



INSTITUTE OF SOUTHEAST ASIAN STUDIES

**INNOCENTS ABROAD
OR
PARTNERS IN DEVELOPMENT?**
An Evaluation of Canada-Indonesia
Aid, Trade, and Investment Relations

GEOFFREY B. HAINSWORTH

Field Report Series No. 15
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FOREWORD

This paper was written in late summer 1983, to serve as a background discussion paper for the CIDA Indonesia Country Program Review. A few final revisions were made to the manuscript in December 1983. Despite delays in publication, the commentary and line of argument remain valid, and it has been decided not to revise or attempt to update the text. Two postscripts, however, might be usefully added.

Indonesia's major thrust under Repelita IV appears largely to be as anticipated. It is striving to implement a more balanced, inward-looking industrialization strategy while at the same time seeking to diversify the basis for export-led growth. The world economy does not show signs of strong improvement, and economic stringency seems to be getting worse rather than better as far as export earning prospects and international borrowing are concerned. Indonesia thus faces increasing pressure to "live within its means" and the government has introduced new income, property and value-added taxes and new austerity measures to meet its budget. It is also encouraging more local and individual self-reliance, including giving larger roles to local government agencies and NGOs for identifying local problems and devising workable solutions. There is also a heightened commitment toward environmental protection and the search for a more sustainable development (see "Economic Growth, Basic Needs and Environment in Indonesia: The Search for Harmonious Development", *Southeast Asian Affairs* 1985).

In Canada, the landslide election victory of the Conservative party means that concessional aid will be more stringently controlled and that the evaluation of country programs from a commercial perspective will be intensified. Paradoxically, this has occurred when the CIDA Indonesia desk has succeeded in reorienting its perspectives away from subsidizing “sunset industries” and major construction projects toward greater focus on education, manpower development and institution building. It also is concentrating more on resource management for which Canada arguably has an extensive and natural comparative advantage. The agreement with BAPPENAS for the new quinquennium also incorporates a large line of credit, under which it is up to Indonesia to choose which Canadian products and technical assistance it requires, rather than CIDA having to decide which Canadian products and services it should try to push. The aid program will also rely more extensively on institutional co-operation, on linkage and twinning arrangements, with Canadian business firms, consultants, universities and NGOs responsible for administering CIDA projects in collaboration with Indonesian counterpart organizations.

Geoffrey B. Hainsworth
March 1985

INNOCENTS ABROAD OR PARTNERS IN DEVELOPMENT? AN EVALUATION OF CANADA-INDONESIA AID, TRADE AND INVESTMENT RELATIONS

Introduction

Most analysts would now agree that economic growth in the countries of ASEAN has remained consistently more buoyant than in any other region of the developing world. It is therefore not surprising that many have suggested that economic recovery in Canada or in other industrial countries could be greatly enhanced if there were more economic links with these dynamic "engines of growth".

Within ASEAN, Indonesia is often pictured as being the most fabulous arena of opportunity for foreign business operations and yet the most elusive and intractable when it comes to actual negotiations and implementation of joint and other commercial ventures.

This report will review Canadian economic involvement with Indonesia under the New Order administration, since 1967. It will provide a commentary on past performance and will seek to illuminate the economic potential as well as the problems in building further exchange and partnership arrangements. The discussion is organized into four parts:

- an introductory section, describing the evolving relationship and the pressures for mutual accommodation in the context of the current global recession;
- an overview of what has been accomplished in terms of stepped-up economic assistance, commodity trade, and

- international joint ventures involving Canadian firms;
- an appraisal of Indonesian development problems, priorities and prospects, both in the years immediately ahead and in a longer perspective; and
- a conclusion, which evaluates Indonesia as a "context of opportunity" for Canadian interests and examines what role Canada might be called upon to play as a partner in development for Indonesia in the future.

Canada's Revitalized Dialogue with Indonesia and ASEAN

A re-evaluation of Canada's potential interest in Southeast Asia ("after Vietnam") began soon after the formation of ASEAN in 1967. This was also the year of transition in Indonesia from Sukarno's Guided Democracy to Suharto's New Order administration. The first event signalled the likelihood of greater political stability and economic security in the region, and the latter event restored Indonesia's membership in the World Bank and the world of international finance and once again opened the doors to foreign business. New opportunities for Canadian aid, trade, investment and banking in Indonesia were quickly recognized, and in Trudeau's celebrated "Mansion House Speech" in 1970, Indonesia was uniquely singled out among ASEAN members as meriting special attention for international economic assistance.¹ In the 1970s, Canada's bilateral aid commitments in the region were shifted almost exclusively to Indonesia as a "country of concentration", away from the previous Commonwealth and Colombo Plan links with Malaysia and Singapore.²

