VIEW

Indonesia

Lessons for the US–China Geo-economic Competition

Kyle Richardson

Indonesia is the world's fourth most populous nation (273 million people) and abuts the globe's busiest trade route (the Straits of Malacca); as such, Indonesia is on track to become the world's fourth-largest economy by 2050.[1] Indonesia will be a major venue for US–China geo-economic competition in the Indo-Pacific. It was no accident that Pres. Xi Jinping chose Jakarta to unveil China's proposal for a Maritime Silk Road in October 2013, a plan that evolved into China's global Belt and Road Initiative (BRI). Pres. Joko "Jokowi" Widodo embraced the BRI to help solve Indonesia's infrastructure needs, signing deals worth billions of dollars in Chinese investment. At the same time, Jokowi established Indonesia as a model for how a developing nation can protect itself from undue Chinese influence by setting key conditions on BRI projects and pursuing alternate foreign investment partners. Despite providing development finance to Indonesia for decades, Washington was slow to incorporate its efforts into the US regional vision of a "free and open Indo-Pacific" (FOIP). The delay gave Beijing an opening to present itself as the partner of choice for infrastructure development and allowed the BRI to dominate public discourse.

The United States reasserted itself as a viable BRI alternative with the creation of the US Development Finance Corporation (DFC) in October 2018 and announcement to double the US government's Indonesian investment portfolio by 2024. To offset the BRI's financial advantages, the US launched initiatives to coordinate its infrastructure financing decisions with Japan and Australia and to create the Blue Dot Network to promote adherence to international norms in infrastructure development. However, to compete with the BRI most effectively, Washington will need to continue rebranding FOIP to emphasize its responsiveness in helping Indonesia meet its economic goals. Over the long term, the United States will also need to accelerate industrial policies that close the technology gap with China in 5G, a key infrastructure area where Jakarta remains uncommitted.

Asia's Newest Tiger?

In the two decades since the 1997 Asian financial crisis, when Indonesia's gross domestic product (GDP) contracted by 13 percent, its economy has grown at a robust five-percent annual rate.[2] As a result, Indonesia climbed the world's largest economy rankings from 36th to 16th with a nominal GDP of 1.1 trillion USD in 2019.[3] Per capita GDP grew from 857 USD to 3,800 USD, decreasing the national poverty rate by 50 percent over that span.[4] In 2011, Goldman Sachs economist Jim O'Neil—known for coining the term BRIC (Brazil, Russia, India, and China) as an investment class—included Indonesia in a new emerging market grouping he called MIST, alongside Mexico, South Korea, and Turkey.[5] O'Neil saw the MIST as the "best large emerging economies" worthy of investment.[6] Given current trends, PricewaterhouseCoopers projects Indonesia to be the world's fourth-largest economy by 2050.[7]

Although not a regional commercial hub like Singapore, Indonesia relies on foreign trade as an engine for growth. Indonesia maintains trade surpluses—35.1 billion USD in 2018—while engaging in foreign trade equivalent to 43 percent of GDP, a higher figure than countries with similar populations like Brazil (30 percent) and the United States (27.5 percent).[8] In 2016, China overtook Japan to become Indonesia's largest trading partner, even though Jakarta and Beijing only established full diplomatic relations in 1990.[9] The rapid growth in Indonesia–China bilateral trade is partly attributable to the creation of the ASEAN–China Free Trade Area (ACTFA) in 2010, the first agreement ASEAN made with a nonmember state.[10] In 2019, Indonesia exchanged 77.6 billion USD in goods with China, more than double its trade relationship with Japan (37 billion USD), Singapore (34 billion USD), and the United States (28.6 billion USD). Indonesia's export markets were more balanced. China purchased 27 billion USD (15.1 percent of total exports), Japan 19.5 billion USD (10.8 percent), and the United States 18.5 billion USD (10.2 percent), although the goods were primarily commodities (e.g., coal, minerals, paper pulp, palm oil).[11] Indonesia had a 11 billion USD trade surplus with the United States in 2018, a fact that put it on the radar of the US Trade Representative (USTR).[12] However, USTR has not acted to restrict Indonesian trade to date.

