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***East Java and Australia:
promoting the business partnership***

Heath McMichael

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Heath McMichael works for the Queensland Trade and Investment Office and is based in Jakarta.

abstract

This paper discusses recent economic trends in one of Indonesia's most important regions, East Java, with a particular focus on the Province's infrastructure development, trade and investment outlook, and the role of the East Java bureaucracy. It examines the pattern of Australian trade with, and investment in, East Java. The paper focuses on particular sectors of the East Java economy that offer the greatest scope, not only for Western Australian companies but for Australian firms generally that are looking for business opportunities outside the increasingly saturated market in Jakarta / West Java.

abbreviations

AMDAL	environmental impact assessment
BAPPEDA	provincial development planning agency
BAPPEDAL	Indonesian Environment Agency
GKS	Gerbangkertosusila
NIP	Ngoro Industrial Park
Rp	Rupiah

***e*ast Java and Australia: promoting the business partnership**

The Australia–Indonesia Ministerial Forum held in Jakarta on 24–25 October 1996 witnessed renewed interest in economic relations between Australia and Eastern Indonesia. The centrepiece of the Forum was the announcement of an Australia–Indonesia Development Area. The announcement flowed from a proposal by Indonesia’s Coordinating Minister for Production and Distribution, Hartarto, for the intensification of sub-regional cooperation between the two countries. Sub-regional partnerships between Australia and Indonesia already exist, including those between Queensland and Central Java and the Northern Territory and Indonesia’s Eastern Provinces. The Western Australia–East Java relationship has entered a phase of further consolidation with the signing in 1995 of a second five-year Memorandum of Understanding between the governments of the two regions.

This paper discusses recent economic trends in one of Indonesia’s most important regions, East Java, with a particular focus on the Province’s infrastructure development, trade and investment outlook, and the role of the East Java bureaucracy. It examines the pattern of Australian trade with, and investment in, East Java. The paper focuses on particular sectors of the East Java economy that offer the greatest scope, not only for Western Australian companies but for Australian firms generally that are looking for business opportunities outside the increasingly saturated market in Jakarta/ West Java.

There are three main reasons why East Java merits attention from Australian business

- its robust economic growth—the Province’s GDP increased at about 7.8 per cent in 1995 in real terms. Per capita income was just over US\$800 in 1995 and at that rate, East Java’s income will double in just over nine years.
- East Java’s emerging international profile—international trade is growing steadily as the local manufacturing sector continues to expand. In Surabaya, three new five-star hotels intended for business visitors and tourists have

opened within the last year and there are now 35 international flights each week to destinations such as Singapore, Hong Kong, Malaysia and China.

- East Java's links to Eastern Indonesia—Surabaya is the pre-eminent trade hub for the eastern archipelago of Indonesia. This includes PT Freeport Indonesia, which supplies its massive gold and copper mining operations in Irian Jaya from Surabaya, and the billion dollar Newmont/Fleur Daniel goldmine in Sumbawa, which is also likely to obtain fresh produce and other supplies from East Java. These links to the east are likely to strengthen as the Indonesian Government gives increased attention to Indonesia's eastern provinces.

East Java's economic outlook

The outlook for growth in East Java remains strong (Tables 1 and 2). With a population of 33 million in 1990, East Java has one of Indonesia's highest provincial GDPs at around US\$25 billion per annum. The Province's growth rate remained above the national average between 1990–1995. Some sectors, for example, building and construction, maintained double-digit growth rates.

Table 1 **East Java in national perspective**

Category	East Java	Indonesia	East Java Share(%)
Population (millions, 1990)	33	180	18
Land Area (thousand sq.km.)	48	1,919	3
GDP (Rp.trillion, 1994)	56	377	15
Exports ^a (US\$billions, 1995)	3	35	9
Investment Approvals (1967–94)			
Foreign (US\$billions)	11	85	13
Domestic (Rp.trillions)	28	283	10
Motor Vehicles (millions, 1995)	2.2	13.7	16
Rice Produced (million metric tons, 1993)	8.6	48.0	18
Corn Produced (million metric tons, 1993)	3.0	7.93	8
Petroleum Refining ^b	2.0	993.1	0.2

Note: ^aExports are non-oil and gas; ^bPetroleum is in million barrels per day, 1994.

Sources: Central Bureau of Statistics; Investment Coordinating Board; East Java Traffic Control Office; Bank of Indonesia.

While lacking natural resources such as oil, timber or minerals, East Java has been able to make the most of geographical diversity, a large population and generally competent bureaucratic administration, to sustain a 'balanced' pattern of growth and development over the last thirty years.¹

Like other parts of Java, East Java is moving from an agricultural to a manufacturing industry and service economy. Table 3 shows how this is occurring: agriculture's contribution dropped from 32 per cent in 1983 to only 20 per cent in 1995, while

industry's share of GDP rose from 16 to 25 per cent. However agriculture still employs roughly half of East Java's workforce.

