liability joint venture which may be no more than 55 per cent foreign owned. Local partners in a joint venture must be registered by the Construction Services Development Board and there are qualification requirements.  |
| Energy services  | Commercial presence can occur through a joint operation representative office, with limits on national treatment as specified in the horizontal section.  |

There are a number of priorities Australian negotiators could usefully pursue in seeking to further liberalise the Indonesian regime.

- It may be possible to negotiate more liberal bindings in cases where the applied most-favoured-nation regime is more open. With construction services, for example, the

applied regime allows for foreign equity of up to 67 per cent for large projects, but the bound rates are less liberal (at 55 per cent). Engineering service firms now also have a 67 per cent equity limit according to the OECD work, but this is not yet reflected in the AANZFTA schedule for Indonesia.

Table 9

**Indonesia: AANZFTA commitments on services provided by Mode 4 (select examples)**

Source: AANZFTA schedules for Indonesia

| Service  | Limits on market access and national treatment  |
|--|---|
| All services sectors for which commitments are made (that is, horizontal commitments), unless otherwise provided | Market access is limited in that directors, managers and technical experts are only allowed to stay for two years (although this can be extended) and an economic needs test applies to managers and technical experts. Temporary business visitors are only permitted to stay for 60 days in the first instance, though this can be extended to a maximum of 120 days. National treatment is limited in two ways: by the possibility of charges levied on foreign service providers and by the need for them to hold a valid working permit. |
| Accounting services  | No commitments made.  |
| Engineering services, including engineering design services  | Mostly as for the horizontal commitments. However, market access for engineering design services is unbound (except for the positions of director and technical expert).  |
| Legal services   | Among other provisions, foreign lawyers are only permitted to work in an Indonesian law firm as employees or experts in international law. They cannot appear in court, cannot exceed 20 per cent of the advocates in the firm and the total employed must not be more than five.   |
| Computer services  | Market access is unbound except for the positions of director and technical expert. Limitations on national treatment are as for the horizontal commitments. However, no commitments have been made in relation to data processing and database services and other computer services.   |
| Services incidental to mining  | No commitments made.  |
| Construction and related engineering services  | As specified in the horizontal commitments.   |
| Energy services  | Market access is unbound except for directors and technical experts. Limitations on national treatment are as specified in the horizontal commitments.  |

- It would be desirable to have Indonesia make some commitments in areas where it has failed to do so thus far, including accounting services and some computing services, as well as services incidental to mining. The definition of services incidental to mining could also be clarified, and perhaps broadened, if it is possible to negotiate reasonable access for this area.
- It would, of course, be desirable to roll back the extensive restrictions in the wide range of areas relevant to the mining and METS sectors. Areas of key interest to Australia include services incidental to mining, engineering services, construction services and conditions for the entry and stay of company personnel. Accounting services, legal services, and computer and software services are also important. In looking at areas to seek to liberalise, it will be important to examine what other ASEAN economies have been able to gain and for Australia to seek equivalent treatment where ASEAN has more liberal access.

# Barriers to investment

Barriers to FDI are perhaps the most serious impediments to mining firms seeking to do business in Indonesia. The previous section discussed a number of restrictions on commercial presence for mining services companies. This section focuses on the equally daunting barriers which confront the minerals sector. Commentary in the business press suggests these barriers have contributed to recent decisions by foreign investors and international mining companies to scale back their interests in Indonesian mining operations such as IndoMet Coal<sup>42</sup> and the Batu Hijau copper and gold mine.<sup>43</sup>

The OECD's FDI Regulatory Restrictiveness Index shows Indonesia to have a highly restrictive foreign investment regime, in spite of the general opening of that country to foreign investment over the period from the mid- 1980s.<sup>44</sup> Indonesia's overall score on the 2016 index is several times the average for OECD economies, and aligns with values recorded for the Philippines, Myanmar and China (Chart 3). Mining and quarrying has a very high restrictiveness index, almost equalling that of the legal and accounting sectors, which have prohibitive barriers to foreign participation (Chart 4).

Chart 3

## OECD FDI Regulatory Restrictiveness Index for 2016, selected countries

Source: OECD FDI Regulatory Restrictiveness Index Database

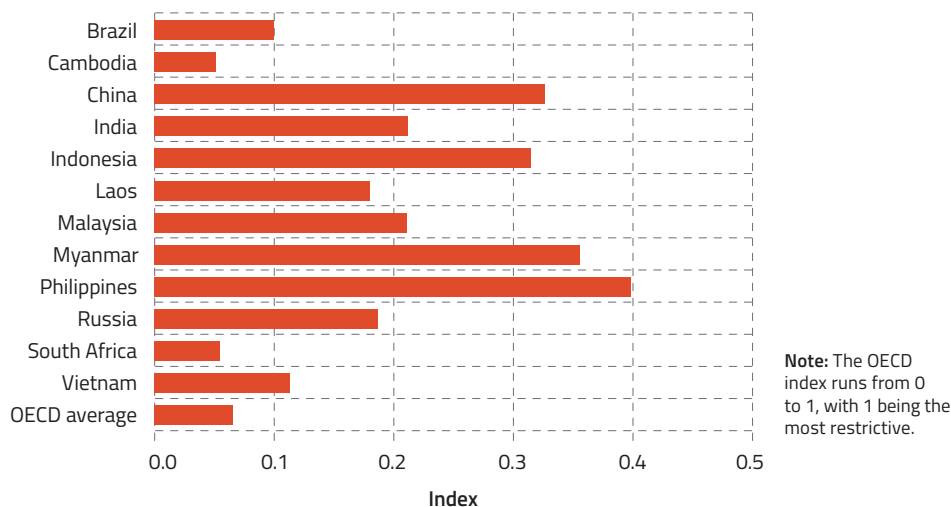
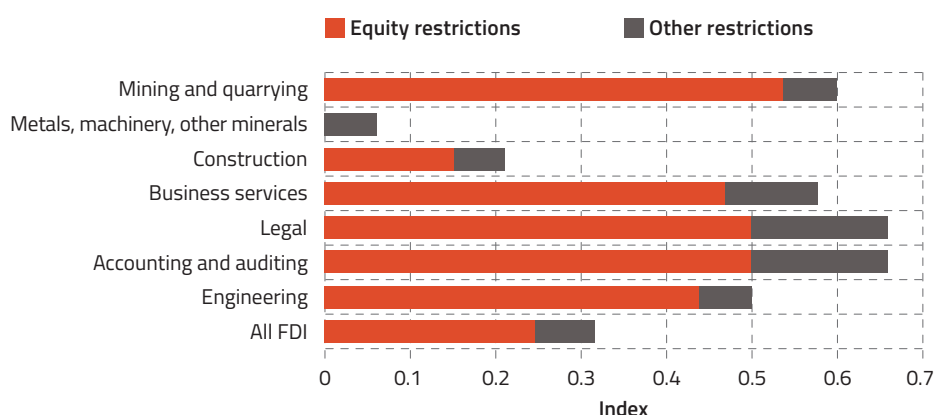


Chart 4

**Indonesia: 2016 FDI Regulatory Restrictiveness Index by sector and type**

Source: OECD FDI Regulatory Restrictiveness Index Database



**Note:** Other restrictions here measure all contributions to the total FDI Regulatory Restrictiveness Index other than equity restrictions.