The lack of adequate transportation and energy infrastructure constrains Indonesia's industrial sector, lowering overall growth and forcing the economy to spend a staggering 24 percent of GDP on logistics.[13] First elected in 2014, President Jokowi outlined his vision to transform Indonesia into a Global Maritime Fulcrum (GMF) at that year's East Asia Summit. His administration issued a five-year National Mid-Term Development Plan for 2015–2019 that called for 460 billion USD in investment to improve maritime connectivity, electrification, and transportation.[14] In 2018, the World Bank ranked Indonesia 46th in terms of global infrastructure—up from 53rd in 2014—but identified it as a "top performer" among middle-income countries, ahead of Mexico, Turkey, and Brazil.[15] The rapid improvement resulted from Jokowi's singular focus on infrastructure and the pursuit of foreign investment to make up shortfalls in domestic financing.[16]

Indonesia Embraces the BRI

Following Xi's proposal of a Maritime Silk Road in Jakarta in 2013, China grew from Indonesia's 13th- to its 2nd-largest foreign investor (5.5 billion USD), trailing only Singapore (8.4 billion USD) and just edging out Japan (5 billion USD).[17] In 2016, Indonesia awarded its first high-speed rail construction project—the Jakarta–Bandung High-Speed Railway (HSR)—to a Chinese firm. A Chinese press release referred to the 50-year Engineer-Procure-Construct (EPC) contract to connect Indonesia's two largest cities as the BRI's "flagship" project in country.[18] Although land acquisition issues delayed completion from 2019 to 2021, the Jokowi administration continues to pursue Chinese investment because of its low cost. Chinese state-owned enterprises (SOE) constructing BRI projects can acquire cheap financing from entities like the Chinese Development Bank, which in turn receives large capital infusions from the central government.[19] In essence, Beijing subsidizes its companies to underbid the competition. In March 2019, Indonesia presented Chinese investors with a menu of 28 projects valued at 91.1 billion USD, with the two sides agreeing on 14.2 billion USD in power plant and industrial park investments.[20]

Indonesia as a Model BRI Country: Impose Conditions and Hedge Bets

Even as Jokowi embraced Chinese investment, he took steps to limit Beijing's potential influence on Indonesia's economy. Indonesia's BRI agreements "do not encompass strategic assets like ports," nor do they involve the types of sovereign guarantees that led to the Chinese takeover of a Sri Lankan port facility in 2017.[21] In addition, Jokowi placed four requirements on the projects that will maximize their economic benefit to Indonesia. BRI investment financing generally employs a preferential buyer's credit (PBC) requiring 70 percent of project materials originate from China and that Chinese workers be employed on the projects. However, Indonesia stipulates that BRI projects: (1) use environmentally friendly technologies; (2) employ local labor with limited Chinese workers; (3) transfer technological knowledge to local partners through training programs; and (4) create added value for Indonesian upstream and downstream industries to reduce dependence on extractive industries.[22]

Jokowi's BRI conditions represent not only smart economics but good politics as well. As journalist Nithin Coca notes, "When it comes to public perception in

Indonesia, Chinese money is simply judged differently, engendering emotional reactions in a country where a common barb is that Chinese workers are stealing Indonesian jobs."[23] Indeed, as Chinese investment has grown in Indonesia, so too have the number of official Chinese workers, which doubled to 30,000 since 2013, an indication of the difficulty of enforcing limits.[24] While the figure pales in comparison to Indonesia's workforce of 124 million, the question of foreign investment and workers is a political one. According to Pew Research, the number of Indonesians holding favorable views of China declined from 66 percent in 2014 to 53 percent in 2018, due to concerns of growing economic dependence on Beijing.[25] In the 2019 presidential campaign, opposition candidate Prabowo Subianto criticized Chinese investment as a "one-way street" and blamed Jokowi for not doing enough to protect Indonesian workers.[26] Even after Jokowi won reelection, the deputy chairman of Indonesia's Corruption Eradication Commission, Muhammad Syarif, cautioned the government "to be more careful with investment from China" as Beijing was "trying to expand their economic influence."[27]

To avoid dependence on China, the Jokowi administration courted a diverse array of foreign investment partners. In 2017, Indonesia awarded a medium-speed rail project to connect Jakarta and Surabaya as well as a contract to build the Patimban Port in West Java to Japanese firms.[28] Jokowi targeted Indian investment to build a port in Sabang (Indonesia's northernmost island) with Coordinating Minister for Economic Affairs Luhut Panjaitan stating that cooperation with New Delhi was critical to prevent a single "superpower" from creating regional instability.[29] As the world's largest Muslim country, Indonesia has also pursued investment from the Middle East to hedge against economic downturns in East Asia. During a visit of Crown Prince Mohammed bin Zayed al-Nahyan in April 2019, the United Arab Emirates (UAE) signed deals worth 9.7 billion USD.[30] The World Bank and Asian Infrastructure Investment Bank (AIIB) are also present in Indonesia with 7.8 billion USD and 939 million USD in respective loans since 2016.[31]

