



Prospects for a closer relationship with Indonesia after Brexit

Dr Jacqueline Hicks

As the United Kingdom considers post-Brexit trade opportunities outside the European Union, this briefing looks at the potential for greater cooperation with Indonesia. It finds that there are some sectoral and trade and investment opportunities between the two countries.

Developing a long-term strategy that signals commitment is key to participation in Indonesia's promising growth trajectory.

The UK can mitigate its reduced bargaining power outside the EU by providing targeted, practical trade facilitation measures in exchange for increased investment opportunities.

Becoming an agile and dynamic economic partner in comparison with the EU's bureaucratic approach chimes well with the small business background of Indonesia's President Widodo.

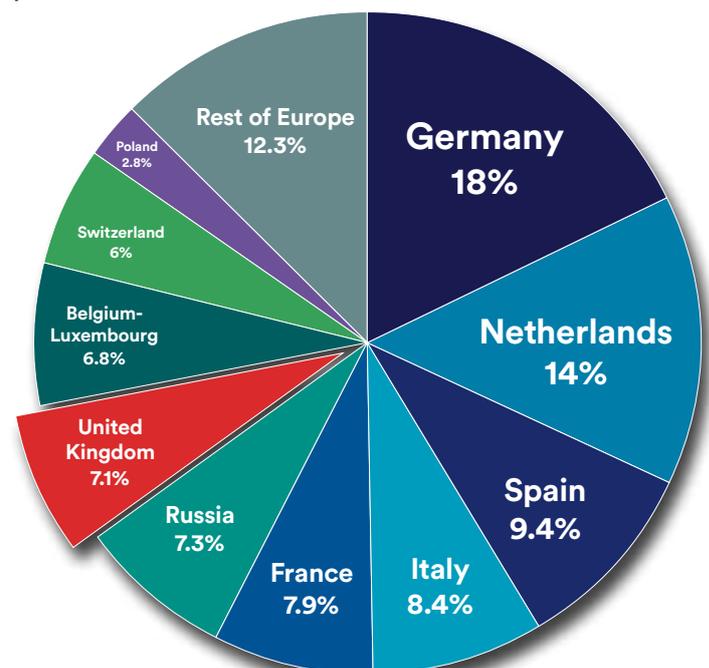
Recommendations

- New trade relations should be negotiated as a package with investment opportunities in mind. Indonesia's bilateral relations with the Netherlands and Japan are good examples for the UK.
- The UK government should increase trade facilitation programmes to support Indonesian companies in meeting import standards rather than dropping them.
- The UK should play to its strength as a more agile actor than the EU by providing fast, targeted and practical trade facilitation and support
- The long-term commitment which the Indonesian government seeks from foreign partners can be signalled with good faith gestures around visas, higher education cooperation and reinvigorated British Council activities in Jakarta.

Indonesia is a priority post-Brexit partner for the UK

Indonesia is one of the fastest growing economies in the world, with PwC predicting it will become **the world's 4th biggest economy by 2050**, behind only China, India and the US.

The two countries currently have a **small trading relationship**. In 2017, the UK accounted for less than 1% of Indonesia's goods exports by value and Indonesia accounts for 0.3% of the UK's goods exports. Bi-lateral trade in services is also small. Around 13% of Indonesia's exports go to European countries, with the UK as one of the most important partners.



Indonesian Exports to European Countries 2017
(% of total value exports to Europe)



There is a **strong investment relationship**, with the UK regularly among the **top ten** sources of direct investment into Indonesia.

The **UK is targeting Indonesia** as one of the first countries to deepen engagement with in its post-Brexit Global Britain Strategy. In 2018, Indonesia received a number of official visits from British Ministers, including the Minister for Asia and the Pacific, Mark Field, Trade Policy Minister George Hollingbery, and international trade secretary, Liam Fox. A UK export finance negotiator was also appointed in Indonesia for the first time ever. New cooperation agreements on anti-corruption, cyber-security and higher education were recently signed.

Is Indonesia ready to do business?

There are **mixed signals on foreign trade and investment** from the current administration. Recent elections raised protectionist rhetoric, which is a normal part of the Indonesian political discourse. In reality, President Widodo is frequently criticised in the domestic press for opening up the economy too much to foreign investors, while his policies are widely described as protectionist by international analysts.