Formal Canada-ASEAN economic relations date back to the 1975 regional development assistance program and have culminated in an agreement for "industrial, technical and commercial co-operation" in June 1982 and the inauguration in Ottawa in April 1983 of "five-plus-one" Canada-ASEAN Joint Co-operation Committee meetings, to be scheduled on an annual or more frequent basis. The evolution of such pan-ASEAN arrangements and negotiations reflects the emergence of greater unity of perspective and increased economic co-operation among ASEAN members. There is, as well, a realization

that these countries can in this way achieve greater combined bargaining power. (Similar five-plus-one committees have been set up with the United States, Japan, Australia and other trading partners.) Such an evolution could also give Canada more leverage in securing uniform or at least similar terms and arrangements in the aid, trade and investment relations that are undertaken with each ASEAN country. For practical and political purposes, however, aid agreements, trading treaties and rules for foreign business operations will continue to be arrived at mainly on a bilateral basis and will be subject to change according to the needs and stipulations of each sovereign nation. In the foreseeable future it seems unlikely that further formal economic and political integration will be achieved within ASEAN.

Indonesia represents 57 per cent of the total population of ASEAN, 63 per cent of its land mass, and 42 per cent of its combined GNP. (See Table 1) It is, in fact, the world's fifth largest country in terms of population, and the third largest developing country (after China and India). Indonesia thus merits much more attention in global affairs than it currently receives. Economically, it attracted increasing attention during the 1970s, partly because it was a major producer in OPEC and the country from which Japan continues to draw much of its energy supplies. Over the course of several years, Indonesia has also been the largest borrower from the World Bank, but its resource wealth and relative financial prudence (at least since the Pertamina crisis of 1975) have saved it from the fate of debtor nations such as Brazil, Mexico or the Philippines. In the ASEAN tradition of export-led growth, Indonesia is the great-grandfather of export economies. Even before Columbus tried to find his way to these fabled spice islands, traders and resource developers in Indonesia were ready to keep the riches flowing faster than the debts could accumulate. Indonesia's wealth is distributed over some 13,677 islands, making Indonesia the most fragmented and, according to many, the most fascinating country on earth.

For its part, Canada has made concerted overtures--in the form of prime ministerial, ministerial, diplomatic, technical, professional

and commercial missions--to Indonesia and ASEAN with accelerating intensity over the last sixteen years. A quarterly Canada-ASEAN newsletter is now produced and widely circulated by External Affairs to publicize the exchange between Canada and those countries, and Export Strategy and Industrial Cooperation booklets are available on a regional or country-by-country basis. The increased volume of trade, aid and investment has resulted in a larger number of trade and CIDA staff being posted to Canadian missions in ASEAN countries. Although press coverage in Canada remains sporadic--lapsing towards total neglect in the absence of spectacular events such as a prime ministerial visit, a volcanic eruption, or a major assassination--attention is bolstered from time to time by Pacific Rim Opportunities Conferences and Op-Ed articles heralding the fabulous potential that the region holds for Canada, if only the means can be found to realize it.

The expanding Canada-Indonesia dialogue serves a range of interests, not the least of which is the political need on both sides to find a broader arena and to achieve a higher profile in international affairs, as well as the need to dilute what seem to be excessive dependency relationships: of Canada on the United States, and of Indonesia on Japan and on the United States. Canada is often considered as "another North American country" without conspicuous predatory intent, a country that also offers a possible testing ground and gateway to the larger market. Indonesia is a very large but not overwhelming country, where foreign aid can show tangible results; it also provides a raison d'être for a Canadian presence in Southeast Asia, now that Canada no longer serves on the International Commission in Vietnam,³ and now that Commonwealth ties with Malaysia and Singapore seem to be less meaningful. There is a need for special efforts in Canada-Indonesia relations because compared to other ASEAN countries Indonesia has only a tiny and temporary resident community of Canadians, and the expatriate Indonesian community in Canada is relatively small. Knowledge of the culture of the other is thus very limited, especially as Bahasa Indonesia is not being taught in any Canadian university--though it is the world's sixth

largest language group--and English is not as prevalent in Indonesia as elsewhere in ASEAN.