Most of these restrictions are classified as equity restrictions in the OECD index, though other impediments are also very important.

The starting point in looking at barriers to mining investment in Indonesia is the 2009 mining law. This law sought, firstly, to end the export of unprocessed minerals by requiring miners to process and refine commodities in Indonesia; secondly, to make use of local or national mining service companies in carrying out mining; and thirdly to require foreign investment enterprises to achieve majority Indonesian ownership over time. It also established a set of mining business licenses of varying types and periods of operation,

with the aim of replacing the 'contract of work' or CoW system (essentially contracts between mining companies and the Indonesian Government) with a mining permit system (two common general licenses are exploration and production Izin Usaha Pertambangan or IUPs).<sup>45</sup> The 2009 law has been modified by subsequent amendments and regulations. An important change occurred in 2014 when a ban on the export of insufficiently processed ores came into effect (though in practice firms could continue to export ores under certain conditions, including, most importantly, a willingness to commit to developing a refining capacity). Further significant modifications were introduced in 2017.

As it stands:

- Foreign companies are required to divest their shareholding to a minority position by the tenth year from the date of production. Companies must achieve 20 per cent Indonesian ownership in year six, with successive requirements of 30, 37, 44 and 51 per cent Indonesian ownership by years seven, eight, nine and ten. Divestment can be accelerated under some circumstances if a company changes from an exploration or production IUP to a PMA (foreign investment company). According to Ashurst, some exemptions to the divestment law (concerning underground mining and smelting) were removed in the January 2017 regulations, so that all foreign investors must now adhere to the requirement to move to majority Indonesian ownership. In the divestment process, shares must be offered first to the central government, and then to provincial or regional governments, to SOEs and regionally owned companies and only after those options have been exhausted, to the private sector.<sup>46</sup>
- Firms must still apply to continue to export unrefined ores. Under the 2017 regulations, one of the conditions for so doing is that firms still on CoWs must convert them to licensing permits (according to the Office of the US Trade Representative, this provides less certainty than contracts in that they are subject to changes in regulations and taxes). Approval to export unrefined mineral concentrates is required from the Minister for Trade annually, with approval based on a recommendation from the Minister of Energy and Mineral Resources (or the Director General of Minerals and Coal

acting on behalf of the minister). The level of domestic processing required for export approval was lowered on a temporary basis under 2014 regulations for copper, iron ore, lead, zinc, manganese, titanium and ilmenite. For copper, for example, the minimum purity requirement for exporting was lowered from 99 to 15 per cent, and for iron ore from 80-88 to 62 per cent. For some other minerals (such as bauxite) the required purity levels remained high. Some of the minimum processing requirements for various minerals under the 2017 regulations are given in Table 10.<sup>47</sup>

- An export duty of 20 per cent on exports of ores was introduced in 2012. The 2014 regulations modified this, imposing an export duty of 25 per cent for concentrates of copper and 20 per cent for various other minerals (including concentrates of iron, manganese, lead, zinc, ilmenite and titanium), rising to prohibitive rates after three years with the objective of encouraging local processing. Under the 2017 regulations, export taxes on firms that have achieved minimum levels of processing generally depend on progress towards developing a refinery capacity. For a range of minerals, where progress is up to 30 per cent of the total (Stage 1), an export duty of 7.5 per cent applies. For Stage 2 (where more than 30 per cent and up to 50 per cent of the refinery development has occurred), the export duty falls to 5 per cent, while for Stage 3 (more than 50 per cent and up to 75 per cent), the export duty falls to 2.5 per cent. Firms that have realised more than 75 per cent of the total refinery development pay no export duty. Special provisions apply for nickel ores and bauxite.<sup>48</sup>



Table 10

**Illustrative minimum processing and refining requirements for metal minerals prior to export**Source: PwC, *Mining in Indonesia*, 9th edition, May 2017, pp. 103–108

| Ore   | Processing requirement   | Refining requirement   |
|---|--|--|
| Copper<br>(fusion process)                    | Copper concentrates $\geq$ 15 per cent Cu  | Various, for example, copper cathode $\geq$ 99 per cent Cu.  |
| Nickel/cobalt<br>(fusion process)             |  | Nickel matte, metal alloys and nickel metal. For example, nickel matte $\geq$ 70 per cent Ni. Nickel metal $\geq$ 93 per cent Ni.        |
| Bauxite                                       |  | Various, for example, smelter grade alumina $\geq$ 98 per cent $\text{Al}_2\text{O}_3$ , or aluminium metal $\geq$ 99 per cent.          |
| Iron ore in the form of hematite or magnetite | Iron concentrates $\geq$ 62 per cent Fe and $\leq$ 1 per cent $\text{TiO}_2$     | Various, for example, sponge iron $>$ 72 per cent Fe.  |
| Lead and zinc                                 | Zinc concentrates $\geq$ 51 per cent Zn; lead concentrates $\geq$ 56 per cent Pb | Metal, metal oxide/hydroxide, or gold metal and/or silver. For example, bullion $\geq$ 90 per cent Zn, or $\text{PbO} \geq$ 98 per cent. |

- There is provision for reserving part of mining production for the domestic market (the Domestic Market Obligation). So far, this has only been applied to coal.<sup>49</sup>

The mining regulations implemented by Indonesia have been of considerable concern to mining companies and there may also be questions as to whether they are likely to work in Indonesia's national interests. According to PwC:

Despite the good intention of developing a value-added downstream sector in Indonesia, the timing may not be right given current global supply and demand considerations for some minerals. The impact of these

regulations to date has therefore been that: some (if not most) smaller-scale mineral miners have suspended operations, some large scale operations have reduced their mining activities and exports, with some leaving Indonesia altogether, while still investing elsewhere. This has not only impacted the miners themselves, but has had a significant impact on Indonesia's export revenues, tax and royalty returns, and domestic economic development.<sup>50</sup>

