



INDONESIA & AUSTRALIA

**Bilateral Relations
Into the 21st Century**

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Bilateral Relations Into the 21st Century



The Indonesia Project
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Foreword

It has become a cliché to say that Indonesia-Australia relations have their ups and downs. This fact should not upset us. Being such close neighbours geographically, but being so different in many respects, makes the relationship one of continuous adjustments by both sides. Of importance to task is to maintain and strengthen the various channels of communication.

The past decade has seen the emergence of an intense web of communication between the peoples of both countries. There may still be some misunderstanding and a lack of appreciation about each other's views or ideas on a whole range of issues. However, many serious problems have largely been overcome due to the willingness on both sides to talk to each other.

In March 2001 an Indonesia-Australia Conference was held by CSIS in cooperation with the Indonesia Project on The Australian National University to discuss recent developments in the two countries and how these might affect the relationship. This report summarizes the main issues in the bilateral relationship that have been raised and discussed in this conference.

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Hadi Soesastro
Executive Director
CSIS

Jakarta, June 2001



CENTRE FOR STRATEGIC AND INTERNATIONAL STUDIES (CSIS) is an independent, non-profit research organization, established on September 1, 1971. CSIS's main activities consist of policy oriented studies on both domestic and international affairs. The aim of this institution is to produce analyses for the benefit of those who need them.

CSIS employs an interdisciplinary approach involving scholars in various fields of study. In this way the complexity of the problem in hand may be dealt with adequately, yet within the bounds required for scholarly analysis. To that extent CSIS researchers and analysts work in an atmosphere and spirit of academic freedom.

CSIS dates back to the activities undertaken independently by two groups of young Indonesian scholars in the early 1960s. One group consisted of Indonesian postgraduate students abroad, especially in Western Europe. The other comprised Indonesian graduates who continued to pursue their studies in the country. They realized that not enough attention had been paid until then to strategic and international studies in Indonesia. It was intellectual contact between those two groups that gave birth to the idea of establishing CSIS. This idea could come into realization thanks to the full support of the late General Ali Moertopo and the late General Soedjono Hoemardani, then personal assistants to the President, and the formation of the *Yayasan Proklamasi* (Proclamation Foundation) in July 1971 to sponsor CSIS and its activities.

CSIS analysts undertake research on various international and domestic developments and problems. Their findings are published in the Centre's journals or in the form of monographs and books. They may also be presented in various fora of discussion such as seminars and conferences, at the national as well as international levels.

CSIS also organizes public lectures and provides lecturers for universities and various other institutions of higher learning.

CSIS publications comprise:

1. Books, monographs, occasional papers, and collections of seminar and conference papers.
 2. *Analisis CSIS*, a bimonthly journal in Indonesian.
 3. *The Indonesian Quarterly*, an English quarterly journal.
 4. *Dokumentasi*, clippings of Indonesian newspapers on selected topics.
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Contents

Foreword	iii
BILATERAL RELATIONS INTO THE 21ST CENTURY	1
• The Context	1
• The Indonesian Political Situation and Developments	4
• Economic Developments in Indonesia	6
• Developments in Australia	9
• Searching for a New Paradigm?	11
INDONESIAN PERSPECTIVES ON THE BILATERAL RELATIONSHIP	20
• Some Facts and Observations <i>S. Wiryono</i>	20
• Trade Relations <i>Noke Kiroyan</i>	30
• Future Relations <i>Jusuf Wanandi</i>	36
Program	45
List of Participants	47

Bilateral Relations Into the 21st Century

THE CONTEXT

For both countries, the meeting took place at a time of political uncertainty and an apparent economic reversal compared with the previous year, related to both domestic and international circumstances.

Key issues for discussion were the opportunities for cooperation in international affairs and security understandings in the Western Pacific and broader Asia Pacific region. In economic matters, opportunities for cooperation related specifically to Indonesia's short-term macroeconomic difficulties, institutional changes, development challenges and potential cooperation in trade and related international economic arrangements.

Political and economic developments in both countries, both immediate and longer term, underpin what is possible in international relations. The immediate political uncertainties were the unfolding and unresolved conflict between the President and the parliament in Indonesia and the much greater prospect of a change in government in Australia than most commentators had estimated several months earlier. In both countries, the pressing economic challenge was a turnabout in performance in late 2000 and 2001. In Indonesia, this was more reflected in indicators of macroeconomic stability (creeping inflation, rising interest rates and falling asset prices). In contrast, the immediate challenge in Australia was revealed in a sharp quarterly decline in economic growth rates at the end of 2000.

