



India and Indonesia: Trade and Investment Complementarities



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Summary

India and Indonesia are increasingly seen as emerging Asian economies, and have undergone massive economic reforms in the past two decades. Strong economic fundamentals with a robust financial sector and manufacturing industry have positioned them among the top five investment destinations in Asia. In order to maximise the gains from their bilateral relations, however, the two countries have to tread a middle path; a mix of seeking complementarities in the economic field, while competing with each other in terms of attracting foreign investments. So far, their trade ties have not realised their true potential but there still is a hope that with the signing of the CECA, India and Indonesia will not only achieve the \$20 billion bilateral trade target by 2015, but will also set new benchmarks for a symbiotic economic relationship.

India-Indonesia bilateral trade is at least two millennia old. In fact, trade along with cultural linkages have been the bedrock of the relationship between the biggest countries of South Asia and Southeast Asia, respectively. Close civilizational and historical interconnections, a shared vision on a range of issues, and ethnic and religious commonalities have played a key role in making the two countries complementary to each other in the world community. In the ancient past, the two nations used to trade in spices, timber, minerals, precious stones, cotton and silk. This also helped in the spread of religion and culture. However, in the present context, trade ties have not realised their true potential, which can be attributed to the lack of imaginative planning as well as ignorance on the part of the business communities of the two countries. The financial crisis of 1997/98 had also disillusioned India vis-à-vis Indonesia, which, in the aftermath of the financial crisis, plummeted to an economic low when its currency was devalued against the international basket of currencies. The time that Indonesia took to recover also delayed India's economic and trade engagement with that country. Now that both India and Indonesia are increasingly seen as emerging Asian economies, trade and investment complementarities need to be comprehensively explored.

Historical background

India's trade ties with the Southeast Asian region have been mentioned in classical texts. As H.B. Sarkar points out: 'When we analyse the data, it will be found that the economic motive provided the Indians with an urge for adventure into the lands of Southeast Asia. Even the names given to the countries concerned are in recognition of this urge. The names appear in Kautilya's *Arthashastra*, the *Pali Niddesa*, and the *Jatakas* etc. They have been culled from the world of plants and minerals as in, *Suvarnabhumi* (the land of gold), *Karpurdvipa* (the island of Camphor), *Yavadvipa* (the island of barley).'¹ Ptolemy, the Alexandrian astronomer, also refers to Java as *Jabadieu* - a name which he translates as 'the island of barley'.²

Throughout the colonial period India's connections with Indonesia were in the capacity of two colonies occupied by the British and the Dutch colonial masters respectively. When India achieved independence, it opted for an inward-looking 'mixed economy' model. However, as a result of the continued growth of India's economic transactions with the ASEAN from 1970s onwards, the amount of trade grew in volume. By 1982 the ASEAN countries' share of India's exports, which had been 2.6 per cent in 1970, had risen to 4.2 per cent. During the same period, India's total imports from the region had risen even

¹ H.B.Sarkar, *Cultural Relations between India and Southeast Asian Countries* (New Delhi: ICCR, 1985), pp. 246-47.

² Kalidas Nag, *Greater India* (Bombay: The Book Centre Private Limited, 1960), p. 153.

more, from 0.6 per cent to 5.9 percent.³ In the early 1990s, while India was struggling with its 'balance of payment crisis', Indonesia and other ASEAN member countries were emerging as powerful economies. India's opening up of its economy together with the rise of the 'Asian Tigers' motivated India to look for opportunities in the east. India took a big step in that direction with its 'Look East Policy'.

Over the past two decades India has engaged comprehensively with Indonesia and the region by way of signing and implementing several bilateral and multilateral trade agreements. India has also invested in Indonesia. Though Indonesian investment in the Indian economy is miniscule compared to India's in Indonesia, things are looking up in terms of bilateral trade and economic cooperation.