Rio Tinto has been affected by these regulations through its interest in the Grasberg Mine in Papua (see Box 1). Freeport-McMoRan, through its Indonesian subsidiary, was one of those companies

still operating under a CoW in early 2017. The new regulations introduced in January and February of that year required that, in order to export ore concentrates, it would need to change the CoW to a special license, commit to building a smelter, pay export duties, and over time divest 51 per cent of its shareholding to Indonesian interests. Freeport Indonesia advised the Indonesian Government that it would only make the change from a CoW if it were to secure 'an investment stability agreement providing equivalent rights with the same level of legal and fiscal certainty enumerated under its ... [CoW] and provided that the ... [CoW] would remain in effect until it is replaced by a mutually satisfactory alternative.' Freeport Indonesia indicated that it was prepared to commence building a smelter and gave notice to the Indonesian Government of its intention to invoke the dispute provisions of the CoW. It also cut production from the mine and laid off part of its work force. It subsequently received a temporary permit to allow exports to go ahead for six months and the parties began negotiations on a long-term solution. A framework agreement was announced in August 2017. Under it, Freeport-McMoRan agreed to convert the CoW to a special license, divest to Indonesian interests 51 per cent of the shares in Freeport Indonesia (in such a way that Freeport-McMoRan would retain operational control) and build a new smelter in Indonesia within five years. In return, it received a commitment that it would have long-term operating rights and a degree of certainty during the term of the license.<sup>51</sup>

AANZFTA contains provisions to improve certainty for Australian investors in Indonesia and other parties to the

agreement. Key benefits are improvements in transparency; an obligation to provide non-discriminatory treatment in certain circumstances (such as armed conflict); a commitment to allow funds to be transferred abroad; and provision for compensation in the event of nationalisation. There is also an investor-state dispute settlement (ISDS) mechanism, as well as provisions relating to national treatment.<sup>52</sup> The latter are limited by Article 12 of the investment chapter, which indicates that national treatment does not apply to existing measures (whether maintained by the central government or regional/local authorities). An Australian-Indonesian investment agreement remains in force, though Indonesia has indicated that it does not intend to renew bilateral investment agreements when their terms expire.<sup>53</sup> This makes AANZFTA all the more important.

The broad objective on investment in AANZFTA and IA-CEPA should be to include the most liberalising commitments possible and the most comprehensive, 'best practice' disciplines in areas such as:

- National treatment (providing for investors from other parties to be treated no less favourably than those in the recipient country)
- Most-favoured-nation (MFN) treatment (providing for investors of each party to be accorded treatment no less favourable than those from other countries)
- Elimination of performance requirements (such as conditioning investment approval on a firm exporting a given percentage of its output) – see the discussion below

- Transparency and disclosure of information in relation to investment laws
- Enabling investors to transfer funds abroad (such as profits, dividends and payments of various kinds) in a freely usable currency and to obtain prompt compensation in the event of expropriation.

**The broad objective on investment in AANZFTA and IA-CEPA should be to include the most liberalising commitments possible and the most comprehensive, 'best practice' disciplines.**

Effective implementation of provisions of this kind would contribute to increased flows of foreign investment in the region which, in many cases, is constrained by a lack of transparency and arbitrary actions by governments.

Article 16 of the investment chapter in AANZFTA provides for work to further develop the chapter. There is ample scope for this. A key objective of any review of AANZFTA should be to develop and improve countries' commitments on investment, with a view to building more liberalising commitments over time. Transparency of investment laws and regulations is another important area (though the text

of AANZFTA on this point already contains useful commitments). At present AANZFTA provides (in Article 16.2) for the parties to discuss the application of MFN principles to the investment chapter. Including a provision of this kind would be a significant step forward.

Disciplines on performance requirements should also be strengthened and are particularly important in Indonesia's case; ideally, they should be prohibited except under carefully defined circumstances. AANZFTA provides for parties to apply the WTO Agreement on Trade-Related Investment Measures. In contrast, the text of the Trans-Pacific Partnership (TPP) Agreement develops in considerable detail the prohibited measures and the circumstances in which the prohibitions apply. This model would appear to be relevant to Australia and Indonesia. In relation to ISDS, the procedure in the TPP has higher standards of transparency than in AANZFTA. For example, in the ordinary course of events, arbitration tribunals would have conducted hearings in public under the TPP. It might also be useful to consider an appellate body or mechanism within the framework of AANZFTA. The Korea-Australia FTA (KAFTA) provides (in Annex 11-E) for the two countries to consider this.<sup>54</sup>

## Trade and industry policy and opportunities for reform

There has been uneven progress on trade liberalisation in Indonesia over the past decade. While tariffs have fallen, other measures indicate creeping protectionism. Patunru and Rahardja note that:

Most of the policies reflective of this trend are non-tariff measures, as tariffs are already very low. The introduction of a more restrictive cap on certain sectors, the ban on raw material exports, and the provision of greater authority for ministers to issue intervention and monitoring policies are just a few examples. The trend began during the tenure of former President Yudhoyono [2004-14], but is continuing under President Joko Widodo (Jokowi).<sup>55</sup>

Protectionism has affected much more than the minerals and METS sectors. Indeed, some of the best-known examples are the efforts to control imports of rice in the interests of producers and the policies Indonesia followed on the live cattle trade with Australia.

This shift can be seen as an element of a much broader resurgence of nationalism in Indonesia, which has political and cultural manifestations as well. Aspinall argues persuasively that the new nationalism has deep historical roots in Indonesia's struggle against colonialism and that its current growth is partly the result of the development of Indonesian democracy after the 'New Order' of President Soeharto came to an end in 1998. In Aspinall's view, it also reflects 'deep insecurities' in Indonesia stemming from continued poverty and inequality and concerns that it has fallen behind many of its neighbours.<sup>56</sup> Economic nationalism has more specific causes as well.

It was accompanied by a loss of influence on the part of 'technocrats' who have competed with nationalists for influence on Indonesian economic policy since the end of the 'New Order'.<sup>57</sup> Other factors were: strong competition from China and other emerging economies in Asia in labour-intensive manufactures; a reaction to the sharp fall in national income which occurred with the East Asian Financial Crisis of 1997-98 and the role of the IMF in addressing it; and a relatively high real exchange rate under the impact of the resources boom.<sup>58</sup> The Global Financial Crisis may also have played a role, though its impact on Indonesia, with growth falling to 4.7 per cent in 2009, was mild compared to the East Asian Financial Crisis (the economy contracted by over 13 per cent in 1998 and did not pass 1997 levels until 2003).