Table 2 Signs of growing activity

Category	1994	1995	Increase (%)
Energy			
Electricity Produced ^a	7.7	10.2	32
Transportation			
Surabaya Toll Road Traffic			
Total Vehicles (trips)	21.9	30.2	38
Heavy Trucks (trips)	1.7	2.8	65
Juanda Airport			
Passenger Arrivals	1.33	1.56	18
Tanjung Perak Seaport			
cargo handled (million metric tons) ^b	17.2	22.1	28
Trade (US\$billions)			
Exports	2.8	3.3	18
Imports	2.3	3.0	30
Property			
Five-star Hotels (room total)	511	1,409	176

Note: ^a Periods compared are April '93–March '94 versus April '94–March '95, corresponding to Indonesian fiscal years. ^b 1993 versus 1994. All figures in millions unless otherwise specified; Electricity is billions of kilowatt hours produced by PLN, the national electric company (many factories produce their own electricity in-house); export figures are Chamber of Commerce estimates.

Sources: Jasa Marga Toll Road Corporation; East Java Transportation Department; East Java Chamber of Commerce; East Java Statistics Office.

Table 3 Changing economic structure and economic growth

Sector	Contribution to GDP (%)				Economic Growth	
	1983		1995		1995	
	Ind.	EJ	Ind.	EJ	Ind.	EJ
Agriculture	22.9	32.5	17.2	19.5	3.96	5.26
Industry	12.7	16.3	24.3	25.9	11.13	10.73
Trade, Hotel, Restaurant	14.7	19.1	16.4	20.4	7.74	9.21
Others	49.7	32.1	42.1	34.2	10.65	6.20
GDP	100.0	100.0	100.0	100.0	8.07	7.80

Note: EJ is East Java, Ind. is Indonesia.

Sources: Central Bureau of Statistics; Surabaya Post, 24 April 1996.

East Java boasts a number of Indonesia's leading state corporations, for instance the state-owned fertiliser and chemical producer, PT Petrokimia Gresik, the state cement corporation, PT Semen Gresik, which has completed a massive plant expansion for export near the port of Tuban on the northwest coast of East Java, and state plantations producing sugar, coffee, tobacco and cacao.

East Java is also the home of major private sector enterprises such as Maspion Industries which employs over 30,000 people in consumer goods and aluminium manufacturing and the cigarette producer, PT Gudang Garam which is Indonesia's highest corporate taxpayer, with sales per year of around US\$2.5 billion. Key property developers in East Java include Dharmala Corporation, the highly diversified Sekar Group which owns three-quarters of the newly-opened US\$60 million Mandarin Hotel, PT Pakuwon Jati, the owners of the Surabaya Sheraton and PT Sinar Galaxy, the developer of the largest shopping mall in eastern Indonesia.

The Surabaya metropolitan area and the surrounding Gerbangkertosusila (GKS) development region are the jewels in East Java's economic crown. Taking in Surabaya and the centres of Gresik, Bangkalan, Mojokerto, Sidoarjo and Lamongan, the GKS has a total population of 7.2 million people, of which 50 per cent are urban dwellers, accounting for over 40 per cent of the province's economic output. Between 1980 and 1990, the annual increase in population was approximately 1.75 per cent, higher than for East Java as a whole and confirming the trend in migration from rural to urban areas.

With a population of around 2.8 million people and a per capita income three times the provincial average, Surabaya is showing evidence of continuing strong growth. The dramatically-changing skyline in and around Surabaya is arresting, especially when viewed against the city's agrarian economic hinterland; at night, one still sees ox-drawn carts hauling their loads of bamboo scaffolding from one construction project to the next.

Deregulation of the Indonesian financial sector in the 1980s witnessed rapid growth in East Java's finance and capital markets. There are 17 foreign banks with branches in Surabaya, but none from Australia. Leading foreign banks are ABN-Amro, Standard and Chartered, Citibank and Hong Kong Bank. When it opened in 1989, the Surabaya Stock Exchange was Indonesia's first privately owned exchange. While the Jakarta Stock Exchange is thirty times bigger, trading Rp 300 billion a day compared to Surabaya's Rp 10 billion a day, the Surabaya exchange is keen to grow and has begun discussions with the Australian Stock Exchange on training in long-distance trading.

Surabaya is also developing a consumer culture with shopping malls selling luxury goods and fast-food outlets catering to young people who seem to possess ample spending money. One indicator of growing consumerism is the success of Surabaya's 'Time Zone' recreation centre which took receipts of around US\$40,000 on a single Saturday not long after opening in late 1995. It is estimated that Surabaya incomes may be rising by as much as 20 per cent a year and at least 5 per cent of the city's population earn more than A\$50,000 a year. Surabaya has become the shopping centre for the rest of East Java: an estimated 18 million East Javanese bought goods in Surabaya in 1994.

Constraints to growth

Against this pattern of rapid economic growth, however, there are a number of constraints which keep the Province's rate of growth in check.

