AN OVERVIEW OF INDONESIA–INDIA ECONOMIC RELATIONS

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ABSTRACT

The Indonesia–India Comprehensive Economic Cooperation Agreement (II-CECA) reflects the strong intention of the g\Governments of Indonesia and India to improve and widen their trading and investment links, which should be of great economic benefit to both countries as well as improving business links. Because Indonesia and India are large, rapidly growing economies, they can both reap the benefits of their demographic dividend and because of their young population, improving and strengthening their economic relations will be to the benefit of both. Moreover, in April 2012, Indonesia and India celebrate 60 years since the establishment of diplomatic relations, and there is much reason to improve and broaden their bilateral economic as well as their social and cultural relations. Indonesia and India have also been growing rapidly after opening up and liberalising their economies, Indonesia since 1967 and India since 1991. These economic reforms have made both economies more competitive and outward-looking, and more able to take advantage of the great potential from closer economic relations between these two countries, relations that will also be underpinned by the long historical and cultural links between Indonesia and India and by the mutual appreciation that both countries are democratic, India since its independence and Indonesia since mid-1998.

Keywords: *Indonesian–Indian Economic Relations, Bilateral Trade, Investment Relations*

JEL Classification: N750, F150

I. INTRODUCTION

In the following pages there is an historical overview of the bilateral economic relations between Indonesia and India. Before this overview, there is a brief economic profile of both countries, which is important, because India and Indonesia, along with China, are the three fastest growing economies in Asia, although India's growth has, during the periods of 2002–2007 and 2007–2011, been higher, at an average annual rate of almost 9.1 per cent and 8.8 per cent respectively, than has Indonesia's at more than 4.6 per cent and 6.1 per cent respectively. On the other hand, in 2011, India's Gross National Income per capita in current US dollars was only USD1330; lower than Indonesia's at USD2550 (World Bank, 2011a). Moreover, Indonesia and India, together with China, are members of the G-20 group, a group of the twenty largest economies in the world.

Despite the Global Financial Crisis (GFC) of 2008–2009, both countries weathered the crisis quite well, because neither is as trade-oriented as China. For instance, the total foreign trade of India as a percentage of GDP is 48.8 per cent and for Indonesia it is 56.9 per cent, but for China it is 72.4 per cent (World Bank, 2009).

Because of their rapid growth, India and Indonesia have for the past decade received rising inflows of foreign direct investment (FDI); although Indonesia's foreign investment policy has in general been more welcoming to FDI in than has India's.

After the brief overview of the economic profiles of both countries, this paper discusses their trade and investment policies. It then analyses the trends in the bilateral trade in goods and services, before discussing their investment relations. The paper will then attempt to identify the various barriers to the trade and investment flows as well as some other issues.

II. AN HISTORICAL OVERVIEW

Indonesia and India have had historical cultural and economic links for a long time. Both are dynamic market economies and have undertaken wide-ranging economic reforms, Indonesia since 1966 and again after the oil boom in 1982, which enabled growth at an average annual rate of 6.7 per cent during the Suharto era (1966 to 1996) before it was hit by the Asian Financial Crisis of 1997–98 when the Indonesian economy contracted by an unprecedented 13.1 per cent (Thee, 2002). The economy recovered, at first slowly, in 1999 but it grew faster in the following years; 4.6 per cent in 2009, 6.1 per cent in 2010 and 6.5 per cent in 2011. However, because of the continuing global uncertainty, including the projected slower growth of Indonesia's major trading partners, China being one, the Indonesian economy is forecast to grow slightly slower at 6.2 per cent in 2012 (World Bank, 2011a). India, on the other hand, introduced sweeping economic reforms in 1991 after it experienced a serious balance of payments crisis. Since then, India has been one of the fastest growing economies in the world along with China, and for the past decade has been growing at 8 to 9 per cent annually, second only to China, which grew very rapidly since Deng Xiaoping, China's pre-eminent leader since 1978, introduced extensive economic reforms in the late 1970s.

