Bilateral Relations between Australia and Indonesia: Economic Aspects

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In 1935 a young Australian economist writing about Australia's trade with the Dutch East Indies said optimistically: "We have a picture of two countries whose trade relations are largely complementary, each providing goods the other needs and cannot conveniently produce itself."[1]

One technique -- almost a professional trick -- that economists have found surprisingly useful is to analyse economic phenomena in several separate steps. The first step is to abstract from a multitude of real world complications by assuming that markets operate perfectly to obtain an "ideal" economic picture of the world. Second, allowance is made for real world "market failures" (such as monopolies and externalities) which lead to distortions from the "ideal" economic model and which might justify intervention by government. And third, the consequences of possible "government failure" (bureaucracy, inefficiency, misuse of power) are allowed for by weighing the potential benefits to be gained from government regulation of economic activity against the costs.[2] It is useful to consider bilateral economic relations between Australia and Indonesia within this framework.

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[1]J.G. Crawford, quoted in Arndt (1968)

[2]Attention to the effects of government failure is a relatively new phenomenon in the economics profession. As Rhoades (1985) notes, "Twenty years ago economists wrote about market failure but rarely about government failure. Today they consider both."

THE ECONOMIC IDEAL

Recently, Han Herderschee and Helen Hughes (appropriately referred to as H4 at an Indonesian conference) summarised the ideal as follows (1986):

> To a Martian economist the location of Australia, Indonesia and Papua New Guinea would suggest intensive economic relations: but geographic proximity should lead to low transport costs. The three countries, moreover, have marked differences in actual resources and are at different levels of development with concommitantly different endowments of labour and human and physical capital that might be thought to encourage specialisation through trade. Such specialisation is realised to some extent in aid, investment and trade flows between Indonesia and Papua New Guinea.

More formally, the main factors of production and economic characteristics which might, in the absence of market distortions, be expected to affect flows of both factors and goods between the two countries are shown in summary form in Table 1.

Table 1

SCHEMA OF ECONOMIC CHARACTERISTICS

Factors of production and economic characteristics	Indonesia	Australia
Land	Acute shortage in Java; shortages (which may be partly due to lack of capital for infrastructure) are becoming evident in the Outer Islands	Abundant
Climate	Tropical	Mainly temperate
Other land resources	Oil rich	Mineral and energy rich
Labour		
Unskilled	Abundant	Shortage
High skilled	Acute shortage	Abundant
Capital	Very scarce	Insufficient
Technology	Very low to low	High
Entrepreneurship	No shortage of risk-takers, but managerial resources are very scarce	Managerial capacities generally adequate. Risk-taking behaviour not common

To a substantial extent, even this rough schema is useful as a partial explanation of the state of economic relations between Australia and Indonesia (Tables 2 and 3). In agriculture, modest trade occurs which reflects the natural characteristics of each country. Australian exports wheat to Indonesia, and Indonesia sends small quantities of tropical beverages (coffee, tea, cocoa) and some timber products in return. In the minerals sector, oil is an important export from Indonesia, while Australia sends small amounts of coal to Indonesia

Table 2

AUSTRALIAN EXPORTS TO INDONESIA BY COMMODITY
A$million

	1974-1975	1979-1980	1983-1984
Food, Beverages, Tobacco	96	133	125
Chemical Products	4	10	12
Combustibles and Fuels	1	32	32
Paper and Printed Matter	1	2	2
Textiles and Clothing	1	4	6
Mineral Products	2	6	6
Base Metals	25	66	84
Machinery	30	13	22
Vehicles	—	3	7
Rubber Products	—	—	1
Wood and Cork Products	—	—	—
Hides and Leather	—	—	—
Other	11	20	100
Total	171	289	397

Source: Australian Bureau of Statistics, *Australian Exports and Imports.*

Table 3

AUSTRALIAN IMPORTS FROM INDONESIA BY COMMODITY
A$ million

	1974-1975	1979-1980	1983-1984
Food, Baverages, Tobacco	12	47	53
Chemical Products	—	—	—
Combustibles and Fuels	1	171	217
Paper and Printed Matter	—	—	—
Textiles and Clothing	1	6	9
Mineral Products	—	1	1
Base Metals	—	—	—
Machinery	—	—	1
Vehicles	—	—	—
Rubber Products	2	11	12
Wood and Cork Products	2	2	3
Hides and Leather	—	—	—
Other	1	2	3
Total	19	240	299