Economic nationalism as it has emerged in Indonesia has several characteristics, some of which it shares with protectionist ideologies in other countries:

- There is a strong belief in the role of the state in promoting growth and industrialisation. Warburton suggests that this idea, which she calls 'the new developmentalism', has been encouraged by the experience of Indonesia's neighbours, with some following highly interventionist policies to promote development. While not new, it has become a vehicle for some of Jokowi's core policies such as promoting infrastructure to support economic development.<sup>59</sup>
- There is an equally strong view on the need to avoid foreign control of Indonesia's natural resource endowment. This helps to explain the somewhat ambivalent attitude

to foreign investment in minerals and requirements to cede majority control to Indonesians. But it also affects other areas of policy. To give one example, Jokowi has spoken of the need to prevent foreign firms from 'occupying' Indonesia in the context of encouraging young Indonesian entrepreneurs to compete vigorously in the domestic market.<sup>60</sup>

- Manufacturing is thought to be a key driver of jobs and growth, and developing linkages between sectors such as mining and manufacturing is an important objective. This idea runs through Indonesia's national development plans. It helps to explain measures to promote further processing of resources in Indonesia. There has not been much recognition of the fact that this may not be an efficient approach and that Indonesia has forgone some of the benefits of the minerals boom because of policies to promote the mineral processing and refining sector.<sup>61</sup>
- As in many other countries, ideas about trade policy are often couched in mercantilist terms, with exports seen as a positive and imports a decided negative, including by the President himself.<sup>62</sup> As one example, the National Industry Development Masterplan for 2015-35 refers to the need to increase the utilisation of domestic products and has explicitly set a target for reducing imports from 43 per cent of output in the non-oil and gas industry sector in 2015 to 20 per cent by 2035. In discussing the benefits and costs of free trade agreements, the Ministry of Industry listed as a disadvantage the 'Increasing number of imported goods and services in the domestic market, which

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potentially threaten Indonesian balance of trade and balance of payment.<sup>63</sup> There has been little appreciation or understanding that imports are essential to effective participation in global value chains, especially in the manufacturing sector that Indonesia seeks to promote.<sup>64</sup> One of the characteristics of mercantilist ideas in Indonesia is the belief that, with its large population, it can grow primarily on the basis of the domestic market. However, the fact that per capita incomes are low means that the market is not, in practice, as large as this belief suggests.

Jokowi's top priorities do not appear to lie in trade. Warburton characterises them as involving three areas: infrastructure, deregulation and de-bureaucratisation. On infrastructure, the Indonesian Government aims to 'deliver 35,000 megawatts of electricity to the grid; to upgrade and develop five port hubs and 19 feeder ports; to build 3,650 kilometres of new roads; and to achieve 100% access to clean water nationwide'. Cutting red tape under the other two priority elements is seen to promote the development of infrastructure.<sup>65</sup> Among other things, building infrastructure is viewed as a means to spread the benefits of growth and industrialisation across Indonesia's sprawling archipelago.

Indonesia is nevertheless negotiating free trade agreements with many other economies. It already has agreements through its membership of ASEAN, including the ASEAN Economic Community itself and ASEAN agreements with Australia and New Zealand, China, India, Japan and Korea. Indonesia also has a bilateral agreement with

Japan and a partial FTA with Pakistan.<sup>66</sup> The *Jakarta Post* reported in December 2016 that Indonesia was seeking to finalise five new agreements in 2017, RCEP, an agreement with the European Free Trade Association (EFTA) and bilateral agreements with Australia, Chile and Peru. It is studying some other agreements, including one with the Eurasian Economic Union (which includes Russia and a number of other economies which once formed part of the Soviet Union).<sup>67</sup> In July, it was reported that Indonesia had agreed to finalise negotiation of a preferential trade agreement with Iran by the end of 2017.<sup>68</sup> ASEAN and the European Union have also recently indicated that they will try to revive negotiations on an agreement which stalled a number of years ago.

The texts of agreements which have been negotiated are often not available, but it is likely that progress has been made in liberalising tariffs on goods, without making much of a dent in non-tariff barriers or impediments to services trade and investment. Tongzon and Cheong write, regarding the ASEAN-Korea Trade in Services Agreement which came into effect in May 2009, that 'Many sectors are currently "unbound", or have relatively low levels of commitment from Indonesia, and from other ASEAN countries, but high levels of commitment from Korea'.<sup>69</sup> It has already been noted that AANZFTA involved relatively few gains on services and investment.

The successful conclusion of the negotiations for RCEP will be particularly important from Australia's perspective. Although RCEP will not have similar provisions to the TPP, it still provides an important opportunity to make

It will be important to keep the beliefs and priorities of Indonesia's leadership in mind in developing proposals for Indonesia's consideration. The emphasis on infrastructure could perhaps lead to further cooperation in areas like improving logistics, which have bedevilled trade with Indonesia.

progress on difficult issues like services trade and investment, where barriers in Indonesia are deeply entrenched. Those with an interest in reform in Indonesia will have their cause strengthened by negotiations in a regional setting involving countries such as China and Japan. RCEP also offers the prospect of building region-wide cooperation in areas which will promote Indonesia's development in a way that the review of AANZFTA will not.

In Australia's own negotiations, it will be important to keep the beliefs and priorities of Indonesia's leadership in mind in developing proposals for Indonesia's consideration. The emphasis on infrastructure could perhaps lead to further cooperation in areas such as improving logistics, which have bedevilled trade with Indonesia. On the other hand, the strength of the belief in processing minerals suggests that Indonesia will not readily make changes in this area. All that may be possible in areas such as these is to negotiate changes at the margin. Encouraging evidence-based policy, for example by supporting work by international and regional agencies (including the World Bank, the IMF, the OECD and the Asian Development Bank) will also be important, as will be continued efforts in APEC. Australia should also continue to share its experience with the Productivity Commission with other regional economies, including Indonesia. It will also be important to encourage dialogue between the Australian and Indonesian business communities. To the extent that this helps the Indonesian business community to develop a more international perspective, it could be influential in changing the Indonesian policy debate.

Indonesia's development plans are also important in looking at areas where Australia and Indonesia can cooperate. The Master Plan of National Industry Development for 2015-2035 sets out Indonesia's long-term vision for industrial development. The plan identifies 10 priority industries for 2015-2035. They include the basic metal and non-metallic mineral industry and the oil, gas and coal-based chemical industry. These two industries are seen to support broader industrialisation involving, for example, capital goods and component industries, and ultimately mainstay industries which will have a key role in the future economy, such as chemicals; textiles, leather and footwear; transportation and power.<sup>70</sup>

Australia's own development assistance program can be utilised to build cooperation with Indonesia on trade and investment issues, without in any way conflicting with its objective of promoting development. This has been recognised by the Australian Government's 'aid for trade' initiative which has set a target for this area of up to 20 per cent of the total aid budget by 2020. The amount allocated for the aid for trade program is substantial at \$771 million in 2017-18, very close to the 20 per cent target. The bulk of this expenditure (around \$505 million) is expected to go to trade-related infrastructure in areas like transport, banking and finance, energy, trade policy and communications. The other major component is for assistance to agriculture, fisheries and forestry. Indonesia is, of course, a major recipient of Australian aid and is expected to receive \$357 million in official development assistance in 2017-18. The

current aid investment plan for Indonesia has, as one important objective, strengthening the aid for trade element of the program.<sup>71</sup>

It will be particularly important to continue to focus, and perhaps to intensify, efforts to improve the transparency and efficiency of Indonesia's border processes and procedures. This might include, for example, increasing cooperation between customs authorities and encouraging more efficient methods of customs administration. Achieving success in this area has the potential to bring about a significant reduction in trade costs, particularly if it leads to greater progress on tackling broader impediments to cross-border trade arising from inadequate physical infrastructure. As already noted, Indonesia's ranking on a World Bank logistics index has fallen since 2007. Another priority is to encourage cooperation and coordination across Indonesian government agencies: sharing experiences on this would be useful.