Water supply. East Java's greatest single handicap is the lack of adequate and reliable supplies of water for industrial and residential use. The water shortage appears all the more critical at the end of the long dry season in East Java. Excessive utilisation of bore water from underground aquifers is leading to salination of Surabaya's water table.

Land acquisition. Land acquisition is a complex and expensive undertaking for private and public sector developers alike. According to the National Planning Agency, BAPPENAS, there are more than 600 regulations which relate to urban management by local (Tingkat II) governments in Indonesia. Many developers in East Java (and elsewhere in Indonesia) claim to own the rights to land without yet having acquired it.

Project start up. Before a project—such as setting up a factory—commences, an environmental impact assessment (AMDAL) is required. Whereas in Australia, relevant planners and engineers would be involved, project start-up in Indonesia requires adherence to a set of general guidelines, which may not fit the particular circumstances.

Reflecting increasing demand for unskilled and semiskilled labour, the minimum wage in East Java has risen to Rp 4,500. The provincial office of the Department of Manpower monitors local companies and foreign joint ventures to see that the minimum wage is met. Companies are now required to provide a meal allowance to workers. The East Java Government maintains that industry should accept greater responsibility for the care of its workforce. During recent labour unrest in Sidoarjo, one of East Java's

largest employers, PT Maspion, avoided trouble by broadening its wage structure to include food and travel allowances for all its employees.

Infrastructure developments

East Java has reasonably good infrastructure: roads are largely passable, phone calls are getting through more easily these days, and power interruptions are rare. However the Province's economic growth is making increased demands on infrastructure. Whereas electrical power supply is now adequate, the same cannot be said of water and rail transportation networks.

Table 4 **Major East Java infrastructure projects**

Category Project	Description (est. date complete)	Est. Value (US\$millions)
Transportation		
Toll Roads/Bridges ^a		
Surabaya east ring road	16km (2000)	250
Surabaya–Mojokerto	38km (1999)	280
Gempol–Pandaan	13km (1998)	0
Pandaan–Malang	30km (1999)	110
Gempol–Pasuruan	32km (1998) ^b	70
Pasuruan–Probolinggo	40km (1999)	130
Gresik–Tuban	75km (2000)	260
Surabaya–Madura bridge	5km ^c	260
Airport (Juanda)	(1999) ^d	75
Seaport (Tanjung Perak)		
Container pier	(1998) ^e	270
Electrical Power		
Paiton Swasta I	(98–99) ^f	2,500
Paiton Swasta II	(1999–2000)	1,700
Pasuruan	(1999) ^g	525
Java–Bali electrical network	n / a	
Water Supply and Treatment		
Umbulan Springs	70 km pipe ^h	n / a
Karang Pilang III plant	n / a	n / a
Telecommunications		
	ⁱ	n / a

Notes: ^aall 2x2 lanes; ^bBechtel Corp. of the United States is reported to be interested; ^cBridge project has been delayed since early 1990s; Japanese OECF loan is still uncertain; ^dlengthen runway, build new facilities; Canadian company Bracknell is expected to do work; ^edouble length of container pier to 1,000 m; Citra Lamtorogung is prime contractor. ^fPaiton Swasta I and II are both 30-year builder-owner operated projects, both to produce 1,230 megawatts of electricity; Paiton Swasta I is owned by Mission Energy Company (40), General Electric Capital Corp. (12.5), Mitsui and Company, Ltd. (32.5) and P.T. Batu Hitam Perkasa (15); Paiton Swasta II is reported to be owned by Siemens Company (50), PowerGen (35), and Bumipertiwi Tatapradipta (15). ^g500 megawatt gas-fired plant; Enron Corp. of United States is involved. ^hUmbulan Springs is a 4,000 litre per second freshwater source; the pipeline project has already been delayed several years due to financing difficulties. ⁱ750,000 new telephone lines slated to be added by 1999.

Source: East Java Planning Board, various press reports.

A number of major infrastructure works are planned or underway in East Java (Table 4).