Source: Australian Bureau of Statistics, *Australian Exports and Imports.*

for use in electric-power generation. In the manufacturing sector relatively little trade occurs, principally because both countries can do better than buy from each other. Australian manufacturers appear to have a modest reputation for competitiveness in some lines of agricultural equipment, but are unable to compete with east Asian manufacturers from Japan (in heavy industrial machinery and high quality manufactured products) and from the newly industrialising countries in light of consumer goods. At the bottom end of the manufacturing ladder, for a range of reasons, Indonesia has found it difficult to compete in international textile and clothing markets, although exports of these commodities have started growing quickly from a very low base during the past few years. In services too, trade between Australia and Indonesia is modest. At first glance this would puzzle a Martian visitor. On the basis of relative labour factor endowments one would expect considerable trade in services to occur (Indonesian guest workers in Australia, Australians selling services such as education to Indonesia).

In free markets economists expect that factors of production, as well as goods, will be mobile. In the absence of barriers (either natural, or government-created), presumably a good deal of labour would move backwards and forwards between Australia and Indonesia. Much of the income that would be generated if this occurred would be recorded as service trade, so to some extent the explanation for the low level of service trade is that labour is not very mobile. This would hardly satisfiy a Martian visitor however, because the Martian would simply face the new puzzle of why more labour movement does not occur. Capital mobility between the two countries is also rather low (Table 4). It is true that both countries are capital importers, and that both are the recipients of large amounts of capital inflow from the US and Japan which is only to be expected. Nevertheless, the flow of capital which has occurred from Australia to Indonesia is tiny, and the absence of any significant capital flow is a phenomenon which needs some explanation. (The foreign aid provided by Australia to Indonesia is also a form of capital movement, but it is largely government induced and would probably be very small in the absence of government intervention. Foreign aid will be discussed separately below).

This brief survey suggests that in the "ideal" economic world there would be a great deal more economic interaction between Indonesia and Australia

Table 4

AUSTRALIAN DIRECT INVESTMENT ABROAD - NUMBERS OF ENTERPRISES
(as of 30 June)

Country	1978	1979	1980	1981	1982	1983
Australian Enterprises investing abroad						
Indonesia	30	30	28	28	26	26
Total ASEAN	137	141	139	143	149	169
Total	167	171	167	171	175	195
Foreign enterprises in which investments were held						
Indonesia	32	32	32	33	32	32
Total ASEAN	217	235	245	249	255	279
Total	249	267	277	282	287	311

Source: Australian Bureau of Statistics, Canberra (mimeo.).

than what occurs at present. If this presumption is correct, several questions arise. First, why is there so little economic interaction between the two nations? Is it because of the existence of market failures? Or is it because of government-created barriers to the movement of goods and factors of production? Second, should anything be done to encourage more economic interaction, and if so, what?

Before taking up these questions, it is worthwhile noting in passing the basic presumption -- that economic interaction between the two countries is, in some sense, small -- would bear closer examination. It is often said that trade and investment flows between Australia and Indonesia are small, but it needs to be explained in what sense, precisely, are they "small." Are the volumes of trade and investment "small" in all areas of economic activity, or are there a few niches where significant interaction takes place? If so, what factors explain the existence of these niches? Are they sectors in which Australia and Indonesia have complementarity? Or are there other factors, such as accidental contacts between businessmen, which explained particular success stories? At present, apart from the generalisation that the degree of economic interaction between the two nations seems small, little is known about these matters. Any policy changes designed to encourage closer bilateral economic relations would need to draw on more detailed information than is at present readily available.

DISTORTIONS CAUSED BY MARKET FAILURE[3]

Economic problems are often due to a variety of factors rather than a single cause, but broadly speaking the high cost of trade between Australia and Indonesia, which is often said to be a major barrier to increased economic integration, appears to be due largely to market failure in two areas -- shipping difficulties, and poor infrastructure in Indonesia.

