

# **CHAPTER I**

## **INTRODUCTION**

In this chapter the writer wants to discuss the research background, the research question that needs to be answered, the theoretical framework used to analyze research questions, hypotheses, research objectives, research methods, and the systematics of writing which are also contained in this chapter.

### **1.1 Background**

#### **History of the Establishment of the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA)**

Australia is an important trade partner for Indonesia. Indonesia's exports to Australia in 2015 reached USD 3.7 billion, placing Australia as the 12th largest export country for Indonesia. Indonesia itself is Australia's main export destination country with a share of 2% of Australia's total exports to the world and ranks 12th as Australia's export destination. Australia is also a major investor country with more than 400 Australian companies operating in Indonesia covering various sectors such as mining, agriculture, construction, infrastructure, finance, health, food, beverages, and transportation.

Given the importance of trade relations between the two countries, in 2007 Indonesia and Australia began a joint feasibility study to examine the benefits of bilateral free trade agreements (FTAs) between the two countries. The research was completed and released to the public in April 2009. The study found that a comprehensive free trade agreement (FTA) would provide economic benefits for both countries. The study also found that the FTA would be an opportunity to accelerate and deepen the economic integration of Australia and Indonesia as the two largest economies in the Asia Pacific region. Further research concludes that bilateral FTAs will

complement and encourage links between Indonesia and Australia in aspects beyond trade and economics.

On November 2, 2010, in Jakarta, Indonesian and Australian leaders entered into an Indonesia-Australia negotiation agreement for the Comprehensive Economic Partnership Agreement (IA-CEPA). The two countries agreed that the IA-CEPA would discuss economic cooperation, trade, and investment issues. The IA-CEPA contributes to economic development to a higher level and a mutually beneficial partnership between the two countries. To achieve this goal, IA-CEPA negotiations will be built based on the principles in the Guiding Principles and Objectives as follows:

- a) Negotiations will be aimed at advancing common goals, accelerating sustainable economic growth and improving living standards.
- b) The two countries will negotiate in a positive and mutual understanding manner.
- c) Negotiations will consider the results of the joint feasibility study released in 2009, the Indonesia-Australia Partnership Business Group Position (IA PBG) Paper; and based on the results achieved in the ASEAN Australia-New Zealand Free Trade Area (AANZFTA) agreement.
- d) Both countries recognize that to achieve mutual benefits, the scope of the IA-CEPA will be more complete and will not only aim to improve the economy but also to facilitate the flow of goods, investment, and services, by reducing trade barriers (rates, non-rates and others), address investment measures that have a detrimental effect, and enhance other technical cooperation in certain sectors that are identified as the main drivers of economic growth.
- e) The scope and scope of negotiations will be as follows:
  - ✓ Economic Cooperation
  - ✓ Trade-in Goods
  - ✓ Service trade
  - ✓ Investment
  - ✓ Other issues (Electronic Commerce, Competition Policy; Government Procurement; Intellectual Property Rights; Environment; Labor and other issues that may be new and that are considered relevant to business realities)

- ✓ Institutional and framework provisions (transparency; general provisions and exceptions; institutional provisions; dispute resolution procedures; and closing provisions).
- f) Due to differences in economic growth rates between the two countries, the IA-CEPA must include flexibility provisions that will consider development issues so that the overall IA-CEPA is development-oriented.
- g) The nature of the IA-CEPA commitment, including the distribution of time frames must be addressed in the initial stages of the negotiations.
- h) The IA-CEPA terminology will be reviewed periodically so as to facilitate the revision of the provisions in the agreement taking into account developments in both countries.
- i) The IA-CEPA will be consistent with the WTO Agreement, including GATT Article XXIV and GATS Article V. Negotiations The IA-CEPA will seek to achieve comprehensive and balanced results through parallel negotiations in all areas of negotiation.
- j) Negotiations in the aspect of economic cooperation will be carried out simultaneously with negotiations on other provisions in order to accommodate input originating from negotiations from other aspects.
- k) IA-CEPA Pre-Agreement Facility (PAF), established to support IA-CEPA negotiations. The IA-CEPA PAF will be used to fund mutually agreed economic cooperation activities carried out during the negotiations. (KPI-KEMENDAG, 2016)