Importantly, progress in these areas could lead to greater participation by Indonesia in regional and global supply chains, which is weak by comparison with some other regional economies. It would be a useful outcome from work under the economic cooperation chapter of AANZFTA and any future provisions along these lines in RCEP. Work in these forums will naturally need to be coordinated with efforts by ASEAN and the international agencies (including the WTO in relation to the Trade Facilitation Agreement). Any efforts will also need to bear in mind Australia's own constraints, including limits on the capacity of our border agencies in the context of other priorities.



## Priorities for the minerals and METS Sectors

AANZFTA has largely completed the task of removing tariff barriers to mining, basic metals and mining equipment. But non-tariff barriers remain important, even if their scope and impact are not well-defined. Services trade and investment are heavily restricted, but are important for mining companies operating in Indonesia and for METS firms seeking to do business there.

Against this background the following impediments could be targeted by mining and METS firms when putting their views to the Australian Government:

- Although tariff liberalisation has largely been achieved, it would be useful to eliminate remaining barriers. For the mineral industry, the 5 per cent tariff on copper cathodes is one which could be usefully removed. There are a number of items where Indonesia's tariffs will remain – sometimes at high levels – out to 2020 and beyond, which could affect the export of mining equipment. In some cases, tariffs will remain at only very low levels and could easily be abolished.
- Non-tariff measures should be at the centre of work on merchandise trade. It would be useful to establish a work program in this area in the context of both the AANZFTA review and IA-CEPA negotiations, to identify key barriers and assess their impact, with a view to eliminating them where possible.
- Services liberalisation is a key priority both for the METS sector and for the mining sector which utilises their inputs. Further liberalisation should be a priority in key areas like services incidental to mining, engineering and construction, as well as services in such areas as law and computing. It should also be possible to re-negotiate bindings on construction and engineering services where applied barriers are more liberal than the bindings under AANZFTA. Restrictions on the movement of personnel for business purposes is an important area and should be a high priority for liberalisation.
- Restrictions on investment have played havoc with the mining sector in Indonesia. While it may not be practicable to seek fundamental changes to Indonesia's policy in this area, it would be useful (and in Indonesia's own interest) to negotiate changes in areas like the rate of taxation on exports of mineral ores, and the time periods over which refining capacity is to be installed and majority Indonesian ownership achieved. Commitments in these areas would add to certainty for industry given the number of policy changes which have been made over the past decade.
- The negotiations for RCEP offer an important opportunity to address entrenched barriers in Indonesia, while also opening the markets of other economies in the region to Indonesia. Along with the bilateral FTA, progress with RCEP should be one of Australia's top priorities in developing a productive commercial relationship with Indonesia.
- Sharing Australia's experience with the Productivity Commission should remain

a priority for Australia, as a way to encourage a rigorous and transparent assessment of the costs of protection. In Indonesia's case, it will be particularly important to address the costs of non-tariff barriers, restrictions on services trade and policies which discourage foreign investment or lead to an inefficient use of resources.

- Bearing in mind Indonesia's own development priorities, it should be possible to intensify programs which provide for cooperation in areas like logistics and trade infrastructure which are a major impediment to trade with Indonesia or doing business in it. Australia's aid program can form a useful way of giving effect to this. This is recognised by the Australian Government's aid for trade initiative.
- It will be important to encourage Indonesia to focus on the benefits of closer integration into regional and global supply chains, where its current performance is a significant impediment to maximising the gains from international trade.
- It will also be important for the AANZFTA review, IA-CEPA and RCEP to include provisions for ongoing work and review in difficult areas like non-tariff barriers, services and investment.

Australia faces challenges in its dialogue with Indonesia in some of these areas given that the stages of development of the two countries are very different, as are their trade and industry policies. For Indonesia, an industry policy which involves a high level of state control and targeting future industry expansion is in the mainstream of politics.

So too, it would appear, are somewhat mercantilist approaches to trade and the close regulation of foreign direct investment. Indonesia's policies in these areas are driven fundamentally by the imperative to promote development. By engaging with Indonesia on this ground, Australia will have its best chance of influencing its policies to the benefit of both countries.

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## Endnotes

- <sup>1</sup> These rankings are for GDP at purchasing power parity and are based on projections by IMF staff in the World Economic Outlook Database, October 2017, viewed 11 October 2017, [www.imf.org](http://www.imf.org). A 2012 report by McKinsey and Company argued that Indonesia could be the seventh largest economy in the world at market exchange rates by 2030, overtaking the United Kingdom and Germany, providing productivity-boosting reforms continued. See R Oberman, R Dobbs, A Budiman, F Thompson and M Rossé, *The Archipelago Economy: Unleashing Indonesia's Potential*, McKinsey Global Institute, 2012. A more recent study by PwC suggests that Indonesia could be the fifth largest economy by 2030 and the fourth largest by 2050 at purchasing power parity. (PwC also projects that Indonesia could be the ninth biggest economy at market exchange rates by 2030 (up from 16th in 2016) and the fourth largest by 2050, but it acknowledges that projections at market exchange rates are far more difficult to make than those at purchasing power parity). See PwC, *The Long View: How will the global economic order change by 2050?*, February 2017, viewed 5 October 2017, available at [www.pwc.com/world2050](http://www.pwc.com/world2050)
- <sup>2</sup> The Bank of Indonesia aims to maintain a stable exchange rate, along with its domestic price objectives. However, the IMF regards the rupiah as a floating currency and Klyuev and Dao find no evidence that the Bank of Indonesia has sought to target a specific exchange rate over the past decade. See V Klyuev and To-Nhu Dao, *Evolution of Exchange Rate Behaviour in the ASEAN-5 Countries*, IMF Working Paper, WP/16/165, 2016.
- <sup>3</sup> Calculated from data in IMF World Economic Outlook Database, October 2017, viewed 11 October 2017, [www.imf.org](http://www.imf.org)
- <sup>4</sup> From data in the United Nations Population Division, World Population Prospects 2017 Database, viewed 11 October 2017, <https://esa.un.org/unpd/wpp/>. The US Bureau of the Census, International Database shows a smaller increase between 2016 and 2030. Viewed 15 June 2017, [www.census.gov](http://www.census.gov)
- <sup>5</sup> S Tabor, *Constraints to Indonesia's Economic Growth*, Asian Development Bank Papers on Indonesia, No.10, December 2015, p. 4, makes this point. The gross incremental capital-output ratio can be defined as the ratio of gross investment as a share of GDP to the growth rate for GDP over the period in question.
- <sup>6</sup> E Ginting and P Aji, *Summary of Indonesia's Economic Analysis*, Asian Development Bank Papers on Indonesia, No. 02, October 2015, p. 5.
- <sup>7</sup> The World Bank, *Indonesia Economic Quarterly*, March 2017, pp. 25–26. Comparing inequality across countries is difficult and Indonesia's Gini coefficient may not be strictly comparable to those of other economies. But OECD estimates are that Australia's Gini coefficient was 33.7 in 2014, while that of the United States was 39.4 in the same year.
- <sup>8</sup> Identifying the causes of these fluctuations would require further analysis, but part of the explanation would appear to lie in movements in the exchange rate. In 2009, for example, the Indonesian rupiah depreciated by more than 7 per cent against the US dollar compared with the rate in the previous year and in 2015 by almost 13 per cent.
- <sup>9</sup> Readers will recognise in this paragraph references to two different ways of analysing international trade flows, the use of gravity models and trade intensity analysis. On these two approaches, see P Drysdale and R Garnaut, 'Trade intensities and the analysis of bilateral trade flows in a many-country