There is little doubt that high shipping costs are a major barrier to trade between Australia and Indonesia. A decade ago, after a detailed study of the issue, an Australian Senate Committee (Australian Parliament, 1975) reported that:

> "Many witnesses ... have given their opinion that the greatest single factor hampering the development of trade between Indonesia and Australia is the high cost of shipping freights, coupled with unreliable and infrequent services. This opinion is not confined to Australians. It has been reported that during a recent trade mission, Indonesian officials more than once expressed the view that Australia was an unsatisfactory source of supply due to the unreliable shipping services. They added, that all things being equal, contracts were placed with Japan, the USA and Taiwan, in preferences to Australia, because of more adequate shipping services from these countries which consequent high probability of receiving deliveries on schedule."

[3]Economist generally acknowledge that free markets might fail to produce socially acceptable outcomes for three main reasons: (1) the existence of monopoly power; (2) because "public goods" are needed, and (3) externalities often exist.

The Committee concluded that:

> "The outlook for improvement in the short term is not good. The theoretical advantage of relatively low freights that Australia and Indonesia should obtain from their proximity does not in practice exist."

Much anecdotal evidence suggests that little has changed in the succeeding ten years.

There does not appear to be any single cause of high transport costs between Australia and Indonesia. Rather, a variety of factors all contribute to the unsatisfactory situation, of which the most important are irregular shipping services partly attributable to low volumes of trade; port delays (partly due to industrial disputes) on the east coast of Australia, and cartelised shipping conference arrangements which involve both price and non-price restrictions. In addition, for many years two major problems at the Indonesian end imposed further costs: poor port facilities (which reflected market failure in capital flows due to externalities), and a range of government-induced price and non-price impositions on trade (which are best considered, technically, as examples of "government failure"). In recent years these two latter factors have become less important, although there is still clearly scope for improvement. The Indonesian Government has invested heavily in port infrastructure, and more dramatically, in April 1985 a sweeping simplification of port administrative procedures was introduced when the new Inpres 4 procedures were announced by President Soeharto.[4] The latter step, in particular, represented an unexpectedly large step towards both deregulation and privatisation of administration procedures in a section of the Indonesian bureaucracy which had hitherto resisted all significant attempts at reform.

DISTORTIONS CAUSED BY GOVERNMENT FAILURE[5]

It is difficult to avoid the conclusion that part of the explanation for the low degree of economic integration between Australia and Indonesia is to be found, directly or indirectly, in the patterns of official controls that have been established by both governments. To say this is not, obviously, to suggest that official controls are inappropriate. Rather, the essential point that needs to be borne in mind is that economic controls (such as import tariffs) which are imposed in pursuit of certain objectives (say, protection of domestic industry) inevitably have side effects and costs (such as the restriction of imports and of

[4]For details, see recent issues of the *Bulletin of Indonesian Economic Studies.* The Inpres 4 changes naturally attracted much discussion in Indonesian newspapers.

[5]The term "government failure" is used here in the technical sense.

bilateral economic relationships). The side effects are generally unintended, and because they lack "transparency" often go largely unnoticed and unmeasured.

There at least four types of restrictions on economic relationships which the Governments of Australia, or Indonesia, or both, have introduced in pursuit of important social and equity objectives: (1) tariffs on imports, (2) other non-tariff barriers (NTBs), both on imports and on domestic economic activity, which restrict bilateral economic relations, (3) controls, such as immigration regulations and licensing requirements for businessmen and staff, on the mobility of labour, (4) domestic regulatory requirements, particularly in Australia, which have had the side effect of reducing incentives to compete in international markets. Each of these types of restrictions can be considered briefly.

Tariffs

One view, strongly put by Herderschee and Hughes for example, is that "tariffs are **the** principal obstacle to the expansion of trade" between Australia and Indonesia (emphasis added). More specifically, reviewing economic relations between Australia, Indonesia, and Papua New Guinea, which they conclude are "negligible and ... not likely to increase in the near future," Herderschee and Hughes argue that "The real barriers to trade are the high existing tariffs in Australia and Indonesia and quantitative restrictions and a threat of protection in Papua New Guinea."

On the one hand, Herderschee and Hughes doubt that Australia is likely to become an important marked for Indonesia. For one thing, the preferential access that Indonesia enjoys into the Australian market is small. For another, prospects for Indonesian exports appear a good deal brighter in the Northern Hemisphere:

> "Indonesia ... has preferential access to large markets such as the EEC, Japan, and the United States. In the long run these markets offer better prospects for most products than Australia. Tariff concessions and the geographic proximity (of Australia) hardly offset the disadvantages of exporting to the relatively small and protected Australian market."