### **Indonesia-Australia Diplomatic Relations in the IA-CEPA**

Indonesia and Australia are two countries that have long-established bilateral relations. Bilateral relations between the two countries have been started and implemented since 1940. Overall, Australia is the 12th largest two-way trade partner for Indonesia measured on an international scale and Indonesia ranks 4th in Australia-ASEAN trade relations. The economic cooperation that exists between Australia and Indonesia is well established and running well. One form of broader economic cooperation between the two countries is the Indonesia Australia Comprehensive Economic Partnership Agreement (IA-CEPA). The IA-CEPA is a form of the comprehensive economic partnership agreement between Australia and Indonesia that covers the

business, trade, investment, and cooperative environment between the two countries. (Harcourt, 2017)

IA-CEPA negotiations for the first round of negotiations were held on 26-27 September 2012 and closed on 26-27 March 2013 in Jakarta. In the first round, Australia-Indonesia focused on re-emphasizing the commitment of the two parties in negotiating an agreement. In addition, in the first round, Australia-Indonesia discussed and shared with each other the challenges to be faced in bilateral trade and investment relations between the two countries.

Then the second round of negotiations was held on 29-31 July 2013 in Canberra, Australia. In the second half, Australia-Indonesia focused on economic cooperation and stakeholder agreements. The implementation of the IA-CEPA would be a positive foundation for the economies of the two countries. However, IA-CEPA negotiations stopped in mid-2013-2015.

In economic relations between countries, Australia has cooperated with Indonesia in terms of export-import, exchange of services, and investment. Australia's main exports to Indonesia are wheat, livestock and agricultural products. While the main imports are petroleum, machinery, semi-finished goods. (Australia D. o., 2015)

Australia-Indonesia has fluctuating diplomatic relations. Conflict involving the two countries also had an impact on economic cooperation. In 2013, the Australian government was found to have tapped the Indonesian government, namely the President of the Republic of Indonesia Susilo Bambang Yudhoyono, First Lady Ani Yudhoyono, Vice President of the Republic of Indonesia Boediono and Minister of Economy Hatta Rajasa since 2009. This was responded by the Indonesian Government by attracting the Ambassador Indonesia for Australia, Nadjib Riphat Kesoema, after wiretapping information was spread. This is a form of violation of sovereignty by Australia against Indonesia.

The espionage action also made it difficult for Indonesia to trust Australia as a partner in various fields, including the economy. Tim Harcourt as an economist from the business school of New South Wales University stated that Indonesia did not want to carry out any investment or trade agreements after the wiretapping case. (Febrianto, 2013)

The case of wiretapping also had an impact on the cancellation of cooperation between PT. Rajawali Nusantara Indonesia (RNI) as one of Indonesia's State-Owned Enterprises (SOEs)

against the purchase of four medium-scale cattle ranches in Australia. This is a form of protest and disappointment for Indonesia due to violations of sovereignty by Australia. In addition, since August 2013, IA-CEPA negotiations have also been temporarily suspended by Australia and Indonesia.

When Australia-Indonesia diplomatic relations were in the process of being recovered in 2014 through the Code of Conduct agreement as a code of conduct for a security cooperation framework, the 3rd IA-CEPA negotiations were still not running. The issue of Indonesia's sovereignty and security, including regarding Australian warships that entered six times and brought illegal immigrants into Indonesian territorial waters in 2013-2014 is still one of the most important issues that must be resolved because it froze military cooperation between the two countries. Indonesia is also in the period of presidential change on October 20, 2014.

