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A Maritime Silk Road and Indonesia's Perspective of Maritime State

This paper was prepared for the Embassy of the People's Republic of China in
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Abstract

This study is intended to see how the Maritime Silk Road (MSR) will be positioned in Indonesia's development and strategic perspective in the context of regional initiatives. While the motivations to promote the MSR are mainly economic, there also exist political considerations and consequences of the initiative that will shape the implementation and outcome of the proposed cooperation. This study takes both economic and political perspectives into consideration. The report of this study is organized as follows. After the introduction, the second section highlights various issues related to the MSR initiative. It discusses the economic transformation in China in order to better explain the motivations of East Asian countries to introduce a 21st Maritime Silk Road. This section also highlights the economic development of Indonesia, and focuses in particular on various aspects related to maritime affairs and connectivity. It is then followed by the third section, which discusses Indonesia's perspective on and expectations of the MSR initiative.

Keywords: Indonesia, China, Maritime Silk Road

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The Embassy of the People's Republic of China in the Republic of Indonesia

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1. Introduction

President Xi Jinping introduced the concept of a 21st Century Maritime Silk Road (MSR) in October 2013 during his first visit to Indonesia. This proposal was intended to promote maritime cooperation and trade between China and other countries in the region, including countries in South East Asia and South Asia. It is part of the New Silk Road initiative that will connect Central Asia, China, South East Asia and all the way to South Asia. The plan is to build maritime infrastructure along the lines of the ancient Silk Road, and thereby create a “silk road economic belt” that would increase connectivity in the region by “enabling everyone to share development opportunities.” However, there are also political considerations and consequences of the initiatives that will shape the implementation and outcomes of the proposed cooperation.

The initiative comes at the same time as the economic transformation currently taking place in China, as well as the further development of other Asian countries. After growing at a very high rate of economic growth – well above 10% annually – for several decades, China is now ready to embrace slower but more stable economic development, and to shift away from being an economy that relies on investment and exports and towards being a one that is consumption-driven. The country also sees that the global economy is no longer simply a market for its products, but is also a source of materials, goods, and services for domestic consumption.

China’s current account surplus has declined to around a quarter of its pre-crisis peak. China’s “Going Global” strategy, which the Chinese central government adopted in 2001, also marked the beginning of China’s remarkable increase in outward investment., China’s outward direct investment grew from US\$5.5 billion to over US\$101 billion per year between 2004 to 2013, and is predicted to reach US\$150 billion by 2015. Although most of these investments were initially driven by demand for resources, they increasingly tap into domestic and regional business opportunities, and are spurred by competitive production costs.

Meanwhile, other countries in Asia have also witnessed remarkable economic progress. Despite the global financial crisis in 2008/2009, the region remains quite resilient and continues to perform well. Some countries in South and South East Asia enjoy reasonable economic growth higher than 5%, while others have the potential to be the next engines of

regional economic growth. Commercial activities between these countries have also been growing very fast.

Against this background, promoting greater cooperation between countries in the region is a logical next step. The MSR is expected to promote better connectivity across this rapidly growing region. This proposal is also in line with other cooperation initiatives in the region, such as the Asia Infrastructure Investment Bank (AIIB), which China initiated in order to support infrastructure financing in the region, or the Master Plan of ASEAN Connectivity (MPAC).

Indonesia, as the largest country in South East Asia, will play a very important role in the successful implementation of the proposed plan. As an archipelagic country, maritime activities have been incorporated into the livelihood of many Indonesian, not only as a source of economic resource, but also as a means of connecting different parts of the country that are separated by the sea. The newly elected President of Indonesia has also emphasized the development of the maritime sector as a means of improving connectivity within the country and with the world. Indonesia has been implementing a master plan for accelerated development that will include the development of maritime activities.

It is then necessary to reconcile the goals of the proposed MSR initiative with Indonesia's perspective on maritime state, as well as with other related initiatives in the region such as the Master Plan of ASEAN Connectivity (MPAC). This study is intended to see how the MSR will be positioned in Indonesia's development and strategic perspective in the context of regional initiatives. While the motivations to promote the MSR are mainly economic, there also exist political considerations and consequences of the initiative that will shape the implementation and outcome of the proposed cooperation. This study takes both economic and political perspectives into consideration.