On the other hand, evaluating the prospects for increased exports from Australia to Indonesia (and, in this context, Papua New Guinea), Herderschee and Hughes conclude that trade liberalisation is likely to yield benefits:

> "The potential for future exports to Indonesia and Papua New Guinea depends on the development of the tariff policy in these countries. If their policies become more inward-looking,

> imports will consist largely of investment and intermediate products; with outward-looking export-oriented policies, their imports will conclude consumer goods as well. In both cases Australian firms could participate in their import growth if they can compete."

Most Australian economists would draw special attention to the qualification contained in the final four words.

Nevertheless, important though tariff barriers are, they are only part of the explanation for the low level of economic interaction between Australia and Indonesia. In placing such heavy emphasis on the effect of tariffs, Herderschee and Hughes are overlooking both the effects of market failure discussed earlier, and the other types of government failure listed above. The economic arguments for tariff liberalisation are certainly strong, but it seems likely that more than tariff liberalisation will be required to foster substantial economic integration between Australia and Indonesia.

Other Non-tariff Barriers

There is a daunting array of non-tariff barriers in both Australia and Indonesia which stands in the way of closer economic integration.[6] At the Indonesian end, the most well-known of these are the numerous regulatory requirements which businessmen must comply with in order to operate in Indonesia. Part of the problem is that the regulations are often, in themselves, onerous and difficult to comply with. Another part of the problem is the uncertainty that the existence of numerous regulatory and quasi-regulatory agencies engenders because regulations are liable to be changed on a short notice and because regulations issued by one agency sometimes conflict with requirements set down by other agencies. The most recent example of the difficulties which Australian and other foreign investors have run into appears to be in the gold mining industry. In February, the Australian magazine Business Review Weekly (BRW) reported that (Chong 1986):

> "An unprecedented rush for gold mining leases, led by Australian companies, has prompted the Indonesian Government to abruptly shut the gate on all other applicants. A highly-placed source in the Department of Mines and Energy told BRW that the decision to stop receiving new applications, from February 17, was made at a meeting three days earlier.
>
> The decision will come as a surprise and a disappointment to Australian companies planning to apply for a licence to prospect for gold in Indonesia, according to Australian mining sources here."

This story in the Business Review Weekly is similar to dozens of other cases which foreign businessmen in Indonesia have commented on in recent years.[7]

[6]See Ariff and Hill (1985) for details.

[7]See *Prospects for Trade ...*, Australian Parliament (1975), p. 60.

There are difficulties at the Australian end as well, although they are not as well publicised. Non-tariff barriers in Australia and other regulatory requirements (such as preferential procurement schemes) restrict Indonesian access to the Australian market. An example of these difficulties are the quality standards set for goods sold in the Australian market. Australian quality standards are naturally set so as to reflect tastes and conditions considered appropriate for a rich country. But inevitably, many goods produced in Indonesia and in other developing countries using labour-intensive technologies often fall below these standards and therefore tend to be excluded from the Australian market.[8]

Controls on the Mobility of Labour

The visiting Martian economist referred to earlier would glance at Table 1 and expect to find substantial movement of labour backwards and forwards between Indonesia and Australia. The Martian would expect that large numbers of Indonesians, especially Javanese, would take on unskilled jobs at low wages in Australia, while skilled Australians would take up highly paid professional jobs in Indonesia. In the real world, of course, such arrangements are unacceptable for social and political reasons in both countries, and so elaborate systems of government regulatory controls on the free movement of labour have been introduced.

On strictly economic grounds, there would be considerable benefits to both countries if labour was more mobile. Indonesia is in need of export revenues, and apart from oil, one resource that Indonesia has in abundance is unskilled labour. Of course, one way to utilise unskilled labour is to promote the export of labour-intensive commodities, but as we have seen, there are government-created as well as market barriers which restrict access of labour-intensive commodities to the Australian market. A second way to utilise unskilled labour is to export services through "guest worker" arrangements. For the foreseeable future, however, there is no prospect of Indonesia earning export revenues in the Australian market through guest worker arrangements because of social and political concerns in Australia about the consequences of any major changes to her immigration policy.