Recognising that present economic links between Indonesia and India are important, yet below their potential, President Susilo Bambang Yudhoyono of Indonesia and Prime Minister Manmohan Singh of India, in November 2005, agreed to undertake a joint study to explore the feasibility of a bilateral Comprehensive Economic Cooperation Agreement (CECA). To this end, they set up a joint study group (JSG), led for Indonesia by Dr. M. Hadi Soesastro, and for India, by Mr. R Gopalan. The Indonesian delegation included Mr. Marzuki

Usman, Chairman of the Economic Association of Indonesia and India; Dr Thee Kian Wie of the Economic Research Centre, Indonesian Institute of Sciences, as chairman of the Working Group on Investment in Indonesia; Mr. Paul Mukundan, Secretary-General of the Indonesian Chamber of Commerce and Industry; and a number of senior Indonesian government officials.

The Joint Study Group met four times, twice in Indonesia and twice in India. The final meeting was held on 15 September 2009 in Jakarta and co-chaired by Dr. Soesastro, Chairman of the Indonesian delegation, and Mr. Gopalan, Chairman of the Indian delegation.

The study by the JSG provides a brief overview of the economic profiles, and the trade and investment profiles, of Indonesia and India. It also analyses the trends in the bilateral goods and services trade, the investment relations and several other areas. The study also identifies several barriers to trade and investment flows and other issues that might be addressed in the bilateral CECA (Joint Study Group, 2009).

III. TRADE AND WELFARE GAINS

The study by the JSG also assessed the potential economic effects for both countries in terms of trade and welfare gains arising out of a reduction of trade barriers that could occur under the proposed CECA. The different empirical estimates made by the JSG indicate that bilateral trade can increase many times between Indonesia and India.

To estimate the economic and welfare gains of the proposed CECA, a multi-sector Computable General Equilibrium (CGE) model was used. The estimates were made for two scenarios (see Table 1).

The data in Table 1 show that under Scenario I, with a 50 per cent import tariff liberalisation and trade facilitation measures, the estimated welfare gains are 0.5 per cent for India and 0.7 per cent for Indonesia. It increases to 1.0 per cent for India and

Table 1. Estimated trade and welfare gains from the CECA

	Scenario I	**Scenario II**
Indicator	50% import tariff reduction and trade facilitation	100% import tariff reduction and trade facilitation
Welfare gains	*(%)*	*(%)*
India	0.5	1.0
Indonesia	0.7	1.4
Bilateral exports	*USD (millions)*	*USD (millions)*
India	15.49	30.98
Indonesia	16.04	32.08

Source: Joint Study Group (2009), page 24.

1.4 per cent for Indonesia under Scenario II when there is a 100 per cent tariff liberalisation along with trade facilitation. These data show that the welfare and trade gains for Indonesia are larger than for India, indicating that a more open, that is, a less protectionist country like Indonesia will benefit more from trade liberalisation than a less open economy like India.

The findings of the multi-sector CGE model also shows that the welfare gains accruing to India could amount to 1.0 per cent of India's GDP, and to Indonesia, 1.4 per cent of its GDP under a scenario of full tariff liberalisation along with setting in place trade facilitating infrastructure (Joint Study Group, 2009).

The above estimates were complemented by some other estimates identifying potential products having comparative advantages, trade complementarities and intra-industry trade, which could be focused upon bilateral trade expansion. Overall, the analysis of the various dimensions of trade in goods between Indonesia and India suggests that there is ample potential for bilateral trade expansion that would be mutually advantageous. These estimates build a strong case for putting in place a free trade agreement (FTA) in goods under the proposed bilateral Comprehensive Economic Cooperation Agreement (CECA). The proposed CECA also aims at setting in place trade facilitation architecture by focusing on greater cooperation in customs facilitation, standards, mutual recognition agreements, sanitary and phytosanitary (SPS) measures and trade remedial measures. According to the JSG study, the CECA is also expected to expand market access in both countries for service providers across a broad range of service sectors and in all modes of service supply. In regard to trade in services, the JSG identified possible services sectors for improved cooperation between Indonesia and India; these include information technology, telecommunications, financial, audio-visual, education, health, tourism and travel, construction, professional services, and transport. The proposed bilateral CECA also needs to include sectors of export interest to both countries. To this end, the study concluded that it would be important to develop rules and disciplines on trade in services based on the provisions of the General Agreement on Trade in Services (GATS), and improve on them wherever possible, including disciplines on domestic regulations. The study further suggested facilitating increased dialogue between the regulatory bodies of the two countries for possible mutual recognition agreements (MRA) (Joint Study Group, 2009).