- When completed in 1998, the Paiton coal-fired steam power plant on the mid-north coast of East Java will have a combined output of over 3,000 MW. It involves both state corporation and private sector interests, including one with a subsidiary of Queensland's New Hope Mining, PT Adaro Coal. The Paiton project will enhance the trans-Java grid which is already partly served by a coal-fired power station in Sidoarjo and the gas turbine power complex in Gresik.
- The Madura Bridge Project to link a proposed industrial estate on the island of Madura off Surabaya with the mainland has yet to commence, although proponents of the project claim to have secured a Japanese OECF loan to cover most of the project's estimated US\$370 million cost.
- There are plans to build a pipeline connecting the Umbulan spring with Surabaya providing water for domestic and industrial uses. A number of domestic and overseas parties, including Australian firm Clough Engineering Ltd, were involved in tendering for the project in 1992–1994. It now appears likely that a consortium between the Jaya and Bimantara Groups will be awarded the contract by the Department of Public Works in Jakarta but there is no indication when the project is likely to commence.
- An extensive network of toll roads will be built linking Probolinggo, Pasuruan, Malang and Mojokerto with Surabaya as part of the planned trans-Java toll road network. Although foreign contractors have shown an interest in toll roads, it is believed Jakarta toll road operator PT Citra Marga Nusaphala Persada, belonging to the President's daughter, will get the lion's share of the work to build the Surabaya network. A physical constraint in constructing the eastern side of the toll ring road through the Kenjeran area to the east of the city is the large number of prawn ponds (*tambak udang*). The prevalence of prawn ponds in this area has also impeded progress in developing two major residential and recreational land use leases on the eastern side of the city owned by Dharmala Group and PT Pakuwon Jati.
- The upgrading of Juanda airport is another project that has been much discussed but is taking a long time to come to fruition. A Canadian engineering company is believed to have an interest but not much is happening at present.
- The existing gas pipeline supplying natural gas from the Kangean Islands off the north coast (Bali North project) of East Java to a gas turbine power station at Gresik is being expanded and the gas distribution system upgraded. Gas is now connected to the main industrial estates around Surabaya and a spur line is being laid beside the highway to Malang. Inevitable 'leakages' of gas from the pipeline will undermine this power source's effectiveness.
- Telecommunications. Up to 750,000 new telephone lines are due to be added to the telephone network by 1999. According to one interlocutor in the East Java Government, it presently only takes seven days to obtain a telephone

connection in Surabaya without bribes. For the subscriber, payment of the telephone connection may be facilitated in 10 instalments to PT Telkom.

- The national government has a clearly ambitious plan to link Gilimanuk in Bali with Banyuwangi on the east coast of East Java by a bridge across the Bali Strait. President Soeharto reportedly discussed the scheme with Dr Mahathir in Kuala Lumpur recently in the context of discussions on a similar large-scale bridge project connecting Sumatra with Malaysia but, like the Madura bridge, its implementation will take considerable time.

Other private sector mega-projects in East Java illustrate the scale of infrastructure works coming on stream or in the pipeline.

- Property developers Dharmala Group, Citra Group and PT Pakuwon Jati are in the forefront of large-scale satellite town developments incorporating residential accommodation, golf courses, office blocks and shopping malls. Located in the city's west these estates were originally known by such appellations as Grande Family Estate or Citraland. However in order to conform with the Government's policy of Indonesianising place names, these projects have undergone some interesting name changes so that we now have estates called Graha Famili, Citra Raya and Pakuwon Indah. The scale of these estates is large by any standards: the Citra Raya project alone is worth US\$500 million and covers 2,000 ha. To date, 2,400 residential units have been completed and the target is 20,000 houses / apartments. The project even envisages relocation of the site of the famous Surabaya Zoo! The cost of individual apartments in the high-rise condominiums is exorbitant, reflecting the developers' belief in the strength of the market for prestige residential accommodation. Prices reach as high as Rp 850 million for a four bedroom apartment in Dharmala's condominium towers.
- PT Batu Hitam Perkasa, owned by Hashim Djojohadikusomo, is constructing a US\$2 billion olefin and ethylene plant near Tuban producing olefin and aromatic by-products for the plastics industry. The investment will be partly Japanese financed.
- A US\$500 million copper smelter project in Gresik, owned by PT Freeport Indonesia (25 per cent) and Mitsubishi (75 per cent) has been delayed through financing difficulties and has yet to begin construction.
- Asea Brown Boveri is expanding its US\$33 million boiler plant in Gresik, built to manufacture boilers for Paiton I, to become its turbine and power generator equipment plant for the whole of Southeast Asia.

Trends and priorities in East Java trade and investment

East Java's exports continue to show healthy growth. Figures produced by the Surabaya Branch of the Bank of Indonesia in 1995/6 show a 15 per cent average annual growth with exports valued at US\$3.04 billion. The top three items, wood products (including teak furniture), sport shoes and frozen prawns together account for over US\$1 billion in export earnings. Average annual growth of imports in 1995/6 was a robust 20 per

cent and imports were valued at US\$3.05 billion, mainly in metals, machinery and chemicals.

The East Java Government's general approach to investment attraction is to expand the Province's industrial base and encourage value-added industries across the board. Despite East Java's famous reputation for independence, however, most major investment and planning decisions are taken in Jakarta where the majority of corporate headquarters and central government planning agencies are located. This is especially true for East Java's infrastructure projects which are controlled by government ministries in the capital.

According to the East Java Investment Coordinating Board, foreign investment over the period 1967–1996 was valued at around US\$24 billion. This compares with a figure of US\$158 billion worth of cumulative foreign investment in Indonesia over the same period. Foreign investment approvals are holding up with about US\$500 million approved in 1995. Under the present Repelita (1993–1998), investment in East Java from public and private sources is expected to reach US\$75 billion in the ratio 20:80 per cent, mainly in manufacturing.