Trade

- Judging from the turnover of trade ministers (three since 2014), there has been some **ambivalence about trade policy** across the administration.
- In 2017, President Widodo created a **new trade negotiating team** (Tim Perunding Perjanjian Perdagangan Internasional) with his most trusted advisor at the helm (Luhut Panjaitan). Establishing such a direct communication channel with the team indicates its importance at the top of government.
- In the context of the US-China trade war, Indonesia has lately experienced trade deficits, which is historically unusual for the country. This has prompted a new round of import tariffs for goods that compete with locally-manufactured products, and **renewed efforts to find new export markets**.
- **Trade deals currently taking priority** include the Regional Comprehensive Economic Partnership for Asian countries and the Comprehensive Economic Partnership Agreement with the EU.



Investment

- **Challenges** for international investors persist in a complex and uncertain regulatory environment with powerful domestic business interests.
- Since Widodo took office in 2014, **Indonesia has improved substantially** in the World Bank's Ease of Doing Business Index, and more modestly in its Logistics Performance Index. The changes to formal processes reflected in these indices will take more time and effort to be felt in service delivery.
- Widodo has staked his political reputation on delivering **big infrastructure projects** in a much needed and impressive building boom over the past five years. Until now, state-owned enterprises have financed an estimated 50-80% of these projects. Alongside some domestic private firms, foreign infrastructure involvement has largely come from **Japan and China** (with state-backed finance).
- Widodo was heavily criticised during the 2019 election campaign for increasing infrastructure-related debt. The government has announced their **support for more domestic and foreign private sector involvement** in infrastructure projects through Public-Private Partnerships and Non-Government Budget Equity Financing (PINA) (private sector financing supported by government policies).

Potential for future UK-Indonesia cooperation

- Based on the current economic relationship between the two countries, the UK is likely to find it easier to increase investment in Indonesia rather than exports. The Indonesian government is keen to increase its integration into global value chains, **bundling investment, trade and production decisions**.
- Such long-term multifaceted commitment is exemplified by Indonesia's current relationship with Japan and the Netherlands, which have more intensive trade and investment relations. While the Netherlands operates within EU rules, their trade and investment is nearly double the UK's. These countries further cement their economic relations by supporting **wide-ranging cultural and educational activities with Indonesia**.
- Some specific sectors for potential cooperation are **wood furniture** exports to the UK, and **infrastructure investment** into Indonesia. **E-commerce and technology services** have recently been opened for foreign investment – sectors that the UK has some comparative advantage in. All these sectors are highly strategic for the Widodo administration.



- Indonesian companies are often unable to take advantage of trade agreements because they struggle to meet the standards set by other countries. While awaiting the UK's deal with the EU, the Indonesian government has shown its priorities for future UK-Indonesia relations by moving to initial talks on **palm oil and timber standards**. While diverging standards are part of the UK's post-Brexit strategy, lowering environmental standards for increased trade with Indonesia risks controversy and reputational damage for the UK.
- The EU includes substantial trade facilitation packages in economic cooperation with Indonesia. The latest is ARISE Plus, a Euro 10 million programme running from 2018-2023 to coincide with its CEPA agreement. The UK could include similar programmes to support Indonesian companies to meet standards for trading with the UK, thus avoiding a race to the bottom on environmental and other standards.
- While such EU economic packages are generous, they can be overly ambitious and wide-ranging. A common complaint across a wide range of Indonesian stakeholders engaged with the EU is that its administrative procedures are slow and cumbersome. By contrast, **the UK has the potential to be more agile, offering targeted and practical measures for trade and investment facilitation**. This chimes well with President Widodo's background as a small businessman.

Further reading

- BKPM Indonesia Investment Coordinating Board, *Domestic and Foreign Direct Investment Realization in Quarter IV and January-December 2017* (2018)

This analysis is based on interviews in January 2019 in Jakarta.

Dr Jacqueline Hicks is the Marie Skłodowska-Curie Individual Fellow at the University of Nottingham Asia Research Institute. She has worked in Indonesia for ten years as a political risk analyst and evaluation consultant for economic and governance projects, including EU trade facilitation, and is fluent in Indonesian. She can be reached at jacqueline.hicks1@nottingham.ac.uk