The decline in currency values in both countries was a sign of both political uncertainty and economic difficulties, and presented new costs (and some opportunities) to business and governments. However, there was a major international dimension in the falling exchange rates against the US\$.

These immediate concerns tended to dominate perspectives. Although no comparisons were made by speakers, the immediate challenges reflected deeper structural problems, with potentially more far reaching consequences in Indonesia. Commentators were not ruling out possibilities of violence in Jakarta in the resolution (or otherwise) of the Presidential-DPR stand-off, and the possibility of a second financial crisis triggered by the decline in the value of the rupiah. Failure to move more quickly on private debt-restructuring and the associated health of the banking sector, the unresolved division of responsibility between the executive and legislative branches of government - fundamentally a constitution issue - and slow institutional and legal reform were all viewed as critical for short and longer-term political stability and sustained economic recovery. Regional conflicts set in the broader context of complex and uncertain implementation of decentralisation legislation hugely complicates the national reform agenda.

Most commentators felt Australia's economic situation was 'fundamentally' healthy, as reflected in a substantial budget surplus, and favourable medium term prospects for inflation and interest rates. Nevertheless, the possibilities of a continued slow-down in the USA and East Asian economies, and the failure to come up with a new reform agenda (policy weariness), both domestically and in terms of international orientation, was a basic concern in Australia. Knee jerk reactions of the government to political reverses have the potential to reverse some key elements of progress in economic reform.

Some sections of the bureaucracy and government in Australia look favourably on bilateral trade agreements, such as the mooted Free Trade Agreement with the USA as an important new direction in policy in light of rebuffs in participation in ASEAN economic fora. Other commentators committed to multilateralism, in good times and in bad, fear the signals which the present government's determination to go ahead with bilateral arrangements outside the region will send to East Asians. These debates are being held against the backdrop of increasingly strong feelings in Canberra (and elsewhere in Australia) that its efforts to contribute to better relations with Indonesia and the region have not been sufficiently reciprocated.

Other contextual issues are lingering feelings within Indonesia over John Howard's reported acceptance of a 'deputy sheriff' role in East Asia, continuing suspicions within some circles in Indonesia of Australia's past and present role in East Timor and uncertainty regarding the new Bush administrations relations with China.

The Conference was opened by Dr. Djisman Simandjuntak and Professor Ross Garnaut, followed by an address by Dr. Hasan Wirajuda, Director General of Political Affairs, Department of Foreign Affairs, against a backdrop of a visit to the President and several ministers on the previous day.

As the conference was held pursuant to 'Chatham House Rules', this summary paper will not attribute names to specific comments except where a presenter has submitted a paper on the topic.

The holding and timing of the conference, the first of its kind in a decade, was in the context of the planned visit of the President of Indonesia to Australia in early April. The visit was subsequently cancelled. It was the fifth time that the President has announced then revised his travel plans to Australia since he came to office. At his meeting with the Australian participants on March 21, 2001 the President had set the tone for the meeting by emphasising his beliefs:

- in the importance of the bilateral relationship in the longer term, set in the context of the need in Indonesia for patience as the country progressed in its historic reformasi process.
- in the need for good trilateral relations between Indonesia, Australia and East Timor - related to the framework of the Western Pacific Forum which he floated in Singapore in 2000.
- and that both Indonesia and Australia needed to develop a sense of their 'non-hegemonic roles' among the smaller states in the Western Pacific, including Papua New Guinea.

In a welcoming comment to open the conference session, it was mentioned that Indonesia was still searching for 'where to go' and 'how to get there' in the new political environment. It was noted that the 'beautiful' picture and vision which the President had unveiled for the participants on the previous day required a lot of work if it were to be operational. The need for 'bold initiatives' in Indonesia at this time was stressed.

Attention was drawn to the importance of the timing of the President's planned visit to Australia, and reiterated how important he felt that good bilateral relations were for the small states in our region. From the Australian end, the value of the meeting might be viewed in the context of Australia's evolution to a society openly engaged in the Asia-Pacific region, and the challenge to maintain and build on this orientation.

We were reminded that it was important for us to be close friends since we were neighbours forever. It was noted that:

- Australia had lost goodwill in Indonesia as a result of the Timor crisis in 1999, but he saw the Western Pacific Forum as a channel through which both countries could work together constructively to rebuild the relationship.
- Sections of the media had not always helped our relationship in the immediate past, although the 'ballast' provided to the relationship through growing 'people to people' relations was an important asset.