More specifically, this study aims to assess the proposed MSR in the context of national and regional initiatives related to maritime activities, while also identifying possible areas of cooperation, both strategically and economically, between Indonesia and China in order to support greater maritime activities in the region. It is done by collecting and assessing opinions and perceptions from relevant stakeholders, such as Indonesian elites and academics, regarding the proposed initiative. This study is expected to serve as a preliminary study and provide a basis for further study in the future in order to explore more specific recommendations on how to develop the proposed MSR initiative.

The study is conducted using a combination of desk research and information collecting activities. Information was collected from various stakeholders and audiences in Indonesia, including relevant government officials, business associations and academic, through in-depth interviews with various key position individuals and officials, complemented by Focus Group Discussions (FGDs).

The report of this study is organized as follows. After the introduction, the second section highlights various issues related to the MSR initiative. It discusses the economic transformation in China in order to better explain the motivations of East Asian countries to introduce a 21st Maritime Silk Road. This section also highlights the economic development of Indonesia, and focuses in particular on various aspects related to maritime affairs and connectivity. It is then followed by the third section, which discusses Indonesia's perspective on and expectations of the MSR initiative. This discussion takes advantage of all information and opinions collected during the study from economic, political, and security perspectives. The last section of the report provides recommendations on how the initiative should be carried out, and how Indonesia could actively contribute too it. The discussion highlights several possible areas of cooperation, as well as some future challenges.

2. Background

The “new normal” for the Chinese economy features slower but more stable growth, and a shift away from an economy that has previously relied on investment and exports towards a new consumption-driven economy that is driven by more diversified forces. As President Xi Jinping declared, China's outbound investment in the next decade will exceed 1.25 trillion USD, and its imports will reach more than 10 trillion USD worth of goods. In addition, he stated that China will send more than 500 million tourists abroad over the next five years. These massive opportunities in the coming decade will also be comes with the current 4 trillion USD of foreign reserves.

Against this backdrop, the Silk Road strategy aims to facilitate large-scale infrastructure construction, energy sale, and transport, as well as the relocation of manufacturing industries - all of which are relevant to Indonesian economy in the long run. China's intention to support the Silk Road strategy was cemented further when President Xi Jinping pledged to use 40 billion USD to create a Silk Road Fund during the APEC Summit on November 2014.

This, in addition to his pledge of 50 billion USD to the Asian Infrastructure Investment Bank, is intended to finance the development of a “Silk Road Economic Belt” (the “Belt” initiative) and a “21st Century Maritime Silk Road” (the “Road” initiative).¹

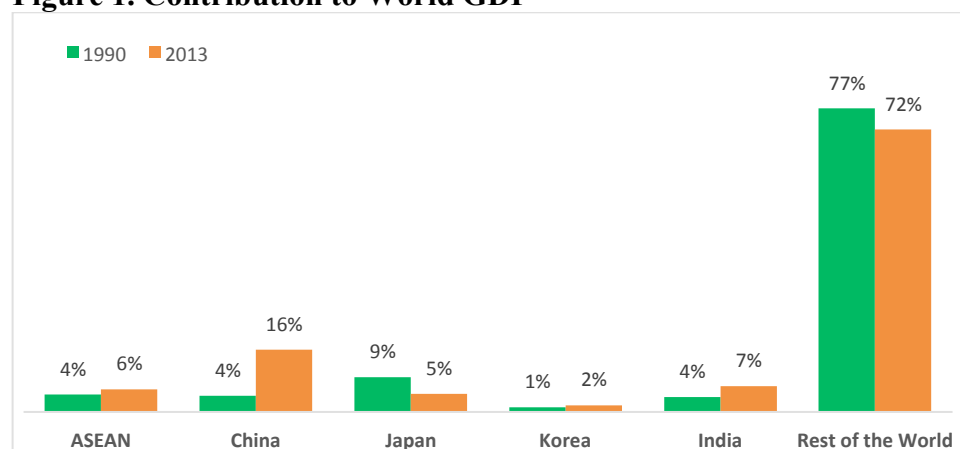
As President Xi Jinping stated, the effort to link the countries is “not merely about building roads and bridges or making linear connection of different places, it should be a three-way combination of infrastructure, institutions and people-to-people exchanges and a five-way progress in policy communication, infrastructure connectivity, trade link, capital flow and understanding among peoples.” This principle forms the essence of the MSR initiatives, namely the five pillars: policy, road, trade, currency and people.