The Joint Study Group (JSG) also noted that although Indonesia and India are destinations for FDI inflows, both countries have also emerged as source countries of outward direct investment in various sectors. Some of the sectors amenable for direct investment from Indonesia into India include hybrid seeds; processed food; electrical and non-electrical machinery; chemicals; infrastructure; hotels, hospitality and tourism; but Indian direct investment into Indonesia could take place in sectors such as food processing; textile fibres; plastics; wood products; agri-biotechnology; pharmaceuticals, light engineering; audio-visual; telecommunications; information technology and education (Joint Study Group, 2009).

Some other areas identified by the JSG for more intensive cooperation include sharing successful developmental experiences; capacity building; and people-to-people contacts. Specific areas of economic cooperation of mutual interest that Indonesia and India can exploit and foster closer collaboration include energy, specifically in oil and gas exploration, power; agriculture and fisheries; forestry; human resource development; transport; special economic zones (SEZ); mining; and visa and work permits. In short, the study demonstrated that there are significant economic complementarities between the Indonesian and Indian economies, and that evolving a CECA would have enormous potential for trade and welfare gains that could be further improved by including the trade in services and fostering investment cooperation. The CECA should also be built on, and should go beyond the agreement reached under the ASEAN–India Free Trade Agreement (Joint Study Group, 2009).

On 15 December 2010, Dr. Mari Pangestu, Indonesia's Minister of Trade, led an Indonesian trade mission to New Delhi. The purpose of this visit was to discuss various issues related to increasing bilateral trade between Indonesia and India, and to make preparations for the forthcoming visit of President Susilo Bambang Yudhoyono in early January 2011 in connection with increasing economic relations between the two countries.

The Indonesian delegation comprised senior government officials from the various ministries, including the Ministry of Foreign Affairs, the Ministry of Industry, and members of the Indonesian Joint Study Group on the Indonesia–India Comprehensive Economic Cooperation Agreement (II-CECA), including Mr. Marzuki Usman and Dr. Thee Kian Wie, as well as a number of senior Indonesian government officials and businessmen. The delegation of Indonesian businessmen comprised representatives from the various sectors expected to represent and contribute significantly to increasing trade between Indonesia and India, such as in food processing, pulp and paper, cosmetics and pharmaceuticals, automotive products, textiles, palm oil, machinery, mining, and the creative industries.

During her visit, Dr. Mari Pangestu, the Indonesian Minister of Trade, met Mr. Shri Anand Sharma, India's Minister of Trade and Industry. During this visit, ministers exchanged views on the latest issues connected with multilateral and regional trade. During this meeting, the discussions focused on the results that had been achieved in increasing trade between the two countries, increasing foreign direct investment by Indian investors in Indonesia and foreign direct investment by Indonesian investors in India, and other aspects of the economic relations between the two countries.

During their meeting, the two ministers agreed to elevate the bilateral economic relations by establishing a more focused mechanism at government level as well as at the private level, to expand and to increase trade and investment and economic relations in general. On that occasion, Dr. Pangestu stated that one of the major bases of these bilateral economic relations would be a comprehensive agreement and, where both parties agreed, that it would be necessary to elevate the economic relations between the two countries in the form of a comprehensive partnership to improve, expand and diversify the bilateral trade and investments and other forms of economic cooperation (Pusat Humas, Kementerian Perdagangan, 2010).

This comprehensive partnership could be achieved through an ASEAN–India Free Trade Agreement (AIFTA) and an Indonesia–India Comprehensive Economic Cooperation Agreement (II-CECA), which would be the outcome and the next step arising from the recommendations of the Indonesia–India Joint Study Group. The two ministers also agreed to establish a government-to-government dialogue forum at the ministerial level that would meet every year. This forum would be assigned to find solutions to any problems arising from constraints faced by Indonesian and Indian businessmen as well as to facilitate and increase the trade and investments between the two countries (Pusat Humas, Kementerian Perdagangan, 2010).