THE INDONESIAN POLITICAL SITUATION AND DEVELOPMENTS

Three speakers addressed the issue of the political developments - Mr. Abdillah Toha, Deputy Head of PAN (National Mandate Party), Lt. Gen Agus Widjojo of the Armed Forces, and Dr. Rizal Sukma from CSIS.

In the first presentation, attention was drawn to the complexity of political developments due to the large number of political players compared to the previous regime, where at the end there was effectively only one. The following points were noted:

- The lack of urgency and direction shown from the 'Palace', mentioned disenchantment with and moves against the President from Golkar and the Central Axis' (and its 'new' *fatwa* which approved of a female President).
- Tensions between the gradual and more radical reformers in TNI and some of the problems the military was now facing in re-positioning itself in the new political context.

- The two burning issues of mobilisation politics and decentralisation politics.

Suggested phrases to describe the Indonesian political situation included 'political paralysis', 'constitutional deadlock' and 'collective stupidity', the latter in contrast to 'collective wisdom or intelligence'.

Another presentation noted the long term nature of military reforms and repositioning, concern over people's high expectations and unrealistic demands for instant results, and international concerns over the continuing military role in politics. It was thought that there had been a failure of politicians to give clear leadership to the military in dealing with regional conflicts (in the discussion it was mentioned that the military is 'ready any time' if there is strong civil leadership). On the bilateral relationship, it was mentioned that TNI and the ADF had established extremely close relations in the past, symbolised by the Pangab Forum, and that there was now a long way to go to re-establish such a relationship.

Rizal mentioned five major challenges in current Indonesian politics, discussed regional autonomy and the problem of Aceh in particular. Important points include:

- *5 key problems*: in coming to terms with the past; a serious lack of democratic rules of the game; the ability (or lack of) of political parties to establish themselves as practitioners of democracy (especially authoritarian tendencies); problems in civil-military relations and challenges posed for political relations by an outpouring of ethnic and religious tensions.
- He dealt with problems of *regional autonomy* and the situation in Aceh in some detail, including multi-layer conflicts, strengthening of regional identity and ethnic parochialism, challenges related to basic law no. 25 1999 (potentially emerging regional disparities), scepticism in Aceh (and Irian) about offers of "special broad autonomy", and uncertain relations between large companies and regional governments.
- In the case of *Aceh*, he pointed to a mood which was very much for independence rather than autonomy, arguing that solutions had to go beyond mere transfers of money to recognition of fundamental difference in social and cultural matters.

He questioned Jakarta's understanding of the roots of the Aceh conflict, but also the 'dimensions of the problem and hence a comprehensive and coherent policy'. These included: a failure to deal with cases of human rights

abuse; a continuing 'military approach'; uncertainty as to which political institutions should be dealing with the secessionist movement; and the problem of the military's capacity to carry out a 'clean and professional' counter-insurgency campaign. In discussions, TNI was exhorted to "be patient, be polite to the people and not to over-react in conflict situations".

Rizal concluded his paper on a somewhat positive note by stressing the need for a strong role to be played by civil society in helping solve political problems, and its important contribution during the recent crisis years.

Discussion

Issues raised in the discussion included

- progress (or lack of progress) in dealing with human rights abuses in Aceh;
- problems in finding solutions to the conflict in Maluku (it was mentioned that the military were restricted by its mission under the 'civil emergency' laws);
- initiatives taken in Irian Jaya (was it merely a poor cousin in regional autonomy initiatives);
- the commitment of Amien Rais to supporting Megawati as a potentially new President.

ECONOMIC DEVELOPMENTS IN INDONESIA

If the problems of politics were disturbing, economics seemed even more challenging, especially from the story told by Sri Mulyani (University of Indonesia).

The session opened with Professor Anwar Nasution (Deputy Senior Governor of the Central Bank). He noted:

- *The Context*: a slowing economy, rising inflation and interest rates, and the fall in the value of the rupiah.
- *Achievements*: a steady rate of economic growth, export expansion, progress on management of NPLs (non performing loans), some achievements with IBRA, and a new monetary instrument through the central bank issue of bonds in the domestic market.

- *Problems:* Size of the public debt, the size of the problem of NPLs and IBRA, uncertainty in investment over issues such as Exxon in Aceh and the need to maintain macroeconomic stability.

Sri Mulyani went over problems of macroeconomic stability, slowing government consumption and investment after they had risen from late 1999, and reiterated concern over the government debt.