Tension again occurred in 2015, at the time of the execution of the Bali Nine duo. Bali Nine is a special designation for nine drug dealers who were caught at Bali's Ngurah Rai Airport on April 17, 2005. Two of the nine suspects are Andrew Chan and Myuran Sukumaran who are Australian citizens. At that time President Joko Widodo rejected the pardon proposal submitted by the suspects. The decision of Chan and Sukumaran's execution by President Joko Widodo cannot be contested anymore. Indonesia received criticism from the community and the Australian government at that time. The criticism was carried out by Australia by attracting the Australian Ambassador to Indonesia, Paul Grigson, on 29 April 2015. (BBC, 2015)

The Bali Nine conflict affected the delivery of Australian aid to Indonesia. Australian Foreign Minister Julie Bishop, stated that Australia would reduce the annual foreign funding budget for Indonesia. Withholding funds from around 605 million A \$ to 600 million A \$ for various economic, education, health, and development programs in Indonesia Even though the funds were cut short of initial estimates, this could lead to prejudice that the discounted aid was Australia's response to the execution of the Bali Nine duo.

### **Indonesian and Australian interests in the IA-CEPA agreement**

Within the framework of the rational actor model, the state is the only main actor that plays a role in issuing a policy as a form of achieving the interests of the state. One form of foreign policy is to form cooperation with other countries. Before cooperation is formed, the parties

involved must conduct negotiations first to align interests in cooperation so that the benefits of cooperation can be obtained by both parties. In the process of running a negotiation in cooperation, there is a calculation of state losses and benefits. As a rational actor, the state wants the maximum profit with the smallest loss and this cooperation can accommodate the country's national interests.

The economic-based cooperation negotiations between Indonesia and Australia, called the IA-CEPA, were stalled due to the political conflict that occurred between 2013 and 2016. Then in 2016, Australia visited Indonesia with an agenda of inviting Indonesia to reactivate the IA-CEPA. Indonesia has two different options, namely accept to activate the cooperation negotiations as requested by Australia or refuse to activate the cooperation negotiations. In 2016 also Indonesia began to intensify its implementation economic diplomacy in its foreign policy program. One of the economic diplomacy strategies itself is to strengthen Indonesia's diplomacy to other countries with good market prospects. Indonesia has conducted diplomacy with Australia in the IA-CEPA with the prospect of Australia becoming Indonesia's new export market in the palm oil industry sector so that exports on the trade balance will continue to be in a surplus.

So, after Australia visited and invited Indonesia to reactivate the IA-CEPA, Indonesia's choice was to reactivate or not to activate the IA-CEPA cooperation negotiations. Judging from the advantages and disadvantages of each option, Indonesia will benefit more if Indonesia reactivates the IA-CEPA negotiations because there are so many economic opportunities that Indonesia can exploit in IA-CEPA cooperation.

## **1.2 Research Question**

Based on the background elaborated before, the writer takes the formulation issues to be discussed in the study are:

**How the Indonesian and Australian governments reactivate the IA-CEPA agreement?**

## **1.3 Theoretical Framework**

In order to Analysis the Indonesia-Australia Agreement to IA-CEPA, the writer will use theory as follow:

### **1.3.1 Neoliberalism Theory**

In explaining the importance of cooperation between countries, the author will use one of the major theories in international relations, namely Neoliberalism. Neoliberalism still uses the same concept as Liberalism in terms of the possibility of progress and change but not in context.

One of the efforts emphasized by Neoliberal in achieving world peace is through cooperation between countries. Cooperation, in this case, can occur in various fields, one of which is the economy. Cooperation in the economic sector developed by the state generally refers to trade and investment. This is also in accordance with one of the state's roles that are emphasized in Neoliberalism is trade liberalization.

Trade liberalization is a trading activity that crosses national borders. This role is consistent with the theory of international trade coined by David Ricardo regarding comparative advantage. The country produces goods that are considered superior and good for the country produced compared to other countries. Ricardo added that all countries can benefit from international trade, including countries that have no absolute advantage in both the economic and industrial sectors.