There is enough common ground between Canada and Indonesia to justify an effort at greater understanding and a more animated dialogue. Both have traditionally been "export economies" and continue to rely significantly upon export-led growth for their prosperity (with ratios of exports to GDP of 27 per cent and 30 per cent respectively for 1982). Both are mainly primary producing countries, with high shares of GDP originating in agriculture, forestry and mining, though Canada's smaller ratio of population to resources (and special access to North American technology and investment) yields a higher per capita GNP. This in turn has helped Canada develop a larger and more sophisticated manufacturing sector, in part through public subsidy. As primary producers and exporters, Canada and Indonesia are competitors in some commodity lines, potential competitors in others, and clearly non-competitive in only a few lines, where different climatic zones or unique resource endowments are determining factors. Similarity in commodity structure can make them potential allies in commodity agreement negotiations, and can also facilitate industry-specific technology transfers, especially in the case of multinational firms with interests in both countries. Both are substantial debtor nations, borrowing against resource endowments, and both are "host nations" to foreign firms that own or manage significant shares of their domestic productive capacities. Canada is also a creditor nation (with some investments in Indonesia and elsewhere) and, being a higher income country, Canada is an aid donor nation, while Indonesia is a substantial aid recipient. Canada's geography, with its population and infrastructure strung mainly along a corridor 100 miles high and 4000 miles long, has evident similarities with Indonesia, which suggests further opportunities for transfer of technology and accumulated know-how in this regard. Aside from transport and communications, there is potential for an exchange of expertise in areas relating to regional development, social service administration, and adaptation of technology to dispersed communities and relatively small-scale operations (as in power and other utility

supply, agricultural servicing and storage facilities, and municipal and community development). Finally, Canada and Indonesia are both political conglomerates, with considerable regional diversity, ethnic factionalism, and with consequent problems in maintaining national cohesion and identity.

There is thus much fuel for dialogue. Spelling out such a list of seemingly "obvious" similarities and differences helps to draw attention to the "peculiar relationship" that exists and is in process of evolving between the two countries. The peculiarity, from an economic viewpoint, stems mainly from the Canadian side--given that Canada is "a rich underdeveloped country, a debtor and creditor nation, and a high income primary producer". This accounts for some of the almost hypocritical ambivalence and fence-sitting propensity exhibited by Canadian spokesmen when it comes to such North-South issues as: commodity agreements, codes of conduct for multinationals, international financial reform, law of the sea and global commons, and protectionism, particularly the dismantling of tariff and non-tariff barriers that limit access of developing country manufacturers to markets of industrial countries. This Canadian abnormality places a special onus on Canada's representatives in the Canada-Indonesia (or broader Canada-LDC) dialogues to make it clear when and why particular considerations may apply. Canada's credulity can be seriously strained when it champions Third World issues as a "soul brother" in international fora, and then follows a domestic practice that is at glaring odds with what is being preached. To avoid a reputation for "speaking with forked tongue", Canada must make clear to Third World partners when it can be counted as "one of us" and when it must behave as "one of them". Having it both ways risks not having it at all.

Governments in Canada and in Indonesia are set upon diversifying their national structures of production away from "excessive" primary producer dependency ("rocks and logs" in Canada, "petroleum, padi and plantations" in Indonesia) and are seeking to create more jobs through industrialization. Both countries can be described as relatively "interventionist" and "protectionist", and yet

each lacks a clear industrial policy that would serve to determine specialization within manufacturing when this is not dictated by dramatic resource advantages or by overwhelming international competition. Lacking clear criteria, both countries are prepared to subsidize, up to a certain level, almost any production on "infant industry" arguments or where a strong political case could be made for the need to promote job creation or regional economic balance. Such subsidy arrangements carry over into export promotion, especially in times of recession when foreign exchange earnings from primary exports are exceptionally depressed and lifestyles built on high imports are threatened by balance of payments crises. Canada and Indonesia both exhibit what have been called neo-Mercantilist tendencies.

Under the pressure of the current prolonged recession, Canada and Indonesia are thus very anxious to increase exports of anything by whatever means possible, and both are increasing their barriers to imports. All transactions and political deliberations, from foreign investment and foreign aid to pollution laws and wage negotiations, are looked at in the context of short-term effects on the balance of payments as much as in the context of the longer-term effects on economic development and the quality of life. Such myopic fixation is not compatible with a belief in international trade as an engine of growth. The latter is concerned with optimal resource allocation guided by some concept of comparative advantage and gains through trade from specialization. It requires that a country discriminate on the basis of efficiency against some forms of "infant industries" so that those that do have the capacity can receive the resources to grow to self-sustaining adulthood. When productive agents are unemployed across the board and no means exist for discriminating analysis, however, the natural tendency is to push everything at once.

From an economist's viewpoint, this is generally regarded as the wrong approach for analyzing international trading accommodation in bilateral terms (in spite of the prevalence of two-country/two-commodity models in economic texts). When there is a faith in multilateralism, bilateral balances can be ignored so long as a country's overall balance of payments is not in chronic deficit or

surplus. Where it is in chronic deficit, correct policy calls for structural adjustment, domestic deflation or devaluation to set things right. That politicians and their advisors have been forced to think and negotiate increasingly in bilateral terms reflects "a breakdown in the international system", or at least some loss of faith in its ability to work. This implies a lack of willingness overall to abide by the rules of discipline of the international system in determining comparative advantage, or a sense that others can manipulate the terms so as to take excessive shares in gains from trade and specialization.