She concluded by drawing attention to concerns over fiscal stability related to limited capacity on the revenue side, constraints to cutting spending and, as debt restructuring floundered, to perceptions of injustice in the allocation of the public budget. (If the government can issue Rp. 650 trillion in bonds to resuscitate banks, why not provide 500 trillion for social expenditure?). There still remained great uncertainty over the IBRA asset sales (reflected in the Vice President's stated opposition to the sale of the Salim palm oil enterprise to Guthrie) and the slow resolution of NPL problems.

Sri Mulyani also mentioned lack of commitment to the IMF GOIs and the weakness of domestic institutions, and concluded on the lack of co-ordination among key policy makers.

Hadi Soesastro (CSIS) stressed the international context. He suggested that there may now be a new paradigm: "bad times make bad policies" on the international front, in contrast to the conventional wisdom of the New Order period. He raised the fundamental questions of how to maintain an open economy in the new era and how can Australia and Indonesia do something together.

Example of the Problems: The loss of commitment to AFTA: the Minister of Industry and Trade recently stated that Indonesia could only continue with an AFTA agenda if others in the region are also committed to the same agenda. An all-embracing process of liberalisation within a MFN context is weakening throughout the region (especially in Singapore).

Hadi had seen an AFTA-CER link as a real chance to cooperate on technical issues of macro management, financial restructuring and institutional building between ASEAN and Australia and New Zealand, both of which had considerable experience in dealing with these problems. But when the link was turned into a traditional Free Trade Agreement it was the 'the kiss of death' for AFTA-CER cooperation. With the ASEAN rejection of the

FTA in 2000, discussion has moved to other forms of closer links, and this is more promising.

He assured the Australian audience that Australia should not worry too much about its exclusion from the East Asian process because there had not been much progress (and may not be much progress) on a range of fronts, especially in relation to a Free Trade Area, in the ASEAN Plus Three forum.

Discussion

Probably the most revealing point raised was that it is fine (and necessary) to catalogue the problems in political and economic spheres, and to discuss possible solutions in each. But the next step is to consider the political economy issue: what are the political constraints to economic policy formulation and implementation in post-Soeharto Indonesia (and in a changing international environment)? We know what some of the reforms should be, but how does Indonesia get there?

Responses of the panel:

- The problem was partly the quality of the economic reformers and the lack of leadership
- The possibility was raised for an 'untouchable team' to help solve corruption
- Parallels were drawn between a super modern hospital and IBRA: looks beautiful but it doesn't function and so the family look after the sick - Indonesia needs institutions that fit the society and political/economic realities.

It seemed, however, that we are only beginning to scratch the surface on this important interface between economics and politics. In his lunchtime address, Mohamad Sadli talked of the 'messy state' - issues such as the lack of leadership, teamwork and clear rules of the game, protection that favoured the wrong groups, etc. He asked whether Indonesia now needed a new paradigm beyond export-oriented investment and wondered whether Indonesia was going to follow the path of Bangladesh (breakdown in central control and enduring problems of poverty) or Taiwan (export-oriented success) in the Post-Soeharto era. The question was answered with another question: is there a need for a new paradigm of development, or is the challenge in the post-Soeharto era that of achieving a 'democratisation' of the old paradigm of export-led development that had contributed to poverty decline?

DEVELOPMENTS IN AUSTRALIA

The discussion was led by three speakers from Australia: Prof. Ross Garnaut from the Australian National University, Patrick Walters from *The Australian*, and John Beggs from the Commonwealth Bank.

It began with a description of the background to Australia's current political and economic circumstances and international orientation. In the first presentation, attention was drawn to how closed Australia had been to the rest of the world, both socially and economically, in the first two-thirds of the 20th century. This was in contrast to the opening up of the economy and disbandment of the white Australia policy in the last third of the century: the Australian economy (and also the New Zealand economy) went from being one of the most closed to one of the most open amongst the high-income economies. The opening up of the latter period gave Australia an opportunity to play a role in international and regional fora such as the Uruguay Round of trade negotiations and APEC. Australia's progress had been made not only in the economic field but also through the maintenance and extension of social welfare support for poorer sections of the community. Unlike many other Western countries, the circumstances of poorer groups had not worsened in the last two decades of the century.

But it was also noted that the process of Australian economic reform had stalled from the early 1990s, when Australia was facing major problems of unemployment. The problems of adjustment of rural and regional Australia to globalisation had contributed to a backlash against platforms of economic reform of the two major political parties, the Liberal Party and the Labor Party. The rise of 'One Nation' should be viewed in this light rather than as being a racist response - although there were elements of racism in the early period of Pauline Hanson's party's rise.