- world: a survey', in R Garnaut and P Drysdale (eds), *Asia Pacific Regionalism: Readings in International Economic Relations*, Harper Educational, Sydney, 1994, pp. 20-35. The intensity approach in the present case takes the imports of Indonesia as a given, whereas the gravity approach typically takes into account a wide range of factors explaining the level of trade between two countries, principally the size of the two economies and the distance between them, but typically also other variables such as a common language or common membership of a free trade agreement. Rahman uses the gravity approach to look at Australia's trade with a number of other countries, concluding, in one paper, that Australia's actual trade with Indonesia was more than the value predicted by his gravity model. See M Rahman, 'Australia's Global Trade Potential: Evidence from the Gravity Model Analysis', 2009 Oxford Business and Economics Conference Program, viewed 18 July 2017, [https://www.researchgate.net/publication/261681497\\_%27Australia%27s\\_Global\\_Trade\\_Potential\\_Evidence\\_from\\_the\\_Gravity\\_Model\\_Analysis%27](https://www.researchgate.net/publication/261681497_%27Australia%27s_Global_Trade_Potential_Evidence_from_the_Gravity_Model_Analysis%27). A later paper by the same author, using panel estimation for a much longer run of years, found that trade with Indonesia was a little below the value predicted by the gravity model and that there was therefore some scope for trade expansion. See M Rahman, 'Exploring Australia's global trade potential: a gravity approach with panel data', (n.d.).
- <sup>10</sup> This total is, of course, an estimate only, given that there can be appreciable differences in timing and valuation between the export statistics of one country and the import statistics of another.
- <sup>11</sup> For the definition of mining and METS, see Technical Annex, Minerals Council of Australia/Trading Nation Consulting, *New frontiers: South and East Asia*, Trade Agenda Report No. 1, Canberra, 2017.
- <sup>12</sup> These data are for 2015 and are from the World Steel Association, *Steel Statistical Yearbook 2016*, viewed 19 July 2017, [www.worldsteel.org](http://www.worldsteel.org). Data are for 'true steel use', obtained by subtracting net indirect exports of steel from apparent steel use. They are in finished steel equivalent.
- <sup>13</sup> Department of Industry (Office of the Chief Economist), *Resources and Energy Statistics 2014*, Canberra, 2014, pp. 37, 65.
- <sup>14</sup> Rio Tinto, *Rio Tinto 2016 Annual Report*, March 2017, viewed 11 July 2017, [www.riotinto.com](http://www.riotinto.com) pp. 29, 36, 131, 221-222.
- <sup>15</sup> See Newcrest Mining Ltd, 'Gosowong, Indonesia', [www.newcrest.com.au/our-business/operations/gosowong](http://www.newcrest.com.au/our-business/operations/gosowong) viewed 27 June 2017; Australian Embassy, Indonesia, 'Newcrest and Antam Ready to Strike Gold in Indonesia', Media Release, Jakarta, 6 November 2016.
- <sup>16</sup> See B Fitzgerald, 'EMR Capital makes mark with \$1bn Indonesia mine deal', *The Australian* digital edition, 23 November 2015; and B Fitzgerald, 'EMR strikes gold with mine' *The Australian*, digital edition, 22 March 2016.
- <sup>17</sup> Austmine, 'Australia's New Driver of Growth: Mining Equipment, Technology and Services', 2013, viewed 29 June 2017, [www.austmine.com.au/Portals/25/Content/Documents/Austmine%20Survey%20Highlights.pdf](http://www.austmine.com.au/Portals/25/Content/Documents/Austmine%20Survey%20Highlights.pdf); Austmine, 'National METS Survey 2015 Results: New Realities, Bigger Horizons' (online summary), viewed 28 June 2017, [www.austmine.com.au](http://www.austmine.com.au); Austmine, 'New Realities, Bigger Horizons, Australian Mining Equipment, Technology and Services (METS) National Survey', (complete study), June 2015.
- <sup>18</sup> University of Sydney for the Export Council of Australia and partner institutions, 'AIBS 2014 Industry Report: Mining Equipment, Technology and Services'; Export Council of Australia/University of Sydney, Sydney, 2014; 'Australian International Business