Indonesia, too, has firm controls on the entry of foreigners into the Indonesian labour market. Foreign investors in Indonesia must justify the employ-

[8]A recent instance of this concerns the import of candles from China to Australia. The Australian Customs service imposed a levy on Chinese candles claiming that the candles had been dumped. A subsequent study by the Industries Assistance Commission was reported to have erred not by taking into account certain factors such as quality (*Sydney Morning Herald*, 10 March 1986). The barriers to trade from developing countries were also discussed in *Prospects for Trade ...*, Australian Parliament (1975), p. 68.

ment of foreign staff to both the BKPM (Foreign Investment Board) and Department of Manpower, and in most other sectors of the Indonesian economy it is extremely difficult for foreign nationals to obtain official permits allowing them to work.

As a final observation, it may be noted that there is a curious symmetry in the existing arrangements which regulate labour movement between Australia and Indonesia: neither country is concerned to restrict the outflow of the type of labour that is relatively abundant at home, but both countries firmly restrict the entry of the type of labour that they are relatively short of. A Martian visitor would doubtless be struck by the paradox.

Domestic Regulations which Discourage International Competition

In both Australia and Indonesia there are many aspects of the domestic regulatory regime which affect the ability of industries to compete internationally. From the Australian point of view, certain elements of the pattern of regulation that have developed within the Australian service sector -- particularly (although not exclusively) the education industry -- are of interest here. A notable characteristic of many Australian service industries is that their survival is dependent on the state rather than the market. As a result, the leaders of these industries (executives, managers and trade union spokesmen alike) have become accustomed to lobbying for additional resources through "political markets" rather than by earning incomes in economic markets. An important consequence of this is that they have become used to operating within a protected Australian market. They are therefore inward-looking and quite unused -- indeed hostile -- to the idea of selling their services at all, let alone overseas. Just as long-term development of the Australian manufacturing sector has been held back by the existence, for decades, of high levels of protection, so the ability of much of the Australian services sector to compete in international markets is being retarded by the protection afforded by the regulatory environment at home.

Examples of inward-looking anti-market attitudes can be found in many parts of the Australian services sector -- education, research of most kinds, the health and legal industries, the arts, transport, and welfare activities, to name a few -- but two cases can be cited which illustrate the general problem. First, during the past year or so, there has been much discussion in Australia about the desirability of and the potential for selling education services overseas. There seems little doubt that the Australian education industry will become increasingly involved in international market because the rewards are attractive. However there is considerable resistance within the highly politicised industry.

Australian journalist, Peter Hastings, referred to commercial opportunities for Australia in Southeast Asia recently but noted that:[9]

> "... whether we are willing to exploit these opportunities is more and more in question. An interesting case is the clear reluctance of some academic staff associations in this country to support the export of tertiary education, an obvious growth industry if properly handled and marketed, on grounds that suggest vested self-interest in maintaining an existing market rather than a desire to exploit a new one. But the opportunities are there. To exploit them requires a major change in our thinking and a much greater acceptance by Australians of Asian neighbours and values."

As Hastings suggests, many academics and teachers are opposed to the concept of selling education at all because it smacks of commercialism and threatens, so they believe, their professional independence.

Similar attitudes are widespread in the Australian scientific and medical research industries. The staff of the CSIRO, a government instrumentality which was established to undertake applied research of benefit to Australian agriculture and industry, are reluctant to undertake income-earning activities outside of the public sector. For example, in March the *Sydney Morning Herald* reported that:[10]

> "A senior research scientist warned yesterday that 'savage' cuts in government grants to the CSIRO's Division of Tropical Crops and Pastures could cost Australia many millions in lost exports."

The same day, the *Canberra Times* carried a story reporting on the call from one of Australia's most emminent medical scientists, Sir Gustav Nossal, for more government support for medical research through the National Health and Medical Research Council. Speaking to businessmen and scientists, Sir Gustav said "If you have the opportunity to impress on politicians the importance of the NHMRC budget, do so." Sir Gustav implied that the alternative, of looking for funds elsewhere, was undesirable. "I don't want to, but we may have to go offshore for backing," he said.