Regarding the mooted free trade arrangement with the USA, it was thought that the FTA was likely to have an adverse effect on Australia's relations in the region (a symbol of turning our back on Asia?). This was unfortunate given that the FTA had only a small chance of success, as it would mean the USA reducing barriers to agricultural trade with Australia. More generally, the Australian government was not helped in holding to a path of open regionalism by the wavering of the Clinton administration on approaches to trade policy, culminating in its capitulation to critics at the abortive Seattle World Trade Organisation Ministerial Meeting.

A second presentation focussed on more recent developments in Australia, with special reference to the political environment. It was considered

that the Australian government had faced five shocks in early 2001: the two unexpected and substantial state election defeats for the Coalition (Liberal and National Parties) governments in Western Australia and Queensland in February-March; the Coalition's defeat in the by-election for the commonwealth seat of Ryan in Queensland; the negative growth outcome for the last quarter of 2000; and the plummeting exchange rate. The government's new taxation policy was under attack and some of its responses were needlessly reactive to immediate political events (eg. removal of the fuel excise). (Quoting Paul Kelly in *The Australian*: "the government paradigm is being shot to pieces" [17/3/01]). The exchange rate risk was very substantial, partly because of international factors, partly because of government wavering on market oriented and fiscally responsible policies and partly because of political uncertainty.

Contributors pointed out that the One Nation party had not performed as well in the state elections as many journalists had implied. Its gains were made mainly at the expense of the conservative (Coalition) side of politics rather than from the Labor Party. Two speakers felt the Hanson gains were mainly a result of frustration with the rate and nature of change outside the major cities.

It was thought that the national elections would be hard fought but that the Labor Party was favoured to win based on current (March) conditions and polls which put Labor well ahead of the government. At the same time, the situation was very volatile. If the economy rebounded early enough, the Coalition could make up ground by attacking Labor for being irresponsible economic managers, referring to the experience in the early and mid 1990's

A third presentation reaffirmed the picture of a strongly growing economy over the past decade, underpinned by productivity and wages growth. More recently, the decline in growth had been almost entirely to a sharp downturn in the construction sector, partly because of the GST (VAT) and partly in the aftermath of the massive building program for the Sydney Olympic Games. It was thought the markets were undervaluing the Australian dollar, which dipped to below US\$0.50 cents for the first time ever in March 2001.

Important new developments in the Australian economy over the past several years, which might be of interest to Indonesia, were the increased spread in equities holdings ('mums and dads' involvement and the falling

cost of holding retail shares), and the development of the corporate bond market.

The presentation concluded by offering two thoughts that might contribute to debates in Indonesia:

- *First*, in helping to understand recent developments in Australia, there is a link between pessimism regarding economic conditions and developments in recent years and months to what the art critic Robert Hughes refers to as the 'culture of whinging' (*kebudayaan ngomel*). Australians frequently fail to appreciate what has been achieved or how lucky they are.
- *Second*, it was suggested that one needs to distinguish major structural problems from short run adjustments in a fundamentally healthy economy and financial sector. In the latter, not only do property prices fall (as they did during Australia's most recent recession in 1991-92) but all prices decline below their historic trends, as they have in the decade of economic malaise in Japan. It was queried whether the Japan model might be more relevant for thinking about longer term economic recovery in Indonesia.

SEARCHING FOR A NEW PARADIGM?

Background

For this discussion there was a panel of six speakers. On the Indonesian side, Jusuf Wanandi (CSIS Board Member), HE. S. Wiryo (former Ambassador to Australia, 1996-1999) and Noke Kiroyan (Australia Indonesia Business Council). On the Australian side, Kevin Rudd (Member of Parliament, Australian Labor Party) and Professors Jamie Mackie (Emeritus ANU) and Richard Robison (Murdoch University, WA). HE. Sabam Siagian (ex-Ambassador to Australia, 1992-1996) made important contributions as Chair. Discussion participants included former Indonesian Foreign Minister Ali Alatas and Australian Ambassador Rick Smith.

Whilst some speakers considered that bilateral relations were at an all-time low 18 months ago (following events surrounding East Timor's independence), others noted that the recent relationship did not look as precarious when seen in a broader historical perspective. In the Soekarno years, Irian Jaya had been a far greater problem. In 1965 Australian soldiers "were shooting Indonesians on the Borneo border".