India and Indonesia: Emerging Economies in Asia

The economies of both India and Indonesia have undergone massive reforms in the past two decades. Among other things, this has facilitated trade, investment liberalisation, fiscal and monetary policy reforms, and infrastructural upgradation. As a consequence, both economies have emerged as dynamic markets⁴ with strong economic fundamentals and a robust financial sector and manufacturing industry. The two economies have been reaping the dividends of low labour costs and have positioned themselves among the top five investment destinations in Asia.

The turmoil and uncertainty gripping the global financial markets and the world economy during the current global financial crisis affected India also. Growth rates declined to 6.7 per cent in 2008, in contrast to 9.2 per cent in 2007 and 9.7 per cent in 2006.⁵ Prompt monetary and fiscal measures were undertaken to enhance demand, boost credit flows, and lower interest rates to counter the slowdown. Some indicators suggest that the government's stimulus package has been effective in reviving growth. Growth is stronger than expected, across categories, such as transport equipment, metal products, textiles, and mining. At the same time, consumer spending continues to gain strength both in durables and non-durables.⁶ Though inflation and unemployment have been issues of concern, economists feel that these would be addressed by the growth momentum.

³ Mohammed Ayoob, *India and Southeast Asia* (London: Routledge, 1990), p. 85.

⁴ Report of the Joint Study Group on the Feasibility of India-Indonesia Comprehensive Economic Cooperation Agreement (CECA), 15 September 2009.

⁵ Asian Development Bank & India FACT SHEET, http://www.adb.org/Documents/Fact_Sheets/IND.pdf (accessed on 14 January 2011).

⁶ Ibid.

As far as Indonesia is concerned, it has experienced strong economic growth since recovering from the 1997 Asian financial crisis. Economic growth accelerated to a 10-year high of 6.3 per cent in 2007 and a respectable 4.5 per cent in 2009, making the country one of the best performers during the global recession. Indonesia has recovered strongly after the initial wobbles when the global financial crisis turned critical in 2008. Following disruptive capital outflows and a precipitous Rupiah depreciation in late 2008, the country steadied itself and recovered quickly. During the course of 2009, its GDP growth has remained positive, unlike that of most of its export-dependent neighbours.⁷ According to reports, at the end of December 2009, Indonesia's international reserves rose to an all-time high of \$ 66.1 billion. Confidence in the country's reserves was further bolstered by currency swap agreements of more than \$30 billion.⁸ Robust economic growth prior to the crisis and sound macroeconomic management during the recessionary phase are reflected in Indonesia's employment numbers. The unemployment rate shrank from 11.2 per cent in 2005—the highest in the previous five years—to 7.9 per cent in August 2009. GDP growth is likely to touch 7 per cent in 2011, driven by domestic consumption and a recovering global economy.⁹

In terms of developmental path undertaken by the two nations, India has been slightly ahead, though Indonesia is not far behind. Post-1997 crisis Indonesia and post-1991 India have been facing the same kind of issues in terms of infrastructure development, foreign direct investment, strengthening of financial institutions, and reducing the tax regime and licensing and bureaucratic hurdles. The point is whether the two nations should seek complementarities in the economic field and match their priorities accordingly, or will they act as competitors?

The answer lies in treading the 'middle path'. While growing economic interdependence and the integration of production networks and strengthening of regional economic institutions tell us that developing economies with leverages in terms of low labour costs are destined to cooperate to achieve growth, it is also true that this becomes difficult when they are competing to attract foreign direct investment. Nevertheless, what actually works to the advantage of India and Indonesia is the fact that while Indonesia is an export oriented economy, India is not. Also, the two nations are not only benefiting from economic cooperation in terms of trade and investment but also from the growing tourism industry. Indonesia was the fourth top tourist destination in ASEAN in 2010 for Indian tourists

⁷ H.S. Kohli and A. Sharma (eds.), *A Resilient Asia Amidst Global Financial Crisis: From Crisis Management to Global Leadership* (New Delhi: Sage Publications, 2010), p. 107.

⁸ See No. 5.

⁹ Ibid.

(about 74,000 Indian tourists visited Indonesia). Visas on arrival have further facilitated the growth in tourism.