VARIOUS FAILURES

This brief survey of some examples of market and government failure suggests that there is a good deal that could be done to encourage more trade and investment between Australia and Indonesia. In some areas, increased government intervention would seem justified to overcome market failures, while in

[9] *Sydney Morning Herald*, 31 March 1986.

[10] *Ibid*

other areas a reduction of government regulatory controls would probably promote economic integration. Whether the benefits of change outweight the costs is a matter for ministers rather than public servants or academics to decide.

AID

The one aspect of bilateral economic relations which is largely unaffected by market forces is the Australian Foreign Aid Programme. Indonesia is a relatively important recipient of Australian aid since after Papua New Guinea, which is accorded very high priority within the Australian aid programme, Indonesia is the largest recipient. Nevertheless, the flow of aid from Australia to Indonesia is not especially large: in recent years Australian aid to Indonesia has averaged between A$40-A$50 million per annum, which is somewhat less than 5 per cent of the total bilateral aid that Indonesia receives and less than 2 per cent of Indonesian total aid receipts per year (Tables 5 and 6).

Table 5

AUSTRALIAN AID BY SECTOR
(Year ending 30 June)

	Economic Planning, Pub. Admin	Public Utilities	Agric.	Industry Mining Construction	Trade, Banking, Tourism, etc.	Educ.	Health	Social	Other	Total Bilateral ODA flows
1980	1	17	5	1	—	3	—	1	—	38
1981	2	19	5	1	—	6	1	1	—	40
1982	2	25	6	1	—	6	1	—	2	44
1983	4	19	6	2	1	9	—	—	2	43
1984	3	20	7	2	1	13	2	1	7	57
1985	3	31	7	2	1	25	1	2	—	72

Source: Australian Development Assistance Bureau.

Table 6

BILATERAL AID TO INDONESIA AND NATURE OF ASSISTANCE.
A$ million (Year ending 30 June)

	Capital Project Ass.	Training Assistance: Project Aid	Training Assistance: Training Aid	Food Aid	Other	Total	As a % of Total Bilateral ODA
1981	21	14	(a)	5	—	40	9
1982	26	13	3	2	—	44	8
1983	18	20	3	—	2	43	8
1984	21	25	3	6	1	56	9

N.B. (a) Included in the Project aid figure.

Source: ADAB. Statistical Research and Reporting Section.
Statistical Summary Australian ODA.

In 1983 the incoming Minister for Foreign Affairs, Mr. Bill Hayden, appointed an independent committee under the chairmanship of Sir Gordon Jackson to review all aspects of the Australian aid programme. The "Jackson Committee" presented its report in early 1984. The Jackson Report was in turn examined by the Australian Parliamentary Joint Committee on Foreign Affairs and Defence under the chairmanship of Gordon Bilney M.P., which presented a report to the Australian Parliament in May 1985. In November 1985, in a major speech to the Australian Parliament, Mr. Hayden accepted the broad thrust of both of these reports on behalf of the Australian Government. This thorough process of review of the Australian aid programme which was the most detailed examination of the programme that has ever been undertaken in Australia, established a number of guidelines which will have an important influence on the Australian aid programme in Indonesia during the next five years or so. Of the many aspects of the aid programme which these reports commented upon, may be discussed in more detail here.

Objectives

One of the first tasks that the Jackson Committee was obliged to undertake was the clear definition of the objectives of the aid programme. This was discussed in chapter 1 of the report entitled "Why Give Aid"? The clear conclusion of the Report was that Australian aid is primarily given for humanitarian purposes, but not solely for humanitarian purposes. The basic premise of the Report, therefore, was that the Australian aid programme has multiple objectives:

> "Aid is given primarily for humanitarian reasons to alleviate poverty through economic and social development ... Aid also complements strategic, economic and foreign policy interests, and by helping developing countries to grow, it provides economic opportunities for Australia."

This conclusion was vigorously criticised. On the one hand, the Committee was criticised for failing to give greater emphasis to humanitarian and development objectives. One the other, business lobby groups and the Department of Trade were unhappy because the Committee had not given higher priority to commercial goals. After a careful evaluation of the various views expressed by different community groups, both the Parliamentary Joint Committee and the Minister for Foreign Affairs endorsed the broad objectives defined by the Jackson Committee. Mr. Hayden summarised the Government's position in the following terms:

> "Primarily, these programmes grow from a humanitarian concern for our fellows. There is no point, however, in being coy about the fact that our aid programme also has our political

> and economic interests firmly in sight ... the Government, in other words, maintains a balance of motives in our aid programme -- a necessary and perfectly defensible balance -- between our humanitarian concern for our fellow human beings and our economic and political interests."