IV. BILATERAL TRADE BETWEEN INDONESIA AND INDIA

At present, India is not one of Indonesia's major trading partners, as can be seen from the data in Table 1, although the volume of Indonesia's merchandise exports to India has shown a gradually rising trend. For this reason, the market share of India in Indonesia's exports rose from only 1.9 per cent in 2001 to 3.4 per cent in 2005. The reason for these low percentages is that India's market is more protected than is Indonesia's.

On the other hand, Indonesia's imports from India during the same period, 2001 to 2005, were slightly smaller than its exports to India. For this reason, during the above period, Indonesia enjoyed an export surplus. Table 2 below provides more recent data on the merchandise trade between Indonesia and India from 2006 through to 2010.

The data in Table 1 show that through the period 2006 to 2010, Indonesia consistently recorded a trade surplus. In fact, throughout this five-year period, the positive trade balance for Indonesia showed a steadily rising trend. The trade in oil and gas, in terms of exports to, and imports from, India are much less significant compared with the bilateral trade in other products.

The major export products from Indonesia to India are presented in Table 3.

The above table shows that Indonesia's two major export commodities by far are palm oil and its fractions and coal, followed by copper ores, copra and natural rubber, which are relatively less important than palm oil and coal. It should also be noted that Indonesia's major exports to India are primary commodities, reflecting the fact that Indonesia is a resource-rich country. For this reason, too, no manufactured products are among Indonesia's major export products to India.

Indonesia's major imports from India are presented in Table 4.

Table 2. Merchandise trade between Indonesia and India, 2006 to 2010

	2006	2007	2008	2009	2010
	USD	USD	USD	USD	USD
Exports to India	3,390,790.2	4,943,906.0	7,163,336.2	7,432,,892.5	9.915,038.9
Oil and gas	64,340.1	58,945.1	102,483.7	81,531.3	63,831.9
Other	3,326,450.1	4,884,960.9	7,060,852.6	7,351,361.2	9,851,207.1
Imports from India	1,407,423.8	1,609,606.8	2,901,852.2	2,209,356.7	3,294,762.2
Oil and gas	95,751.7	5,204.4	391,526.2	124,433.8	598,741.7
Other	1,311,672.2	1,604,402.4	2,510,326.1	2,084,922.9	2,696,020.5
Trade balance	1,983,366.4	3,334,299.2	4,261,484.0	5,223,535.8	6,620,276.8

Source: Ministry of Trade (2011)

Table 3. Indonesia's major export products to India in 2008 and 2009

Export commodity	2008	2009
	USD (millions)	*USD (millions)*
Palm oil and its fractions	4,109	3,330
Coal	1,232	1,950
Copper ores	272	273
Coconut (copra)	140	150
Natural rubber	71	125

Source: Direktorat Jendral Kerja Sama Perdagangan Internasional (2010a).

Table 4. Indonesia's major imports from India, 2008

No.	Product code	Product label	Indonesia's imports from India
			USD (millions)
1	2710	Petroleum oils, not crude	587.2,
2	2902	Cyclic hydrocarbons	294.5
3	2304	Soy bean oil cake and other solid residues	222.5
4	1202	Ground nuts, not roasted	128.9
5	5201	Cotton, not carded or combed	109.3
	Total	All products	2,659.3

Source: Direktorat Jenderal Kerja Sama Perdagangan Internasional (2010a).

The data in Table 4 show that India's major exports to Indonesia are also primary commodities, reflecting the fact that India too, like Indonesia, is largely a primary commodity exporter. The data in Tables 5a and 5b show the relative position of India as an exporting country to Indonesia and as an importing country from Indonesia over the period 2005–2010.

Table 5a. The relative position of India as an export market for Indonesia's products, 2005–2010

2005	2009	2010
2%	4%	4%

Source: Direktorat Jenderal Kerja Sama Perdagangan Internasional (2010a). p. 12.