The cooperative relationship established between the two countries is inseparable from the fulfillment of the national interests of each country. The national interest of a country becomes important for a country which is usually reflected in a country's foreign policy. In his book entitled *Politics Among Nations*, Morgenthau sees the concept of importance as part of eternal politics and is not influenced by time and place. According to Morgenthau, national interests refer to the protection of the physical nation-state, political and cultural identity to oppose various interference from other countries. The national interests of each country differ depending on the conditions of a country. Therefore, Morgenthau sees the concept of national interests as being influenced by two factors, the first is the need and the second is changing and it is decided through the situation. In a world of competing countries, the power of a country is the minimum requirements and conditions for countries to be able to survive. although the interests of the state are always there and are not

influenced by time and place, what is in the country's interests will change with the passage of time and the changing international situation. (Sorensen, 2012)

Bilateral relations between Indonesia and Australia are the motives of the two countries to maintain peace between the two. Improving economic prosperity through trade relations that are facilitated and primarily to maintain national interest. Indonesia is an important partner for Australia so that relations with Indonesia become one of the means to fulfill national interests.

IA-CEPA is an agreement between the two countries to strengthen economic relations between the two countries. Not only for the country but through the IA-CEPA it is expected to provide opportunities and open markets for businesses, primary producers and investors. Hope in the future the cooperation between Indonesia and Australia can bring the two countries to economic integration.

### **1.3.2 Economic Integration Theory**

According to Baldwin and Venables (1995), basically there are three types of regional economic integration. The first is a free trade agreement (FTA), which is a form of economic integration that removes tariff barriers in the trade of its member countries but still has authority in determining tariffs on non-member countries. An example of a regional FTA is the Association of Southeast Asia Nations (ASEAN). The second is the Customs Union (CU) or joint customs where member countries not only eliminate fellow member fees but also set a shared rate for non-member countries. An example of a CU is the European Union (EU). The third type is the Custom Market (CM) or a shared market. Common markets condition the existence of free movement between factors of production and goods and services between member countries. ASEAN has now formed a joint market with the entry into force of the ASEAN Economic Community since January 2016. As of January 1, 2016, there were 635 economic integrations recorded in the World Trade Organization (WTO) with 423 of them already in force. Most forms of economic integration have different applicable times for trade in goods and services. Some forms of economic integration involving developing countries usually have a simpler scope of cooperation, for example, the exclusion of the service sector and investment in the scope of cooperation. More



modern economic integration such as the one that developed in the last decade involves various issues outside the issue of trade.

A number of theoretical and empirical studies have addressed the question of how regional economic integration affects member countries and what is the role of regional economic integration for the global trade system as a whole.

Economic integration that discriminates against non-member countries in member trade is actually not consistent with the principle of the Most Favored Nation (MFN) established by the WTO. However, the General Agreement on Tariff and Trade (GATT) Article XXIV allows for the integration of the economy as long as it meets certain conditions. FTAs are permitted under the terms of the GATT as long as the FTA removes substantial trade barriers. Substantial understanding is defined as removing barriers to all trade with exceptions that are still consistent with other WTO provisions.

Economic integration such as FTA has an impact on global welfare. There are two aspects that can be reviewed. First, the FTA reduces global welfare because member states reduce tariff barriers for fellow members and continue to provide higher tariffs for non-members. If the FTA member is a small country and the market is perfectly competitive then the FTA has no impact on global welfare. However, if FTA causes a change in terms of trade or if the market is not perfectly competitive, there is a shift in production, then it can be said that the FTA has a negative effect on the non-member countries as a whole. The second aspect is the fact that FTA member countries still have the opportunity to regulate external barriers for non-members enabling the trade war and the destruction of the multilateral trade system established by the WTO.

The rapid development of the number of FTAs has led to debate whether the FTA improves the welfare of its member countries. Research on FTA is more focused on the theory of increasing and decreasing welfare between member countries and nonmembers, but it does not discuss increasing welfare among fellow FTA member countries. Baier (2004) conducted a literature survey that examined the impact of FTAs on the welfare of member countries. Baier (2004) concludes that for more than 4 decades since the founding of the GATT in 1947 research using the gravity model does not provide convincing evidence that the FTA has increased the flow of trade in member countries. But in reality, since the 1990s the number of FTAs has actually grown more

rapidly than before. Member countries of the newly formed FTA continue to assume that the FTA agreement will increase international trade. (KPI, 2016)