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- <sup>19</sup> See D Skene, 'AIBS 2015: A comparison of results against Austmine's 2015 METS Survey', Australian Trade Commission, 2015, viewed 22 April 2017, [www.austrade.gov.au/news/economic-analysis/aibs-2015-a-comparison-of-results-against-austmines-2015-mets-survey](http://www.austrade.gov.au/news/economic-analysis/aibs-2015-a-comparison-of-results-against-austmines-2015-mets-survey)
- <sup>20</sup> The Frankfurt-listed Hochtief AG owned almost 73 per cent of CMIC through its wholly owned Australian subsidiary as at 23 January 2017. The Spanish-based firm, ACS held around 72 per cent of Hochtief at the end of 2016. See CIMIC, *2016 Annual Report*, p.17, viewed 3 October 2017, [www.cimic.com.au/\\_data/assets/pdf\\_file/0018/34623/FINAL-CIMIC-2016-ANNUAL-REPORT.pdf](http://www.cimic.com.au/_data/assets/pdf_file/0018/34623/FINAL-CIMIC-2016-ANNUAL-REPORT.pdf)
- <sup>21</sup> Based on a number of reports on the Thiess website, viewed 30 September 2017, [www.thiess.com](http://www.thiess.com). In particular see 'Melak Coal Mine', [www.thiess.com/projects/melak-coal-mine](http://www.thiess.com/projects/melak-coal-mine); 'Senakin Coal Mine', [www.thiess.com/projects/senakin-coal-mine](http://www.thiess.com/projects/senakin-coal-mine); and 'KPC Sangatta Coal Mine', [www.thiess.com/projects/kaltim-prima-coal-mine](http://www.thiess.com/projects/kaltim-prima-coal-mine)
- <sup>22</sup> See Macmahon Holdings Ltd, ASX Releases of 1 March, 8 May, 10 July, 12 July and 8 August 2017, last viewed 3 October 2017, [www.asx.com.au/asx/statistics/announcements.do](http://www.asx.com.au/asx/statistics/announcements.do); Macmahon Holdings Ltd, 'Martabe Gold Mine' viewed 27 June 2017, [www.macmahon.com.au/mining/martabe-gold-mine.html](http://www.macmahon.com.au/mining/martabe-gold-mine.html); Macmahon Holdings Ltd, 'Lhoknga', viewed on 27 June 2017, [www.macmahon.com.au/mining/lhoknga.html](http://www.macmahon.com.au/mining/lhoknga.html); T Ingram, 'Macmahon called on to deliver after shareholders pass AMNT deal', *Australian Financial Review*, digital edition, posted 12 July 2017; Macmahon, 'Full Year Results August 2017', Investor Presentation, p.10, viewed 3 October 2017, [http://mah.live.irmau.com/irm/PDF/1795\\_0/InvestorPresentation](http://mah.live.irmau.com/irm/PDF/1795_0/InvestorPresentation)
- <sup>23</sup> Banlaw website, viewed 30 September 2017, [www.banlaw.com](http://www.banlaw.com). See especially 'UFFV-MTU Indonesia', [www.banlaw.com/case-studies/uffv-mtu-indonesia/](http://www.banlaw.com/case-studies/uffv-mtu-indonesia/) and 'KPC and Atlas Copco Nusantara (5 years on)', [www.banlaw.com/case-studies/kpc-and-atlas-copco-nusantara-5-years-on/](http://www.banlaw.com/case-studies/kpc-and-atlas-copco-nusantara-5-years-on/)
- <sup>24</sup> Based on reports and press releases at the Technomics website, viewed 30 September 2017, [www.technomics.net](http://www.technomics.net). See in particular, 'Company Profile', [www.technomics.net/about-us/company-profile/](http://www.technomics.net/about-us/company-profile/)
- <sup>25</sup> 'Australian International Business Survey 2015, Industry Profile Report: Mining Equipment, Technology and Services', p. 3.
- <sup>26</sup> The World Bank, *Doing Business 2017: Indonesia*, Washington D.C. 2017, pp. 6, 11-15.
- <sup>27</sup> World Economic Forum, *Global Competitiveness Report 2016-2017*, Geneva, 2017, last viewed 21 September 2017, [www.weforum.org/reports/the-global-competitiveness-report-2016-2017-1](http://www.weforum.org/reports/the-global-competitiveness-report-2016-2017-1), pp. 204-205.
- <sup>28</sup> World Bank, International Logistics Performance Index 2016, viewed 1 June 2017, <http://lpi.worldbank.org/international/global>
- <sup>29</sup> See World Economic Forum, op. cit., p. 204. Transparency International also gives a corruption perceptions ranking of 176 countries, with Indonesia in 2016 sharing 90th spot with several other countries. See 'Corruption Perceptions Index 2016', viewed 23 June 2017, [www.transparency.org/news/feature/corruption\\_perceptions\\_index\\_2016](http://www.transparency.org/news/feature/corruption_perceptions_index_2016)
- <sup>30</sup> Tariff data in this section are mostly drawn from the Indonesian 'legal enactment of tariff commitments under AANZFTA', HS 2012 format, last viewed 21 September 2017,

- [www.dfat.gov.au](http://www.dfat.gov.au). The HS 2012 schedule has been domestically-enacted by Indonesia and has been agreed within AANZFTA except for two items dealing with live cattle.
- <sup>31</sup> Sea water is another item with a five per cent tariff and technically falls within the definition of mining products used here.
- <sup>32</sup> The HS codes for products of this type are 730531 and 730539 in the 2012 nomenclature.
- <sup>33</sup> The HS code for products of this type is 721049. It does not include cases where the coating was electrolytically applied.
- <sup>34</sup> The information in this paragraph is based on PwC, *Indonesian Pocket Tax Book 2017*, viewed 21 June 2017, [www.pwc.com/id](http://www.pwc.com/id); and Deloitte, *Indonesian Tax Guide 2016*, viewed 22 June 2017, [www2.deloitte.com/content/dam/Deloitte/id/Documents/tax/id-tax-indonesian-tax-guide-english-2016.pdf](http://www2.deloitte.com/content/dam/Deloitte/id/Documents/tax/id-tax-indonesian-tax-guide-english-2016.pdf)
- <sup>35</sup> Technical barriers to trade have been defined by the European Commission as 'mandatory technical regulations and voluntary standards that define specific characteristics that a product should have, such as its size, shape, design, labelling/marketing/packaging, functioning or performance'. Conformity assessment procedures are also included. See European Commission, 'Technical Barriers to Trade', viewed 1 July 2017, [www.trade.ec.europa.eu](http://www.trade.ec.europa.eu)
- <sup>36</sup> See E Munadi, 'Indonesia's Non-Tariff Measures: An Overview', in L Y Ing, S F de Cordoba and O Cadot (eds), *Non-Tariff Measures in ASEAN*, ERIA Research Project Report 2015-1, ERIA, Jakarta, pp. 65-76.
- <sup>37</sup> The information in this paragraph is based on material on liberalising and restricting measures reported in the Global Trade Alert Database on policies that affect world commerce, viewed 1 July 2017, [www.globaltradealert.org](http://www.globaltradealert.org)
- <sup>38</sup> OECD, 'OECD Services Trade Restrictiveness Index (STRI): Indonesia', last viewed 24 September 2017, [www.oecd.org/tad/services-trade/STRI\\_IDN.pdf](http://www.oecd.org/tad/services-trade/STRI_IDN.pdf)
- <sup>39</sup> This list of restrictions, as well as the ones for construction and engineering, is indicative only: there are many other barriers. For a detailed list, see OECD, *Services Trade Restrictiveness Index*, last viewed 24 September 2017, <http://oe.cd/stri>
- <sup>40</sup> H K Nordås, 'Services Trade Restrictiveness Index (STRI): The Trade Effect of Regulatory Differences', *OECD Trade Policy Papers*, No 189, OECD Publishing, Paris, 2016, p. 10.
- <sup>41</sup> See S Miroudot and K Pertel, 'Water in the GATS: Methodology and Results', *OECD Trade Policy Papers*, No. 185, OECD Publishing, Paris, 2015.
- <sup>42</sup> 'BHP exits Indonesian coal asset', *Australian Mining*, posted 8 June 2016, viewed 27 June 2017, [www.australianmining.com.au](http://www.australianmining.com.au)
- <sup>43</sup> 'Newmont divests \$1.3 bn Indonesian mine', *Australian Mining*, posted 1 July 2016, viewed 22 March 2017, [www.australianmining.com.au](http://www.australianmining.com.au)
- <sup>44</sup> *OECD Investment Policy Reviews: Indonesia*, 2010, viewed 10 July 2017, [www.oecd.org](http://www.oecd.org)
- <sup>45</sup> See J Kurnia, 'Memo on Law No. 4 of 2009 on Mineral and Coal Mining', Indonesian Mining Law, viewed 10 July 2017, [www.indonesianmininglaw.com](http://www.indonesianmininglaw.com)
- <sup>46</sup> See Ashurst, 'Indonesia ushers in 2017 with changes to Mining Law', *Indonesia Update*, 8 February 2017, viewed 22 March 2017, [www.ashurst.com/en](http://www.ashurst.com/en)
- <sup>47</sup> See *ibid.*; C Scott and Lian Yok Tan, 'Indonesian Mining Law – What's Going On?' K and L Gates, 28 January 2014, viewed 22 March 2017, <http://m.klgates.com>; USTR, *2017 National Trade Estimate Report on Foreign Trade Barriers*, Office of the United States Trade Representative, Washington, D.C., 2017, pp. 227, 234.
- <sup>48</sup> See PwC, *Mining in Indonesia: Investment and Taxation Guide*, 9<sup>th</sup> ed., May 2017, viewed 11 July 2017, [www.pwc.com/id](http://www.pwc.com/id)