In this matter, the Jackson Committee, the Parliamentary Joint Committee and the Australian Minister for Foreign Affairs have all been completely frank in defining the precise objectives of Australian aid policy. This is to the benefit of donor and recipient alike.

Regional Priorities

A second important aspect of the recommendations contained in the Jackson Report was the shift in the geographical allocation of Australian aid that the Report foreshadowed. For a range of reasons, the Committee suggested that it is desirable that the amount of aid that Australia provides to Papua New Guinea should decline slowly in real terms. The Committee did not specify, in geographic terms, where Australian foreign aid expenditures should rise, but it seems likely that there will be long term tendency for Australian aid to be increasingly directed towards Southeast Asia, China, and South Asia. Within this context, considering the difficult development problems that still exist in Java and eastern Indonesia especially, it seems likely that Australian aid to Indonesia will rise steadily in real terms.

Country Programming

A third significant recommendation contained in the Jackson Report was that country programming should become an integral part of the bilateral aid programme:

> "... aid strategies should be developed ahead for five years or so on an indicative forward-rolling basis. Country analyses and aid strategy formulation should be the core of aid programming. Projects and programmes should be carefully prepared and praised against a country's development background in detailed financial and socio-economic terms."

As a step in this direction, several draft country programmes, including an ADAB country programme for Indonesia, have already been prepared within ADAB. Naturally no programme would be finalised without consultations with the government of the recipient country, and in the case of Indonesia, the ADAB draft programme has already been discussed in broad terms with Indonesian officials. Further discussions will take place. From Australia's point of view, the preparation of country programmes will assist considerably in the formulation of a consistent approach to the provision of aid. Hopefully, the preparation of country programmes will be useful to the governments of the recipient nations as well since the arrangements for the delivery of Australian aid will become more predictable.

Mixed Credit Arrangements

In recent years there has been an increased tendency for donor nations to combine aid with other financing arrangements to subsidise trade to developing countries. The Jackson Committee took the view that the use of "mixed credits" introduces a distortion into the aid process, and from the development assistance point of view is undesirable. As the Jackson Report put it:

> "Several donor countries are increasingly manipulating aid programmes to promote the exports of their goods and services ... such policies not only diminish the value of aid to recipients but are 'beggar my neighbour' in nature with regard to other donors."

The Committee's views on this matter, as the Parliamentary Joint Committee put it, proved amongst the most contentious in the Jackson Report. The Joint Committee went on to observe that:

> "Critics of the Jackson Committee's views, in the business community, have been virtually unanimous in calling for: (1) increased tying of the aid programme; (2) an improved range and increased funding of direct financing mechanisms such as DIFFs; (3) a much closer integration of trade and aid policies with much greater weight being given to economic and commercial considerations."

It was against this background of controversy that in his speech to the Australian Parliament in November 1985, Mr. Hayden emphasised the Australian government's primary commitment to development goals:

> "There is no reason why industry should not take part in our aid programme so long as equity and effectiveness remain the primary considerations and so long as this guiding principle is strictly observed: the aid must be good for the recipient."

In view of these guidelines, the increasing reliance by donor and recipient nations on mixed credit arrangements in the Asian region poses substantial problems for Australia as a donor nation. Should Australia join with other countries in, as the Jackson Committee put it, "manipulating aid programmes to promote the exports of their goods and services" or not? If reliance on mixed credit arrangements continues to grow within the Asian region, as it has during the past few years, it will become increasingly difficult for Australia to resist the pressures to match the hidden trade subsidies which are being offered by other donors.

CONCLUSION

The degree of economic integration between Australia and Indonesia is low. The reasons for the low degree of economic integration are unclear, but it seems that there is no single factor which stands in the way of closer bilateral relations. Rather, a combination of factors is involved. This situation is unlikely to change significantly in the foreseeable future because substantial policy changes would be needed in both Australia and Indonesia to promote closer economic integration. In both countries, there would probably be significant opposition to the types of policy changes which would be needed.

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