Trade and Investment Potential

Dr. Manmohan Singh, prime minister of India and Dr. H. Susilo Bambang Yudhoyono, president of Indonesia, inked a bilateral strategic partnership agreement in November 2005. As part of the agreement, the two sides agreed to increase bilateral trade up to \$10 billion by 2010. Total trade in 2010 surpassed this target, touching \$12 billion; up from \$4 billion in 2005. The two leaders also signed an MoU to set up a joint study group (JSG) to examine the feasibility of a comprehensive economic cooperation agreement (CECA) between the two countries.¹⁰ In order to fully realise the trade potential, India and Indonesia have pledged to increase the volume of trade to the \$20 billion mark by 2015. This is working as the driving force behind the accelerated negotiations on CECA and is likely to create mutually assuring tariff reduction timelines and increased cooperation in the services sector.

India-Indonesia Trade (Year to Year Trends)

S.No.	Year	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
1	Export	1,380.20	2,032.96	2,164.17	2,559.82	3,063.36
2	%Growth	-	47.29	6.45	18.28	19.67
3	%Share	1.34	1.61	1.33	1.38	1.71
4	Import	3,008.11	4,181.96	4,821.25	6,666.34	8,656.66
5	%Growth	-	39.02	15.29	38.27	29.86
6	%Share	2.02	2.25	1.92	2.2	3
7	Total Trade	4,388.31	6,214.92	6,985.42	9,226.17	11,720.03
8	%Growth	-	41.62	12.4	32.08	27.03
9	%Share	1.74	1.99	1.68	1.89	2.51

Source: Export-Import Databank, Ministry of Commerce¹¹

From the table, it is evident that India's exports have almost trebled in the last five years, while the share of imports is equally impressive. Among the important items that India exports to Indonesia are gems and jewellery, mechanical equipment, and raw minerals, while in the case of Indonesia it has been chemicals, hides and skin, engineering products,

¹⁰ No. 4.

¹¹ <http://commerce.nic.in/eidb/iecnt.asp> (accessed on 11 January 2011).

minerals and precious stones. Evidently, the two nations complement each other in a number of areas. Trade meetings and delegation level talks could do more to promote better trade, and government to government contact would reassure the business community of both countries.

Cooperation in the Energy Sector

Coal accounts for over half of India's total energy generation. More than 50 per cent of India's domestic coal production is utilised for power generation while three-quarters of India's electricity is generated from the more than 80 coal-fired thermal plants. According to India's minister of state for coal, Shriprakash Jaiswal, coal imports are likely to rise by 21 per cent over 2011. He added that though local production has increased by about eight per cent, energy requirements have risen by 15 per cent.¹² This clearly indicates that India is in dire need of reliable and long-term coal imports, without which domestic demand cannot be met.

India's major source of imported coking coal is Australia, while Indonesia is the main source for non-coking coal. The close proximity of Indonesia to India compared to other source countries gives it a freight advantage.¹³ Indian companies have been looking for mining rights and even joint ventures with their Indonesian counterparts for securing long term supplies of coal. In August 2007, Tata Power acquired a 30 per cent stake in the Indonesian energy giant PT Bumi Resources, by paying close to \$1.3 billion (Rs. 6,000 crore). Anil Dhirubhai Ambani Group's Reliance Power also acquired three coal mines in Indonesia and plans to invest over Rs. 3,000 crore in that country. In June 2010, it announced that it plans to buy two Indonesian coal companies through its unit, Reliance Coal Resources. Coal from Indonesia will be used for the Krishnapatnam ultra mega power project and others.¹⁴ GMR Energy has acquired full ownership interest of the Barasentosa Lestari coal mine in Indonesia, by investing Rs. 400 crore. With the acquisition of the Aries mines, the Essar Group has become the fourth Indian business house to buy coal mines in Indonesia. In the past two years, almost all power giants - NTPC, Essar Power, Adani Power, JSW Energy, Indiabulls Power and Lanco Infratech - have been exploring options to own coal mines in Indonesia, to fuel some of their proposed projects.¹⁵

¹² <http://www.commodityonline.com/news/India-s-coal-needs-to-get-more-pressing-28021-3-1.html>. (accessed on 11 July 2010).