## **1.4 Hypothesis**

From the results of the background analysis and theoretical framework above, the writer argues that there are 2 important points in re-activating the IA-CEPA economic agreement:

### **1. Mutual Beneficial Cooperation**

IA-CEPA will provide benefits for both countries, not only in trade but also services and investment in addition to other fields for the benefit of both countries. the role of the state emphasized in Neoliberalism, namely trade liberalization. Trade liberalization is a trading activity that crosses national borders. Meanwhile, Australian administrative procedures for exporters and importers from Australia will be facilitated and Australian investors will get the convenience and protection to invest in Indonesia

### **2. Partnership**

A partnership is not just a free trade agreement (FTA). but the IA-CEPA has become a comprehensive partnership and business strategy carried out by Indonesia and Australia. So how can this partnership be developed in the future to run the economic powerhouse, which is a concept of cooperation between the two countries by utilizing each other's advantages and productivity to target market access to third countries.

## **1.5 Purpose of Research**

As stated above, the purpose of the IA-CEPA agreement analysis is:

Describe the Economic policies and Economic cooperation in the IA-CEPA negotiations between Indonesia and Australia.

## **1.6 Research Methods**

This study uses two approaches that are quantitative and qualitative. The quantitative approach uses a descriptive analysis of the performance of trade to the two countries both bilaterally and globally. While the qualitative approach will be carried out through a review of policies in each country which includes export, import and domestic policies which are considered as barriers to trade.

In this study, researcher used two data collection techniques that are:

1. Literature Study, which is collecting data from a number of Literature such as books, scientific journals, newspapers, and articles.
2. Documentation Study, which is collecting data from a number of official documents. The official documents such as data, press statements, and reports from government agencies authorized by the Indonesian Ministry of Foreign Affairs, the Indonesian Ministry of Trade, the Australian Department of Foreign Affairs and Trade, the Australian Embassy, as well as data from official research-related organizations. These data can be accessed via the internet

## **1.7 Data Source**

The data collection method used in the writing of this research is literature study and tracking media using secondary data analysis. Secondary data is a source of research data obtained by researchers indirectly or through intermediaries. Secondary data is usually in the form of evidence, records, or historical reports organized in published or unpublished archives. In this study, the authors used secondary data obtained from books, journals, articles, reports, government websites, and news related to Indonesia's economic and political interests.

## **1.8 Scope of Research**

The scope of research is intended to limit qualitative research so that researchers are not trapped in a variety of data obtained. This research focuses on the interests of Indonesia and Australia in reactivating the IA-CEPA and economic cooperation between Indonesia and Australia before and after the IA-CEPA negotiations.

## **1.9 System of Writing**

This Undergraduate thesis is systematically written based on the rules applied in scientific writing. It is divided into several chapters with the different discussions within its own territory but interrelated. In order to facilitate interpreting the topic issue, this undergraduate thesis will be divided into five chapters that consist of:

- Chapter 1: This chapter examines the background of the research, research question that needs to be answered, theoretical framework that is used to analyze the research question, hypothesis, purpose of the research, method of research, and the systematic writing that is also written in this chapter
- Chapter 2: This chapter discusses the dynamics of relations between Indonesia and Australia. in addition, this chapter will discuss the interests of Australia in Indonesia and vice versa in the political and economic fields, also diplomatic issues between Indonesia and Australia.
- Chapter 3: This chapter discusses the analysis of Indonesian and Australian trade developments which is divided into two:
  - 1.The development of Indonesia and Australia which includes the Indonesia-Australia macroeconomic profile, the Performance of Trade in goods and services, as well as Indonesia's investment with Australia.
  - 2.Analysis of policies affecting trade and supporting IA-CEPA cooperation schemes in both Indonesia and Australia.

- Chapter 4: This chapter discusses specifically what interests Indonesia and Australia in the IA-CEPA. The author will also answer research question related to obstacles in the IA-CEPA cooperation agreement.
- Chapter 5: This chapter is a conclusion that contains the result of the discussion of the previous four chapters.