East Java's principal foreign investors are Taiwan, Japan, Singapore, Hong Kong, South Korea, the United States and the Netherlands. New foreign manufacturing joint ventures favour setting up their operations in one of East Java's new privately-owned industrial estates, such as Dharmala Group's Ngoro Industrial Park (NIP). NIP is now 60 per cent subscribed with joint ventures from Taiwan, Hong Kong and Singapore producing light manufactured goods, such as paper clips, name tags and canned mangoes, mainly for re-export.

The East Java Investment Coordinating Board has identified agro-industry as a key sector for investment. It is keen to see investments that add value to East Java's export commodities such as processed fruit.

Other priority areas for investment are

- seafood processing
- horticulture
- production of animal feed
- timber processing
- pulp and paper
- leather goods and apparel.

There is also serious interest in exploitation of the Province's mineral deposits, for example, bentonite.

Changes announced as part of the deregulatory packages of 1993–1994 covering investment procedures have given provincial-level investment coordinating agencies a more important role in the issuing of land use permits for joint venture operations.

The head of the East Java Investment Coordinating Board is Bambang Koesbandono whose previous job was in BAPPEDA.

East Java administration

The 'Balanced Development' study makes the point that East Java's successes in social and economic policy is at least in part attributable to a professional bureaucracy and the perceived legitimacy of the provincial administration (Dick et al. 1993). In economic policy terms the key institution is the provincial planning agency, BAPPEDA, headed by Oemar Moehtadi. As BAPPEDA's Vice Chairman and later Chairman under the former pro-business Governor of the Province, Soelarso, Moehtadi guided the establishment of East Java's international linkages, including the Western Australia–East Java relationship. Since the present Governor, Basofi Sudirman, came to power in 1993, Moehtadi has had an even more influential role to play in economic policymaking, given Basofi's preoccupation with East Java's political agenda (Moehtadi is due to retire in the next year or so).

Another provincial administrator with a wealth of experience in economic and fiscal management is Soelarso's former assistant and current head of the East Java Development Bank, Mohamad Zuhdi. While East Java's strong reputation in the field of economic management has rested on the shoulders of career public servants such as Moehtadi and Zuhdi, it remains to be seen whether their imminent retirement leaves a gap of experience and professionalism that the next generation of administrators finds difficult to bridge.

With an annual budget of US\$6 billion, the Surabaya Municipal Authorities (Pemerintah Kotamadya DATI II) are responsible for urban planning and management issues, including approvals for property and infrastructure projects in the city. Amongst notable performers at this level of administration are Alisjahbana in BAPPEDA Tingkat II and the head of the Public Works Service, Benyamin Hilly. Both men have had experience of the international environment; the former through his postgraduate studies in urban planning in the Netherlands and the latter through his involvement in setting up the Surabaya–Seattle Sister City Relationship. Hilly is currently working with Djohan Silas and the Surabaya Institute of Technology to set up a Masters of Urban Planning degree course with RMIT in Melbourne.

East Java is attempting to address public transportation, water supply, drainage and environmental control issues through government cooperation at kabupaten (regency) level. However, where effective cooperation occurs between two kabupaten administrations, for example between Surabaya and Sidoarjo over revenue-sharing from the Bungurasih land transport terminal, this may fuel resentment on the part of other kabupatens not participating in such forms of cooperation.

A major constraint on effective urban planning is the shortage of local government revenues. For example Kabupaten Sidoarjo's experiment in decentralisation in line with the national government's urban management policies has been beset with difficulties. The population of Sidoarjo, currently 1.17 million people, is growing faster than any kabupaten in East Java. Urbanisation is proceeding apace on account of the good access provided by the Surabaya–Gempol toll road and the development of a significant industrial base in the regency, centring on plastics production and household goods. According to East Java Vice Governor Soeprapto, Sidoarjo does not generate enough income to pay for public sector salaries and services which must be subsidised by funding from both central and provincial government coffers according to complex budgeting procedures. In an attempt to generate additional revenue, the kabupaten has increased local land taxes, a measure highly unpopular with local rate payers and industry alike.

Funding for housing in the urban areas of East Java for low income groups is a problem as the high cost of land makes traditional single storey housing projects prohibitively expensive, even when undertaken in partnership with the private sector. Property developers must adhere to the 1-3-6 rule in providing high, middle and low-income housing. In order to maintain their obligations, developers, unsurprisingly, have tended to concentrate on putting up low cost housing estates on the margins of Surabaya where land is at its cheapest.

East Java and Australia: trade and investment patterns

Against a background of burgeoning bilateral trade (such as a 31 per cent increase in the value of Australia's exports to Indonesia in 1995/1996 totalling A\$2.77 billion and a 27 per cent rise in Indonesian exports to Australia over the same period amounting to A\$1.52 billion), the question arises how quickly Australia's trade with East Java is also growing. The unreliability of data for trade flows at provincial level in Indonesia makes it difficult to convey accurate estimates but East Java Government figures reveal that Australia ranks amongst the ten biggest exporters to East Java. The main exports are commodities, with soft grain wheat suitable for Bogasari Flour Mill's noodle production being a significant item. Australia currently occupies seventh position as a destination for East Java exports which are worth US\$110.5 million. Main export items to Australia are paper, plastic bags, writing pads, kitchenware and cement tiles.