US Response: Building on a Long History of Assistance and Investment

The United States has a long-standing, three-pronged economic presence in Indonesia that predates the BRI and includes both direct assistance and infrastructure investment. First, USAID provided Indonesia an average of 177 million USD in development assistance over the past 20 years for projects in the areas of biodiversity, health, and anticorruption.[32] Second, the Millennium Challenge Corporation (MCC), an independent US foreign assistance agency that provides select countries with aid for up to five years, granted 474 million USD to Indonesia from 2013–2018, with a focus on renewable energy and nutrition. The MCC subsequently designated Indonesia as eligible to develop a second compact.[33] Third, the Overseas Private Investment Corporation (OPIC) promoted American private investment in support of Indonesian development goals through an array of financial guarantees. Since 1974, OPIC "committed $2.35 billion in finance and insurance across 116 projects in Indonesia, covering a range of sectors, from energy to healthcare."[34] In July 2018, Jokowi inaugurated Indonesia's first wind plant in Sulawesi, a project OPIC supported with 120 million USD in financing.[35]

To better compete with the BRI, Congress passed the BUILD Act in 2018 to strengthen OPIC, which it renamed as the DFC. The legislation expanded the DFC's investment "tools," doubled its exposure cap to 60 billion USD, and substituted a "requirement" for US involvement in a project to a "preference."[36] This last provision gives the DFC the financial flexibility to invest in local companies for infrastructure development—one of Indonesia's primary requests—thus, giving DFC an advantage over the BRI. At present, the DFC maintains a 125-million USD portfolio in Indonesia focused on energy, manufacturing, and healthcare projects but announced plans in 2019 to double those investments.[37] As an indication of the DFC's growing political clout, its chief executive officer, Adam Boehler, met Jokowi on 10 January 2020 and announced that the DFC "will play a critical role in supporting Indonesia, particularly by developing quality infrastructure that establishes a strong foundation for the country's next stage of growth."[38] The DFC also initiated strategic trilateral investment cooperation with its Japanese and Australian counterparts in Indonesia, a pooling of resources that will help offset the BRI's capitalization advantage.[39]

A final US concern is the lack of an American 5G alternative to compete with China's Huawei. To date, the Jokowi administration has not committed Indonesia to any particular company, although the usual players (e.g., Huawei, Sony-Ericsson) are in the mix.[40] However, the United States can only exert limited influence on Indonesia's decision process by highlighting the potential national security risks to Indonesia of a Chinese-built 5G infrastructure, as the United States currently has nothing of its own to offer. But while Jokowi has demonstrated reticence to rely too heavily on Chinese investment, Indonesia may not have a choice on 5G unless a cost-competitive Western alternative is forthcoming.

Competing Visions of the Indo-Pacific

America's 5G dilemma is reflective of its slow response to the BRI. President Trump first offered the US alternative of a FOIP at the November 2017 APEC Summit in Hanoi, four years after Xi first proposed the BRI.[41] Eighteen months later, the Department of Defense codified the president's vision into four principles, all presented through a security lens. Three of them —respect of sovereignty, peaceful resolution of disputes, and freedom of navigation—were clear references to disputes in the South China Sea. The third principle—"free, fair, and reciprocal trade based on open investment, transparent agreements, and connectivity"—was economically focused, but connectivity was defined as "access to international waters" rather than infrastructure.[42] The Department of State finally released a version of FOIP in November 2019 that incorporated US economic development and infrastructure investment efforts in the region.[43] Unfortunately, the United States only began to link its security-focused FOIP to Jokowi's economic-themed GMF vision starting in 2017.[44] As such, the BRI had a six-year window from its launch in which it appeared more responsive to Indonesia's goals. This placed Washington at a disadvantage in advancing the US regional narrative.

Toward A More Comprehensive US Alternative to the BRI

Indonesia offers valuable lessons for how the United States can retool its efforts to compete with the BRI in Asia and elsewhere. First, Washington can point to Indonesia itself as a model for how to acquire infrastructure financing from China without subversive economic influence. Jakarta's conditions-based approach to BRI agreements combined with its foreign diversification strategy prevents China from dictating the terms. This example could be particularly effective in Southeast Asia, where countries are connected to Indonesia through ASEAN, or in Latin America where large democracies like Brazil and Argentina are also considering BRI projects. The United States should encourage Indonesia to share its BRI best practices with these countries to help them set similar conditions.