The current crisis is not simply a short-term response to OPEC price hikes, high US interest rates, or unions pushing up wages faster than productivity. At the root of the problem is the fact that most nations are simply not prepared to have their economic momentum and their economic structures determined exogenously by international market forces, competitive or otherwise. This is particularly the case for developing countries, which are insistent on improving their productive structures and terms of trade after decades or centuries of what they interpret as an imposed global division of labour relegating them to "cheap, labour-intensive, low technology, high risk, overly competitive, primary producing industries". Less defensibly, resistance to exogenous control is also characteristic of highly diversified industrial nations unwilling to "vacate the field" in inappropriate "backward" industries or to increase their vulnerability to international competition.

What this has led to is a global structural disequilibrium and a series of stand-offs, with nations doing what they can unilaterally to promote industrialization in their own countries, to push whatever they can onto export markets to pay for "essential" imports, and to bargain bilaterally and in small regional groupings to ease some of the strain by "second-best" adjustments in lieu of multilateral accommodation. The Canada-Indonesia dialogue is one of such bilateral negotiations, at least in part, and there is a tendency now towards linkage and packaging in order to bring everything onto the table and to thus obtain concessions and special agreements. Insofar as the momentum towards freer multilateral trade as promoted by

GATT and the various "Rounds of Talks" seems somewhat in abeyance,⁴ other suggestions have been voiced for selective customs unions and regional free trade areas (such as Canada-United States, or ASEAN, following the example of EEC) as explicit second-best alternatives. Should such linkages appear too confining, as in the case of Canada-United States trade relations, or inoperable, as the various Pacific Rim free trade area proposals now appear to be, we are left with the "third option" of seeking to promote tariff reform and improved trade relations on a bilateral country-by-country basis.

The third option--bilateralism--is essentially where most Canadian efforts have recently been directed, though there is evidence that the aversion to closer US links may currently be abating, perhaps out of desperation.⁵ Indonesia meanwhile finds itself courted by other ASEAN members, who have more developed industrial sectors and smaller domestic markets, and who advocate freer intra-ASEAN trade and closer economic integration. While making some moves in this direction, Indonesia is also actively manipulating its third option with all its industrial trading partners, seeking broader and more profitable trade, aid and investment interrelationships. This reminds us that Canada is not alone in giving revitalized attention to its Indonesian connections. In fact, its stepped-up efforts lag notably in many respects behind the rushing crowd of potential partners in development from Japan, Hong Kong, other East Asian NICs, Australia, West Germany, Holland and several other EEC member countries. Its network of economic relations is thus subject to continual and close comparison.

What does Canada want out of the dialogue in economic terms, and what does it have to offer? From Indonesia's viewpoint, how indispensable is its Canadian connection as a source of aid, trade, investment and other benefits? From the Canadian standpoint, how important is Indonesia as a political ally, and as an outlet for Canadian products, lending, and investment? Where are the areas of mutual benefit, and what are the points of conflict and contradiction between helping Indonesia develop and helping oneself to Indonesia's wealth? How pragmatic and Machiavellian must we be in pushing particular

Canadian commercial and political interests, perhaps at the risk of losing longer-term good-neighbour relations? What is the bottom line, and how resilient and flexible can Canada be in accommodating Indonesia's demands, especially those that would have unpopular effects in Canada?

These are the questions that need to be answered in a full-blown review of Canada-Indonesia political-economic relations. What follows is only a partial excursion towards understanding what is involved, especially in regard to aid, trade, and investment relations somewhat narrowly defined. It is hoped that this paper might illuminate the territory for decisions that must be political, not merely economic, whether these be carefully deliberated or made, for the most part, in haste. Where objectives, trade-offs, and strategies are not clearly spelled out, one must deduce these from "behaviour as revealed preference". As things look at present (summer of 1983), Canadian foreign policy, and the Canada-Indonesia dialogue, seem to be headed in an increasingly neo-Mercantilist direction.⁶

An Overview of Canada-Indonesia Economic Relations

Persistent global recession and the apparent lack of adequate solutions to Canada's regional development and unemployment problems have prompted a major reorganization towards a realpolitik approach in that part of the federal establishment that is concerned with foreign affairs. Starting in October 1983, after several years of preparation, all agencies with extra-territorial responsibilities will be linked by committees and a system of hierarchical reporting on a country-program basis. All aspects of foreign policy will be continually and explicitly assessed in terms of their tangible (especially short-term) benefits to Canada and to the needs of various specific regional problems across the country.⁷ The monolithic structure is still experiencing teething problems and has yet to prove itself operational; it is quite possible that a change of government will modify and simplify the edifice before it is really put to the test. But it appears that both Liberals and Conservatives agree: commercial considerations must be kept uppermost and must be closely calculated