Given that import duties are determined by the value of the product including freight, Australia's proximity to Indonesia relative to other suppliers makes it a competitive supplier of high value perishable items in bulk. Increased shipment of exports by air to Surabaya is likely to result from the expansion of air services between Australia and East Java. Ansett has already commenced a service linking Australia's east coast cities with Surabaya via Darwin and Bali.

In terms of investment, Australia ranks ninth as a foreign investor in East Java with US\$1.89 billion invested in 15 approved projects in East Java, mainly in the construction sector. Amongst those projects that have been realised are joint ventures involving Boral and CSR Ltd, producing export-quality plasterboard and readymix concrete respectively. A joint venture between local developer PT Ready Indah and New South Wales company Healthcare of Australia will construct a A\$25 million prestige hospital for high-income earners due to be completed by 1997. East Java investment in Australia is concentrated overwhelmingly in residential and some retail property, especially in Western Australia.

Opportunities in East Java for Australian companies

Australian business can tap East Java's commercial potential by exploiting competitive advantages of proximity and goodwill. The following sectors offer the most potential.

Infrastructure development. While the scale of the planned infrastructure projects already mentioned is probably beyond the scope of most Australian contractors, there could still be opportunities for Australian firms to get involved in downstream work on a sub-contract basis. A consortium-based approach is an effective strategy for maximising the chances of a successful bid.

Concern about endemic flooding in parts of East Java has led to renewed interest in flood mitigation and irrigation works. This could open up opportunities for companies with relevant expertise in hydro-engineering, in collaboration with the Jasa Tirta Water Management Authority which manages East Java's main waterway, the Brantas River, and its tributaries.

Construction materials. Although suffering from an over-supply of quality retail and office accommodation, growth in the building and construction sector in East Java remains strong. High-rise residential condominium developments have mushroomed in various parts of the city, for example the Adistana towers in Jln Ngagel and the Paragon apartments in Jln Mayjen Sungkono. Supplies of high quality bricks for prestige building projects are in demand as these can not be found locally. In general, however, the cost of many imported Australian building materials, subject to a 20–30 per cent duty, makes these products unattractive to the Indonesian construction industry.

Hotel industry. Surabaya has witnessed a quantum leap in the number and quality of its hotels. The city now boasts five 5-star hotels (Hyatt, Shangri-La, Sheraton, Mandarin and the Westin). Since 1994, the number of 3 to 5 star-rated hotel rooms has increased by approximately 60 per cent, making it difficult for hotels to lift their occupancy rates above 60–70 per cent. Two 3 to 4 star hotels have recently opened, the Novotel and Ibis Hotels operated by PT Accor Asia-Pacific Indonesia, and more are currently in the

planning stage, (the Century Atlit in Jln Tunjungan and the Holiday Inn in Jln Basuki Rachmat). Completion of these new hotels has greatly expanded the supply of banquet and conference facilities and could assist Surabaya attract international conventions, although it still has a long way to travel before it can rival Jakarta and Bali in this regard.

The boom in the hotel construction sector should also provide a number of opportunities for Australian firms. Tenders will be let for hotel interior design and fit-out work. The need to train increasing numbers of staff in East Java's hospitality sector should also yield good prospects for companies specialising in hospitality industry training and management.

Land use planning and design. Australia enjoys a good reputation in the area of design and planning of mixed residential and recreational facilities, including golf courses. Cheaper and more widely available land in East Java has resulted in a proliferation of golf course developments with a number of links either recently completed or on the drawing board. Major golf course developers in East Java include, the Sekar Group, the Jaya Group and cigarette manufacturer PT Sampoerna. Australian golf course designers, such as Peter Thomson, have been employed by local East Java firms looking to establish 'prestige' links. According to one East Java developer, however, the Province's golf course development may have already reached saturation point as there at most 300 regular players in Surabaya.

Major property asset management. While some East Java property developers consider Australia to be too highly priced in terms of building materials and machinery, all agree that there are very good opportunities for Australian firms and individuals to manage their prestige property assets. For example, recognising Australian expertise in this area, Dharmala Group are keen to employ managers of golf courses, golf club houses, 3-star hotels and private hospitals. The prospects for Australian property asset managers is enhanced because of the shortage middle manager-level expertise in East Java (and elsewhere in Indonesia).

Food processing and supply. Food exports are an increasingly large export income earner for East Java and there are opportunities for the supply of food processing equipment, especially packaging, sorting and cold storage equipment. Food processing in East Java is dominated by the Sekar Group, which manufactures chilled beef, fresh frozen prawns and cashews under the Finna label. As a reflection of growing consumer tastes in East Java, Sekar is looking to find new food brands which it wants to handle through the company's rapidly expanding wholesale distribution system based on the Fair Price supermarket chain. Sekar are willing to stock lines that are both innovative and reflect Australia's image as a producer of green and clean food products.