Nevertheless, the question remains about whether Indonesia will be one of the key players in the Maritime Silk Road (MSR), and whether it is ready to embrace the new China. Is China an opportunity? Or is it a threat?

2.1 Implication of China’s Economic Transition

By 2013, China remains the second largest economy in the world - generating 15.84% of world GDP (PPP), and growing its GDP at a faster rate than most emerging countries (Figure 1). China’s share of world GDP (PPP) has increased from 3.8% in 1990 to 15.4% in 2013, and thus far exceeds that of India, which only increased its share in the world GDP from 3.2% to 5.8% during the same period. Meanwhile, the shares of global GDP belonging to other East Asian countries, such as the ASEAN countries, Japan and Korea, has declined from 14.6% to 11.8%.

Figure 1. Contribution to World GDP



¹ While the “Belt” is a network of highways, railways and other critical infrastructure linking China to Central and South Asia, the Middle East and Europe, the “Road” is actually a maritime route along Asia, the Middle East, Africa and Europe. The “Roads” initiative includes the building and expansion of ports and industrial parks throughout the regions it passes by.

Nevertheless, the slowing of its growth and rebalancing of its economy are signals of China's transition to a "new normal." According to the World Economic Outlook Database, China's economic growth rate declined to 7.7% in 2013 from 10.41% in 2010. The economy is also rebalancing, as evidenced by the decline of the country's current account surplus from 10.08% of GDP in 2007 to 1.93% in 2013. China has seemingly passed the turning point of the manufacturing inverse U-curve that is widely observed in the early economic history of advanced countries such as US and Japan.²

Undoubtedly, China is in the midst of a major structural overhaul aimed at shifting its economy away from the decades-long reliance on state-driven investment and manufacturing exports and towards a consumption-driven economy. Nevertheless, the problem of the imbalance of development between China's eastern region and its central and western regions remains, and thus requires a transfer of resources and industries between its different regions. China used to be an attractive manufacturing base for three reasons: low tax rates, cheap labour, and well-organised infrastructure. Nevertheless, wages have risen as millions of Chinese have moved away from the countryside and into cities. As China's population is rapidly aging, it is also getting more difficult for employers to find and retain workers. Moreover, increasing wages are consequently leading to a rising middle class consumer market.

To address the aforementioned progress, China needs to open up to the big market in the Eurasian continent, in addition to the East and developed world. In specific reference to ASEAN, China's role will likely shift as it goes from being one of the exporting competitors to ASEAN to being an important new consumer market for ASEAN products. The focus on ASEAN is a direct consequence of the China-ASEAN FTA, under which nearly all import duties from Indonesia, Thailand, Malaysia and Philippines have been eliminated.³ Meanwhile, the economic slowdown in the EU and the US in recent years has contributed to weaker demand for Chinese products in these two markets. Consequently, China will need to redistribute the export commodities that were once directed to the US and the EU market to other big rising markets – namely that of Asia.⁴

² Yang Yao, "A New Normal, but with Robust Growth: China's Growth Prospect in the Next 10 Years", Brookings Institution, 2014.

³ Vietnam will follow suit in December next year.

⁴ The opening up of China in 1978 was a real watershed that has helped propelled the region's economic ascent; since then China's economy has been growing by leaps and bounds. In 1990 China's GDP (PPP) accounted only around 3.8% of the world GDP, but by 2013 the number reached 15.4%. India's economic liberalization in the early 1990s has also had a significant impact on the region's economic growth, albeit somewhat less spectacular than China's has had.

