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Real Economic Ties Should Underpin U.S.–Indonesia Partnership

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There is one very useful thing about economic issues: Progress on them is measurable.

Any presidential visit to Indonesia is certain to contain a list of "deliverables." In the case of President Obama's upcoming trip and the "Comprehensive Partnership" with Indonesia that he will launch, most of the deliverables have been front-loaded. A science and technology cooperation agreement, an Overseas Investment Corporation agreement, a defense cooperation framework agreement, the return of the Peace Corps to Indonesia, and renewed contact with Indonesia's special forces are already done.

One can count up these deliverables and use them to measure the breadth of the U.S.–Indonesia relationship. Or one could add up official visits between the two countries, of which there have been many, including most recently the September meeting in Washington of the new U.S.–Indonesia Joint Commission chaired by Secretary of State Hillary Clinton and Indonesian Foreign Minister Marty Natalegawa.

Ultimately though, these are all qualitative measures, the value of which lie squarely in the eye of the analyst. There is the possibility that the U.S. and Indonesia could have a great deal of contact without making much net progress on the issues. And while the U.S. does provide Indonesia with some important aid (for instance, in areas of counterterrorism and education), measuring the health of the relationship by the total level of assistance is a distinctly third-world way of measuring a relationship with a member of the G-20.

Indeed, the U.S.–Indonesia economic relationship is the only truly measurable area of relations between these two nations. And the truth is that this economic relationship is underperforming—due to bottlenecks on the Indonesian side. President Obama should be direct with the Indonesians about this. All of America's big plans for its partnership with Indonesia will be unrealized if the U.S. cannot underpin it with stronger economic ties. And without improvements on Indonesia's side, that will not happen.

Untapped Potential. Indonesia's macroeconomic picture is relatively bright. Its economy grew 4.5 percent in 2009 and should accelerate to 6 percent in 2010. Indonesian GDP, adjusted for purchasing power, will soon become the 15th worldwide to exceed $1 trillion and could be a full 50 percent larger by 2015.[1] Indonesia's economy is balanced, with no overwhelming reliance on exports or unsustainably rapid rates of domestic investment—improving its chances for continued strong growth.

The economy in Asia closest to Indonesia's size is South Korea's. How do America's economic relationships with the two stack up? In 2009, Indonesia

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imported $5.1 billion in goods from the U.S., exported $12.9 billion, and hosted $16 billion in direct U.S. investment. South Korea, with an economy only about 30 percent larger than Indonesia's, took in almost six times as much in American goods, exported three times as much to the U.S., and hosted $27 billion in U.S. investment. In the area of services, the U.S. exported $1.4 billion to Indonesia in 2009 and $12.6 billion to South Korea.

It is a good bet that, under current circumstances, the new U.S.–Indonesia partnership will not keep pace with Indonesia's economic potential. Why? The answer boils down to economic freedom and the business environment in Indonesia.

Bottlenecks in the U.S.–Indonesia Economic Relationship. The Heritage Foundation/*Wall Street Journal*'s 2010 *Index of Economic Freedom* ranks Indonesia 21st out of 41 Asian Pacific countries scored, below the world average and below many of its neighbors, including Thailand and the Philippines. South Korea, by contrast, is ranked the eighth freest economy in the region.

Indonesia performs poorest in freedom from corruption, property rights, and investment freedom.

Transparency International ranks Indonesia 110th in the world on corruption issues and scores it the same this year as it did last year. The *Index of Economic Freedom* also cites the impact of corruption in the area of property rights in addition to "arbitrary and inconsistent" court rulings, rulings "against foreigners in commercial disputes that ignore contracts between the parties," difficulty enforcing international arbitration awards, and lack of clear land titles. On property rights, Indonesia scores 30 out of 100; South Korea scores 70. The world average is 43.8.

With regard to investment freedom, Indonesia scores 35 in the *Index*, in contrast to a world average of 49 and a South Korean score of 70. The *Index* narrative on investment freedom notes problems with "corruption; unpredictable, inconsistent and non-transparent regulations; weak contract enforcement; labor market rigidities; and inadequate infrastructure."

Corruption being a common thread through Indonesia's worst scores, it bears noting that Indonesia did itself no favors with its 2009–2010 farcical handling of the Bank Century bailout controversy, where the only official paying a price for alleged improprieties was Sri Mulyani Indrawati, one of the least likely to have violated any laws or professional ethics. The same goes for what *The Economist* has called a "witch hunt" against officials of the Indonesian Corruption Eradication Commission. A great deal of Indonesian commentary of late has focused on President Yudhoyono's flagging anti-corruption campaign. These high-profile examples only serve to underscore the point.

It's not just the Heritage/*Wall Street Journal* research that highlights Indonesian shortcomings on economic freedom issues. Such concerns are borne out by the American business community. To date, there has been no movement on the onerous requirement that pharmaceutical companies manufacture locally or in partnership with Indonesian firms in order to sell their products in the Indonesian market. Local content requirements in the telecom sector continue to be a problem with no resolution in sight. And progress made in facilitating the registration of food, beverage, and other products for sale in Indonesia—with major implications for American exporters—is now threatened by the prospect of new, infeasible labeling requirements.

On investment, the U.S. Trade Representative's 2010 National Trade Estimates Report has put a finer point on last year's description: "Indonesia maintains significant and far-reaching foreign investment restrictions. Its investment climate continues to be characterized by legal uncertainty, economic nationalism and disproportionate influence of business interests seeking control and ownership of existing enterprises and new market opportunities."[2] These are concerns also echoed by international businesses.

1. International Monetary Fund, Report for Selected Countries and Subjects, at *http://www.imf.org/external/pubs/ft/weo/2010/01/weodata/weorept.aspx?sy=2008&ey=2015&scsm=1&ssd=1&sort=country&ds=.&br=1&c=536&s=PPPGDP&grp=0&a=&pr.x=94&pr.y=12* (November 4, 2010).

There has been welcomed progress in areas like the import and distribution of foreign films and streamlining the investment approval process. But unfortunately, for every issue that is resolved, it seems another pops up—like a new regulation requiring importers to register as either distributor or manufacturer, ignoring the fact that world-class companies are often both. And there are others. On January 1, 2011, a new law goes into effect requiring commercial ships plying Indonesian ports to be Indonesian-flagged.

Raise the Expectation Bar on U.S.–Indonesia Relations. There will be those who say it is unfair to compare Indonesia to South Korea, those who will point to the success of an individual company or new investment approvals as signs of a healthy and growing U.S.–Indonesian economic relationship. But this is the problem—U.S.–Indonesia relations have long been plagued by happy talk and low expectations.

Sure, South Korea is a high bar. But where Korea is today would have been an exceptionally high bar for the Korea of 30 years ago. South Korea has had its ups and downs, but it did not become an Asian tiger by ignoring its problems. And it was not bestowed that title for reasons unassociated with its economic progress—neither should Indonesia, which has a very long way to go in instituting market reform and rule of law and ensuring its people's prosperity. America does the people of Indonesia no favors by pretending otherwise.

President Obama should set a first-class standard for the U.S.–Indonesia economic relationship, one that can be measured in vastly increased economic activity and serve as the economic underpinning of a partnership that will long outlive his presidency.

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2. United States Trade Representative, "Foreign Trade Barriers: Indonesia," 2009, at *http://www.ustr.gov/sites/default/files/uploads/reports/2009/NTE/asset_upload_file255_15479.pdf* (November 4, 2010).