¹³ Ibid.

¹⁴ <http://timesofindia.indiatimes.com/business/india-business/Reliance-Power-to-buy-two-Indonesian-coal-companies-/articleshow/6031142.cms> (accessed on 15 January 2011).

¹⁵ <http://www.business-standard.com/india/news/essar-buys-100-mt-indonesian-coal-mine-for-rs-900-crore/389791/> (accessed on 15 January 2011).

Moreover, Coal India Ltd has proposed the development of a coal block in Indonesia in a joint venture with the country's state sector. The proposal was mooted at the India-Indonesia working group meeting held in Jakarta in June 2010. An agreement with the Indonesian government will help CIL gain a foothold in India's largest sourcing point of thermal coal.¹⁶ The power trading utility PTC India has also entered into a five-year agreement with an Indonesian firm to purchase 700,000 tonnes of Indonesian coal a year for selling to power projects in India.¹⁷ NTPC is also looking to purchase two mines in Sumatra and East Kalimantan, which might together have as much as 1.8 billion metric tons of coal. The purchase is likely to be completed by March 2011.¹⁸ All this clearly shows that coal would be the bedrock of the burgeoning energy relations between the two nations.

Investment and Manufacturing Sector

The India-Indonesia JWG notes that while the two countries are destinations of FDI inflows, they have also emerged as sources of outward investment in different sectors. The JSG adds that the proposed CECA would facilitate more investment within a cooperative framework to promote increased investment flows between the two countries alongside stronger investment facilitation. Some of the sectors in which Indonesia can invest in India include chemicals, infrastructure, hotel, hospitality and tourism, hybrid-seeds, processed food, electrical and non-electrical machinery etc., whereas Indian investment into Indonesia could be in areas such as agri-biotech, food processing, textiles, plastics, pharmaceuticals, light engineering, telecommunications, and IT products. Specific areas of mutual interest which both countries can exploit in close collaboration include energy (oil and gas exploration), agriculture and fisheries, forestry, transportation, SEZs, etc.¹⁹ The two nations need to outline the priority areas for cooperation both in terms of investment and growth.

Services Sector

With reference to the trade in services, the JSG identifies several sectors for enhanced cooperation between India and Indonesia. These include IT, telecommunications, financial, audio-visual, education, health, tourism and travel, professional services, and

¹⁶ <http://www.thehindubusinessline.com/2010/06/19/stories/2010061952320200.htm> (accessed on 12 November 2010).

¹⁷ http://coal.energy-business-review.com/news/ptc_india_signs_agreement_to_buy_indonesian_coal_100723 (accessed on 13 January 2011).

¹⁸ <http://www.thejakartaglobe.com/business/indonesian-coal-mines-in-sumatra-kalimantan-draw-interest-from-indias-ntpc/393658> (accessed on 17 January 2011).

¹⁹ No. 4.

transportation. Facilitation of dialogue between the regulatory bodies of the two countries for possible Mutual Recognition Agreements (MRAs) is important in this regard.²⁰ There is also a need to clear the cobwebs on phyto-sanitary regulations as well as legal assistance to traders in case of dispute. Further, it is also necessary to have a review process between the two nations which would come into force when the negotiations on the matter are completed.

Conclusion

In the overall analysis, it can be said that economic and trade complementarities between India and Indonesia are immense and, therefore, there is a need for the two countries to sort out the nagging issues and clarify doubts. For its part, Jakarta needs to understand Indian sensitivities about the re-export of Chinese goods and the liberalisation of Indonesia's services sector. The two nations should also work to sort out issues related to MRA in a spirit of co-operation. Finally, India and Indonesia need to sort out doubts about certain tariff reduction in select sectors, if they are to further boost their bilateral trade ties.

²⁰ No. 4.