Table 5b. The relative position of India as a source of Indonesia's imports, 2005–2010

2005	2009	2010
1%	1%	1%

Source: Direktorat Jenderal Kerja Sama Perdagangan Internasional (2010a).

The data in Tables 5a and 5b show clearly that Indonesia and India are not yet important trading partners, because their bilateral trade is considerably less than 10 per cent, with India's relative position as an export market for Indonesia's products accounting for only 4 per cent in 2010, and India's relative position as a source for Indonesia's imports accounting for a minuscule 1 per cent in 2010.

According to estimates by the Joint Study Group, for the trade in services, Indonesia has a large potential in exporting services to India in the field of computer and related services; telecommunication services; financial services; construction services, and tourism services, although the market for trade in services in India is, just like the case of merchandise trade, less open than in the case of Indonesia. On the other hand, India has a large potential for exporting services to Indonesia in the field of information technology services; telecommunication services; financial services; audio-visual services; health-related and social services; and tourism services. Indonesia and India have also a large potential to benefit by cooperating in the following services: financial, tourism and construction (Direktorat Jendral Kerja Sama Perdagangan Internasional, 2010b).

According to a computable general equilibrium (CGE) model prepared by Dr. Ram Upendra Das, Senior Fellow at the Research and Information System for Developing Countries, New Delhi, on 16 December 2010; there would be an increase in bilateral trade in exports from India over an estimated range of 15.5 to 31 per cent by 2012, and from Indonesia there would be an estimated range of exports of 16 to 32 per cent by 2012. The estimated welfare gains from this increased bilateral trade would amount to 1.0 per cent of GDP for India, and the estimated welfare gains for Indonesia would amount to 1.4 per cent.

However, to achieve these goals, India would need to lower its protectionist trade barriers, which, in general, are higher than Indonesia's. For instance, India's domestic regulations relating to foreign trade and foreign investment are not so transparent. Some sectors, such as agriculture and the textile, garments, and automotive industries, are still protected by high tariffs. In India, import tariffs against agricultural products vary from one state to another and in addition agricultural products are burdened by additional duties and uncertainty by the imposition of quota-equivalent tariffs. Imports of textiles and textile products have also to be accompanied by pre-shipment certificates to certify that the products do not contain dangerous materials (Direktorat Jenderal Kerja Sama Perdagangan Internasional, 2010b)

V. FOREIGN DIRECT INVESTMENT

Although there were some Indian overseas direct investment during the early 1960s, notably in East Africa, direct investment by Indian private firms only picked up since the late 1960s. With the steady progress that has been made in manufacturing, several Indian firms found themselves in a position to make direct investments in other countries, particularly, but not exclusively, in other developing countries. Having embarked on industrialisation earlier than most other developing countries, including Indonesia, Indian firms have acquired sufficient industrial and technological capabilities and managerial abilities to share their experience with other developing countries. Indian firms, in several respects, were, more than most industrialised countries, suited to undertake direct investment in other developing countries because of the considerable experience they have gained in adapting and modifying advanced technology to suit their own country's peculiar conditions and requirements (Thee, 1981).

In addition to this technological advantage, some Indian investors also felt that their management of their overseas enterprises might be psychologically more in tune with the psycho-social conditions of a developing country; particularly by displaying a greater tolerance and understanding of their local employees than would Western managers. Another reason why India has undertaken direct investment overseas is that their foreign ventures are earning precious foreign exchange for India in the form of dividends, royalties, technical know-how fees, engineering service fees and other fees (Thee, 1981).

Like other big developing countries, such as Brazil and Mexico, India's route to direct overseas investment has probably been enabled by its initial industrial success in its own large and growing domestic market; success that subsequently led to exports. With the rise in protectionism in other developing countries, including Indonesia since 2010, a result of the flood of Chinese manufactured exports entering their markets, it was only natural that Indian firms would gradually turn to setting up their own investment projects in other developing countries, including Indonesia (Thee, 1981).