The fact that most of the countries in the region adopted export-led growth policy also suits China's current needs.⁵ Export-led growth requires the opening of domestic markets to foreign competition in order to gain market access in other countries, which leads to spectacular export growth in the region. The region recorded a significant jump in exports from 500.67 billion USD in 1990 to 4.95 trillion USD in 2013. Additionally, the region's trade-to-GDP ratio has risen from 57.32% in 1990 to over 59.66% in 2008 and its export-to-GDP ratio reached 29.49% in 2012.⁶ The rapid growth in trade reflects the region's dominant position in global manufacturing, due to low wages, increasingly educated labor forces, sophisticated technologies, high productivity growth, large markets and, above all, the ability to bundle together diverse production advantages.⁷

In addition, the region of Asia is also part of existing production network for automotive and electronic industries originated – a process that started at the beginning of the 1970s, when companies from Japan and later from Korea and Taiwan began relocating some of their production facilities to other countries in East and Southeast Asia. Athukorala and Yamashita argue that, since the early 1990s, intra-industry trade has grown faster in East Asia than in North America or Europe.⁸ Indeed, according to one estimate, more than 70% of intra-Asian trade consists of intermediate goods used in production, and of this, half is driven by final demand outside of Asia. On the other hand, China's final demand accounted for only 6.4% of total Asian trade – which is only half of what Japan was contributed, slightly below a quarter of what the US contributed.⁹

Nevertheless, certain countries in Asia, such as Myanmar, Pakistan and North Korea, remain relatively underdeveloped when compared to some other countries, most notably Japan, Korea and Singapore. Indeed, in a provocative paper, Dollar argues that the 'rise of Asia' is something of a myth.¹⁰ Asia is a large and heterogeneous region that contains about half of the world's population. In particular, he argues that since the 1990s, China economic performance, measured in terms of GDP growth rate, has bested that of all other countries in the region, and that therefore China was responsible for most of the region's gains (Figure 1).

⁵ "Going Global: Australia, Brazil, Indonesia, Korea and South Africa in International Affairs", KAS and Australian Institute of International Affairs, 2011

⁶ Calculations were done for China, India, Japan, Korea and ASEAN countries excluding Brunei Darussalam, Cambodia and Myanmar using data from World Development Indicator 2014

⁷ "Emerging Asian Regionalism: A Partnership for Shared Prosperity", Asian Development Bank, 2008.

⁸ Athukorala, Prema-chandra and Nobuaki Yamashita, "Production Fragmentation and Trade Integration: East Asia in Global Context," Canberra: Research School of Pacific and Asian Studies Working Paper, Australian National University, 2005.

⁹ "Uncoupling Asia: Myth and Reality", Asian Development Bank, 2008

¹⁰ David Dollar, "Asian Century or Multi-polar Century?" 2007.

2.2 The MSR Initiatives in the Wake of China's Economic Transition

During the process of shifting to a new consumption-driven economy, China needs to open up to the big market in the Eurasian continent. Essentially, the New Silk Road strategy aims to facilitate large-scale infrastructure construction, energy sale and transport, as well as the relocation of manufacturing industries - all of which are relevant to Indonesian economy in the long-term.

Nevertheless it will also increase China's active participation in the regional affairs, prompting it to take on the role of a responsible major country in the region – all of which are on China's agenda for its neighbourhood diplomacy.

The ancient Silk Road consisted of several trade routes connecting major civilizations across Asia, Europe and Africa, which facilitated the exchanges of goods, know-how, people, and ideas, and which consequently promoted economic, cultural and social progress in various countries. In addition, it facilitated dialogue between different civilizations. In contrast to during these ancient times, peace, development and cooperation are the underlying themes of the New Silk Road Initiatives. Nevertheless, challenges to this initiative exist in the form of complex international and regional landscapes.