- <sup>49</sup> Ibid., p. 13.
- <sup>50</sup> Ibid., p. 10.
- <sup>51</sup> See Freeport-McMoRan, 'Freeport-McMoRan Reports First-Quarter March 31, 2017 Results' and 'Freeport-McMoRan Updates Status of PT Freeport Indonesia Operations', viewed 11 July 2017, <http://fcx.com>. Also 'Freeport-McMoRan Announces Framework for Agreement with Indonesian Government Regarding Long-Term Operating Rights for PT Freeport Indonesia', media release, Freeport-McMoRan, Phoenix, 29 August 2017; and J Topsfield, 'Freeport to seek Rio Tinto approval for deal with Indonesia on Grasberg mine', *Sydney Morning Herald*, digital edition, 29 August 2017. The quotation is from the first of the sources in this endnote.
- <sup>52</sup> On the benefits of the AANZFTA, see Department of Foreign Affairs and Trade, 'AANZFTA Fact Sheet – Investment', 24 February 2009, viewed 12 July 2017, [www.dfat.gov.au](http://www.dfat.gov.au)
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- <sup>54</sup> The last point is noted in E Jung and G Hufbauer, 'ISDS Provisions in Korea's FTAs: Guidance for the TPP', Peterson Institute for International Economics, Trade and Investment Policy Watch, June 2015 viewed 6 August 2017, <https://piie.com/blogs/trade-investment-policy-watch/isds-provisions-koreas-ftas-guidance-tpp>
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- <sup>56</sup> E Aspinall, 'The New Nationalism in Indonesia', *Asia and the Pacific Policy Studies*, Vol. 3, Issue 1, January 2016, pp. 72-82.
- <sup>57</sup> See S Marks, 'The ASEAN-China Free Trade Agreement: Political Economy in Indonesia', *Bulletin of Indonesian Economic Studies*, Vol. 51, No. 2, 2017, p. 289.
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- <sup>61</sup> However, a publication by the Ministry of Industry did note that the ban on mineral ore exports from January 2014 had affected Indonesia's export growth. See Ministry of Industry (Indonesia), *Industry Facts and Figures*, p. 13, viewed 16 July 2017, [www.kemendiperin.go.id/download/8244](http://www.kemendiperin.go.id/download/8244)
- <sup>62</sup> E Warburton, art. cit., pp. 309-10.
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- <sup>65</sup> E Warburton, art. cit., p. 308.
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- <sup>70</sup> See Ministry of Industry (Indonesia), op. cit., pp. 23-27.
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## Glossary

|         |  |
|---------|--|
| AANZFTA | ASEAN-Australia-New Zealand Free Trade Agreement                 |
| ABS     | Australian Bureau of Statistics                                  |
| AIBS    | Australian International Business Survey                         |
| APEC    | Asia-Pacific Economic Cooperation                                |
| ASEAN   | Association of Southeast Asian Nations                           |
| c.i.f.  | cost, insurance and freight                                      |
| CoW     | Contract of Work   |
| DFAT    | Department of Foreign Affairs and Trade                          |
| FDI     | foreign direct investment  |
| FTA     | free trade agreement   |
| GDP     | gross domestic product   |
| HS      | Harmonized Commodity Description and Coding System               |
| IA-CEPA | Indonesia-Australia Comprehensive Economic Partnership Agreement |
| IMF     | International Monetary Fund                                      |
| ISDS    | Investor-State Dispute Settlement                                |
| METS    | Mining Equipment, Technology and Services                        |
| MFN     | most-favoured-nation   |
| NTBs    | non-tariff barriers  |
| NTMs    | non-tariff measures  |
| OECD    | Organisation for Economic Cooperation and Development            |
| PwC     | PricewaterhouseCoopers   |
| RCEP    | Regional Comprehensive Economic Partnership                      |
| SOE     | state owned enterprise   |
| STRI    | OECD Services Trade Restrictiveness Index                        |
| TFA     | Trade Facilitation Agreement                                     |
| TPP     | Trans-Pacific Partnership Agreement                              |
| WTO     | World Trade Organization   |

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# Indonesia

**NEW FRONTIERS: SOUTH AND EAST ASIA**

The Minerals Council of Australia is the peak national body representing Australia's exploration, mining and minerals processing industry, nationally and internationally, in its contribution to sustainable economic and social development. This publication is part of the overall program of the MCA, as endorsed by its Board of Directors, but does not necessarily reflect the views of individual members of the Board.

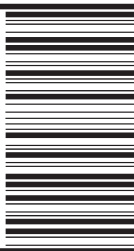
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Indonesia is undergoing a transformation which will have profound implications for the world and for Australia. Already South-East Asia's biggest economy, Indonesia is one of the fastest growing economies in our region. Yet despite its proximity, size and growth, Australia's trade and investment links with Indonesia are relatively under-developed.

Mining and mining services are key areas where the two economies have complementarities. Jakarta and Canberra have made progress freeing up trade in these sectors, but significant impediments remain. This report identifies the opportunities, conducts a stocktake of the barriers and sets out a policy agenda for trade and market liberalisation covering mining and mining equipment, technology and services that will deliver benefits to both countries.

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