The first Indian project approved in Indonesia was in 1972, five years after the Suharto Government had opened the door to foreign direct investment by the enactment of its foreign investment law in 1967. By the end of 1978, a total of 18 Indian investment projects had been approved by Indonesia's investment coordinating board, the Badan Kerjasama Penanaman Modal (BKPM) (Thee, 1981).

To give an idea of the most recent realised Indian direct investment in Indonesia, Table 6 presents Indian investment projects in Indonesia, specifically during the first two quarters of 2011.

The data in Table 6 show that during the first half of 2011, Japanese

Table 6. Statistics of foreign direct investment realisation based on capital investment activity by country in 2011

Country	First quarter		Second quarter	
	Projects	Investment *(USD million)*	Projects	Investment *(USD million)*
Asia	477	1847.1	745	1756.2
ASEAN	213	1299.1	310	906
Brunei Darussalam	2	10.5	-	-
The Philippines	1	0.1	4	0.2
Malaysia	60	128.4	95	96.2
Thailand	8	21.4	8	38.1
Singapore	142	1138.8	203	771.4
Asia excluding ASEAN	264	548	435	850.2
United Arab Emirates	3	5.7	2	-
Hong Kong (SAR)	12	6.1	35	8.7
India	15	17.3	22	18.0
Japan	78	345.2	150	289.8
South Korea	109	139.3	133	199.1
People's Republic of China	32	28.4	51	50.7
Taiwan	11	5.1	36	183.8
Jordan	1	0.4	1	-
Qatar	-	-	1	-
Europe	148	604.3	261	833.0
European Union	140	596.3	245	826.7
Other Europe	8	8.0	16	6.3
North America	36	362.1	57	579.3
United States of America	24	359.1	47	577.0
Australia	38	25.7	41	12.5
Western Samoa	3	8.1	3	9.8
New Zealand	1	-	6	-
Vanuatu	-	-	-	-
Africa	16	28.4	24	121.1
Joint countries	187	1528.1	328	1482.3
Total	902	4395.7	1456	4784.3

direct investment and direct investment from the East Asian newly industrialised economies, specifically South Korea, Taiwan and Singapore, and from Indonesia's ASEAN partner, Malaysia, was much larger than Indian direct investment. In fact, Indian direct investment during this period was even less than that of China, the other rapidly growing Asian economy, despite its four decades presence in Indonesia. This low presence may reflect the fact that Indian investors are still largely focused on their own large, rapidly growing, domestic market.

However, in view of their firm-specific assets, including their technological, managerial and marketing capabilities, and their familiarity with the Indonesian market, Indian investors have great potential in several sectors, as indicated above, including food processing, textile fibres, plastics, wood products, agri- and bio-technology products, pharmaceuticals (particularly generic pharmaceuticals), light engineering products, audiovisual products, telecommunications, information technology, and education, in which India has a comparative advantage (Direktorat Jenderal Kerja Sama Perdagangan Internasional, 2010a).

Although there is as yet little Indonesian direct investment because of the perceived difficulty of investing in India, which still has a less liberal policy to foreign direct investment (FDI) than Indonesia has to inflows of FDI, Indonesian investors should have good opportunities to undertake direct investments in the fields in which they are quite competitive, such as the fields of processed food, electrical and non-electrical machinery, chemicals, infrastructure, hotels and hospitality and tourism. Thus far, however, data on Indonesia's direct investment in India are quite scarce, if there are any at all.

VI. CONCLUSION

The Indonesia–India Comprehensive Economic Cooperation Agreement (II-CECA) reflects the strong intention of the governments of Indonesia and India to improve and increase their trading and investment links, as well as business links, which should be of great economic benefit to both countries. Because Indonesia and India have large, rapidly growing economies, they can reap the benefits of their demographic dividend, a consequence of their young population.

Indonesia and India have also been growing rapidly from opening up and liberalising their economies, Indonesia since 1967 and India since 1991. These economic reforms have made both economies more competitive and outward-looking, opening up great potential gains from closer economic relations.

These closer economic relations will also be underpinned by the long historical and cultural links between Indonesia and India and by the mutual appreciation that both countries are democratic, India since its independence in 1947 and Indonesia since mid-1998.

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