Exports of Australian meat, fruit and vegetables to the East Java prestige hotel

market are advantaged by the increased air and sea transport links between Australia and Surabaya through either Bali or Jakarta. The Northern Territory Government has announced a new Darwin–Bali–Surabaya shipping service to start in mid-November 1996. This service will involve a single 485 DWT tonne vessel converted to container cargo and will have a sailing transit time of four weeks. Cargo under consideration for the service includes fertiliser from Surabaya for the Ord River region and meat and fruit juices from Darwin for the hotel sector in Bali and Surabaya.

Waste water treatment. Under the Indonesian Government's PROKASIH clean rivers program, East Java was selected as a model for the implementation of stringent regulations aimed at reducing the level of pollutants being discharged into the Province's rivers. The A\$25 million Australian Government-funded Pollution Control Indonesia project, now in its third year, focuses on institution-strengthening and human resource development of East Java's pollution monitoring apparatus. The project is proceeding with the full cooperation of the Indonesian Environment Agency (BAPPEDAL).

Indonesian Government legislation makes it mandatory for industries to submit an AMDAL assessment. Firms producing substantial amounts of industrial effluent are required to install waste-water treatment mechanisms. However, despite some early promise and the goodwill generated by the Pollution Control Indonesia project, Australian waste-water treatment companies have had only limited success in East Java. Many utilities producing effluent are reluctant to invest in expensive pollution control devices. For instance, Surabaya's public hospital system, which discharges biological effluent directly into the Brantas River, has too small a budget to pay for sophisticated waste-water treatment mechanisms. One Australian company recently introduced hospitals in Surabaya to its waste removal technology but the capacity of its rapid destructor proved to be much greater than the ability of the East Java hospital system to accommodate it.

Education services and technical training. Surabaya shows a growing demand for overseas education. The United States and Europe exert a strong pull but Australia has advantages of proximity, a good lifestyle, a good academic reputation and has gained a strong market share. Australia is now the number one overseas destination for Indonesian students.

Indonesia's needs are enormous in the area of technical training. One of the strategic industries overseen by the Minister for Research and Technology, Dr Habibie, is the PT PAL naval shipyards in Surabaya. Opportunities exist for Australian training consultancies to conduct courses for engineers, marine scientists, computer managers, including in PT PAL.

Tourism. East Java's abundant natural beauty and unique culture make it an attractive destination for tourists. However Provincial tourism authorities must address a number

of existing weaknesses so that investment in tourism may reach its full potential. Particular weaknesses include the low standard of English of East Java's hospitality sector, poor marketing of its tourist assets and the lack of a tourist ethos amongst the people of the Province. There are opportunities for Australian business in implementing programs to strengthen the skills of the tourism workforce and develop a community-based tourism ethos. A coordinated marketing and promotional strategy could be formulated in conjunction with local authorities covering all levels and regions of the Province.

Franchising. As any stroll around one of Surabaya's new shopping complexes will testify, the city's growing consumer culture is fertile ground for franchised fast food, leisure and entertainment facilities. Quick, quality printing, for items such as stationery and business cards, is one opportunity worth pursuing.

Total quality control. Opportunities exist in this field as Indonesian manufacturers become more aware of the need to obtain a competitive edge through adherence to quality control systems and environmental safeguards. There is increasing interest in obtaining ISO 9000 and 14000 series qualifications, for example in the steel manufacturing and fabricating industries. One Australian consultant has already established a good business in East Java advising firms on how to obtain ISO qualifications.

Healthcare services. For the present there are no private quality healthcare centres in Surabaya. Rather than flying to Singapore or Australia for treatment or elective surgery, Surabayans who can afford it would prefer to obtain healthcare at local private clinics and boutique hospitals, albeit at a premium cost. Health services that could be provided by Australian companies include pathology and hospital management, training and equipment.

Building a business partnership

It is encouraging that Australian companies are beginning to investigate opportunities outside Jakarta in important regional centres, for example Surabaya, Semarang, Bali and Ujung Pandang. In part, this shows the results of bilateral government efforts to create an appropriate 'enabling environment' to encourage growth at sub-regional level, for example through closer state-provincial links which help bolster mutual confidence.

In the case of East Java, there are some inviting trade and investment prospects for Australian companies. The goodwill generated towards Australia through educational links and regular exchanges of personnel under the West Australia–East Java agreement help to cultivate a positive environment for Australian companies seeking to locate their manufacturing or fabrication operations in the Province. Significant East Java

companies are looking to diversify their operations and several are keen to do business with Australian firms in a variety of sectors, from hospital construction and management, to the supply of quality processed foods or leisure facility management.

East Java's public sector is also interested in what Australian companies have to offer in infrastructure design, construction and asset management, especially where government business enterprises, such as the East Java Water Supply Authority, are becoming aware of the need to improve their services and earn increased revenues. The provision of finance packages is necessary to overcome the problem of the Province's budgetary limitations. It is possible that Australian banks could play a greater role in the provision of debt finance for Australian companies and consortiums participating in project bids. Another source of funding are the multilateral banks, for example, the Asian Development Bank, which are often interested in lending for certain sector-specific projects, such as in environmental management.