Second, Washington must use its economic tools to compete with the BRI. The United States will likely not be able to match the vast financial resources that China is dedicating to the BRI. However, the United States does not need to. Countries like Indonesia have little desire to be beholden to Beijing. They simply need the United States (and other investors) to be present and contributing to their economic needs to drive a harder bargain with China. To that end, the DFC's effort to double its Indonesian investments makes the United States a visible BRI alternative. The signing of the US–Indonesia "Cooperation Framework to Strengthen Infrastructure Finance and Market Building" in September 2020 to facilitate additional private sector investment will build on that effort.[45] US initiatives to coordinate infrastructure investment decisions with Japan and Australia, two countries with large stakes in Indonesia, are also a smart way to offset China's larger financial resources. Washington should seek to coordinate similarly with other allied investors in Europe and the Middle East. With fewer resources, the

United States must also commit to high quality investments. BRI projects often result in shoddy construction, delayed completions, and a high use of foreign workers. US projects should be well-built, on time, and use domestic labor to create a positive contrast for American investment. The US–Japan–Australia Blue Dot Network initiative—launched in November 2019 to promote transparency in infrastructure through an evaluation and certification process involving governments, the private sector and civil society—will help to distinguish these projects from their BRI counterparts.[46]

Third, the United States needs to market the economic scope of its revised November 2019 regional vision. Part of what makes the BRI successful is its branding and focus on meeting the infrastructure needs of developing economies. Viewed from Jakarta, it made little sense for the United States to offer a security-focused narrative as the initial alternative in 2017. The revised version of FOIP must now emphasize how American development assistance and infrastructure investment, which are long-standing, will increase and adapt to help countries like Indonesia achieve their economic goals. This is important because the BRI operated with little opposition for six years, developing a name recognition that far exceeds the FOIP.

Fourth, the United States needs to address critical areas of the ongoing geo-economic competition where it does not possess the tools to win and where a better narrative will not mask its deficiencies. The development of 5G infrastructure is one of those areas. To compete with Huawei, the United States cannot only ban the company from its market and convince its allies and partners to do likewise. The United States will need to accelerate efforts to engage its domestic telecommunications and technology companies to craft an industrial policy that facilitates the necessary investment and infrastructure development to make 5G viable and exportable. In January 2020, a bipartisan group of senators introduced legislation—S.3189, the Utilizing Strategic Allied (USA) Telecommunications Act—which would provide 750 million USD in grants to accelerate the deployment of domestic 5G networks and another 500 million USD to promote adoption of non-Chinese alternatives abroad.[47] In August, the Trump administration announced the release of additional spectrum for commercial 5G development.[48] As domestic 5G development will take time to scale, the United States should work with allies to promote the best non-Chinese alternatives (i.e., Sony-Ericsson or Nokia) available today in Indonesia and elsewhere.

Finally, the United States should leverage the BRI to undermine China's stranglehold on global manufacturing. China's rapid economic growth was fueled through a combination of cheap labor, foreign technology, and infrastructure that facilitated its development into a manufacturing juggernaut.[49] However, other countries possess cheap labor as well, and multinational firms are now looking to diversify supply chains after the disruptions of the US–China trade war and the COVID-19 pandemic. China's robust infrastructure provides it with a comparative advantage. If the BRI, DFC, and other foreign investment help Indonesia close the infrastructure gap, then it will become an attractive option for businesses looking to build new factories. To that end, the United States should promote Indonesia as an investment opportunity for US firms looking for non-Chinese production locations. Indonesia's enormous internal markets make it an attractive location to produce both for domestic consumption and for export to the world.

Conclusion

Jakarta's embrace of the BRI and China's newfound status as Indonesia's largest trading partner and second-largest investor should not be of undue concern to Washington. Jakarta is traditionally nonaligned and wary of becoming too dependent on Beijing (or any nation) for strategic as well as domestic political reasons. For this reason, Jokowi has set the conditions for Indonesia's engagement with the BRI and hedged his investment bets. He will no doubt continue to triangulate between Beijing and Washington (as well as Tokyo and New Delhi) to reap the rewards of the geo-economic competition for Indonesia's own gain. This is a model for other countries to follow. It is also the reason the United States and its allies need only compete to keep Indonesia from falling under Beijing's sway. Fortunately, the United States is already doing so through the wide array of foreign assistance tools (DFC, USAID, MCC) at its disposal, but there is room for improvement. The American alternative to the BRI will require creating a US industrial policy that closes the 5G gap and communicating a vision that responds to regional desires for better infrastructure. In Indonesia, the United States has a good story to tell. ✪

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Mr. Richardson is a Foreign Service Officer with the Department of State and wrote the first version of this essay earlier this year as a student at the National War College. The piece received second prize in the national Secretary of Defense Essay Competition for 2020.

Notes

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