This paper has focused mainly on the opportunities for Australian business in East Java. The building of business partnerships, however, is not a one-way street. The strength of the economic relationship between East Java and Australia will depend on the extent to which East Java's business sector is able to find opportunities in the Australian market. Far-sighted Australian firms and government agencies will give careful thought to East Java's development aspirations and the legitimate commercial interests of its business community.

Notes

Paper presented to the Indonesia Study Group, Australian National University, Canberra on 30 October 1996. The views expressed are those of the author and are not attributable to the Department of Foreign Affairs and Trade, with whom the author was then employed.

- ¹ For a comprehensive analysis of East Java's economic growth in the twentieth century, see Howard Dick, James J. Fox and Jamie Mackie (eds), 1993, *Balanced Development: East Java in the New Order*, Oxford University Press, New York.

Appendix One: some practicalities on doing business in East Java

- The selection of a reliable business partner is the key to success in East Java. A strategy of building a personal relationship with principals of East Java companies over a number of visits is most likely to yield business rewards.
- Take time to get to know the East Java Government bureaucracy. Indonesia has devolved a lot of decision-making to the provincial level and East Java's bureaucracy is both strong and generally competent. Prospective investors and bidders for project work should spend time familiarising themselves with the personalities in key planning and supervisory agencies, particularly in the Provincial Development Planning Agency (BAPPEDA), the Provincial Investment Planning Agency (BKPMMD), and the Surabaya Municipal Planning Agency (BAPPEDA Tingkat II).
- The 'Buku Kerja' published by the East Java Government is a useful guide to the bureaucracy.
- Australian business people often lose out in competition over tenders for projects because they are insufficiently aggressive and not prepared to undercut competitors.
- The guides to doing business put out and regularly updated by business advisory and accounting firms such as Ernst and Young and Price Waterhouse are useful compendiums of information on the regulations governing the setting up of representative offices, joint ventures, and taxation regimes.
- In terms of making initial contact with potential partners, the following business networks may help: the Indonesia–Australia Business Council (East Java Branch) was established in 1993 and is linked to the IABC in Jakarta. It organises speakers and events at the Heritage Club in Surabaya and other venues.

The Rotary and Lions Clubs are particularly active in East Java and offer a convenient business network, especially for Australian members of these organisations. The Austrade Office and the Western Australia–East Java Office in Surabaya are also available as resources.

Appendix Two: Australia–Indonesia bilateral trade and investment highlights

- Australian investment in Indonesia is clearly on the rise, although difficult to quantify. The total amount of Australian investment could be around US\$5 billion, with some uncertainty in the figures as a result of third country investment through Singapore.
- The pattern of investment is expanding away from the traditional mining base and investment in the chemical industry is growing strongly.
- The financial services sector and manufacturing have also been the scene of substantial Australian investments, for example, Lend Lease announced in 1995 six joint ventures with the Sinar Mas corporation and CSR will build a gypsum board plant near Jakarta.
- Key sectors for growth in the Indonesian economy where significant prospects lie for Australian investors occur in telecommunications, power generation, water supply and sanitation.
- All the major Australian construction companies are engaged in Indonesia, for example, John Holland which has had a presence in Indonesia for 20 years.
- Urban planning is increasingly important as Indonesia comes to grips with growing problems related to rapid urbanisation. Demand for leisure-linked property developments is strong and there is more than ample work for golf course designers and architects who project-manage integrated housing estates and resorts.
- The distribution sector remains closed to foreign investment, but Davids' Holdings has established a technical services agreement with Indonesia's largest supermarket chain, the Hero Group, to provide wholesale distribution services.
- Indonesian investment in Australia is concentrated overwhelmingly in residential and some retail property.
- With respect to trade, a 31 per cent increase in the value of Australia's exports to Indonesia in 1995/1996 totaling A\$2.77 billion is evidence of a substantial acceleration in export growth compared to the annual trend growth rate between 1985–1995 of 19 per cent per year. Commodity exports still dominate,

especially cotton, wheat, and live cattle, but services exports show a 17 per cent growth over the last five years. Australia's share of total Indonesian imports is now just under 5 per cent.

- Service companies now account for 65 per cent of Australian firms listed in Austrade's Directory of Australian Companies in Indonesia and areas of high potential include, financial services, business advisory services, quality control and property / hotel management.
- A 27 per cent rise in Indonesian exports to Australia occurred in 1995/1996. The main imports from Indonesia, totaling A\$1.52 billion, are crude petroleum and oil (43 per cent of total imports), textile yarn and refined petroleum products. However, the fact that the strongest growth in Indonesian exports to Australia in the past few years has included paper products, textiles, and simple processed wood products, indicates the emergence of a wider range of manufactured products in exports to Australia.