The New Silk Road initiatives consisted of the “Belt” and the “Road” (or MSR) initiatives, both of which cover multiple provinces, autonomous regions, and major municipalities in China's central, western and east coastal regions. Consistent with the country's regional development strategy, new urbanization strategy and opening-up strategy, this initiative will boost the shaping of an all-directional opening of China. In this initiative, the nurturing of amity, sincerity, mutual benefits, and inclusiveness will be central to building friendlier political relations, stronger economic ties, closer security cooperation, and deeper cultural links between neighbouring countries in order link the past with the present.

There are three existing agendas for these initiatives. First, they intend to link Central Asia, South Asia, Southeast Asia, and West Asia together in order to boost connectivity and complementarity across the sub-regions, and to ultimately assist the establishment of Asia's supply chain, industrial chain, and value chain. This will, in turn, bring Pan-Asian and Eurasian regional cooperation to a new level. Second, the initiatives aim to foresee infrastructure development and systemic innovation, both of which are necessary to build

conducive business environments in relevant countries and in the regions as a whole. All of these should establish an orderly and unimpeded flow of production factors, to lower trade cost, and to reduce trade and investment barriers. In addition, the initiatives aim to boost the development of landlocked countries and the remote areas of coastal countries in order to provide greater drive for reform and the opening-up of the various countries. Third, the initiatives aimed to strengthen people-to-people exchanges among all countries across a wide spectrum, which will enable “soft” exchanges for future peace and development in Asia. In essence, the three agendas of the “Belt” and MSR initiatives are based on five pillars:

- **Policy**
- **Roads:** Development of cross-border transportation infrastructure and the construction of transportation network linking Asia’s sub-regions and connecting Asia with Europe and Africa.
- **Trade:** Facilitation of trade and investment, as well as removal of trade barriers
- **Currency:** More trade settlements in local currencies and more currency swap schemes, strengthening bilateral and multilateral financial cooperation, development of new financial arms for regional development, reduction of transaction cost, enhancement of capacity to fend off financial risks through regional arrangement, and enhancement of regional competitiveness in a global scheme.
- **People:** Improvement of state-to-state relations, enhancement of inter-civilization dialogue, exchange and understanding, as well as improvement of friendship between different peoples, especially at the grassroots level.

The initiatives will rely on existing bilateral and multilateral mechanisms between China and other countries in the region, and will use existing platforms of regional cooperation that have proven to be effective. In other words, the initiatives will be built on the continuation and upgrading of existing cooperation. Furthermore, they will not overlap or compete with existing mechanism, such as the Shanghai Cooperation Organization, the Eurasian Economic community or the ASEAN, and China FTA.

Multilaterally, Indonesia has established a cordial working relationship with China through the various cooperation frameworks within the ASEAN-centered regional security architecture. These cooperation frameworks include the ASEAN Regional Forum (ARF), the East Asia Summit (EAS), ASEAN Defense Ministers Meeting Plus (ADMM Plus), and the ASEAN Maritime Forum Plus. During the visit of President Xi Jinping to Indonesia in 2013,

Indonesia and China has agreed to upgrade their relationship to the level of a comprehensive strategic partnership in various fields.¹¹

2.3 The Relevance of the MSR Initiatives to the Indonesian Economy

Indonesia managed to overcome the negative consequences of the 2008 Global Financial Crisis thanks to sound domestic macroeconomic policy, and thanks to the expansionary programs of several large countries such as the United States. The economy grew by more than 6% until 2012, although the growth rate has slowed down recently. Despite this performance, the Indonesian economy remains tainted by various structural problems. Two issues are quite relevant to Indonesia and China economic relations, and more specifically the MSR initiative: industrial development and foreign investment, and infrastructure development.

2.3.1 Foreign Investment and Industrial Development

In order to reap the benefits of being part of the ASEAN market and establish a stronger position in the global value chain, the Indonesian government needs to prioritize the development of lower secondary industry over the development of high technology industry. Reviving lower secondary industries that are labour intensive will improve Indonesia's exports performance, and will alleviate Indonesia's economic slowdown and employment problems.

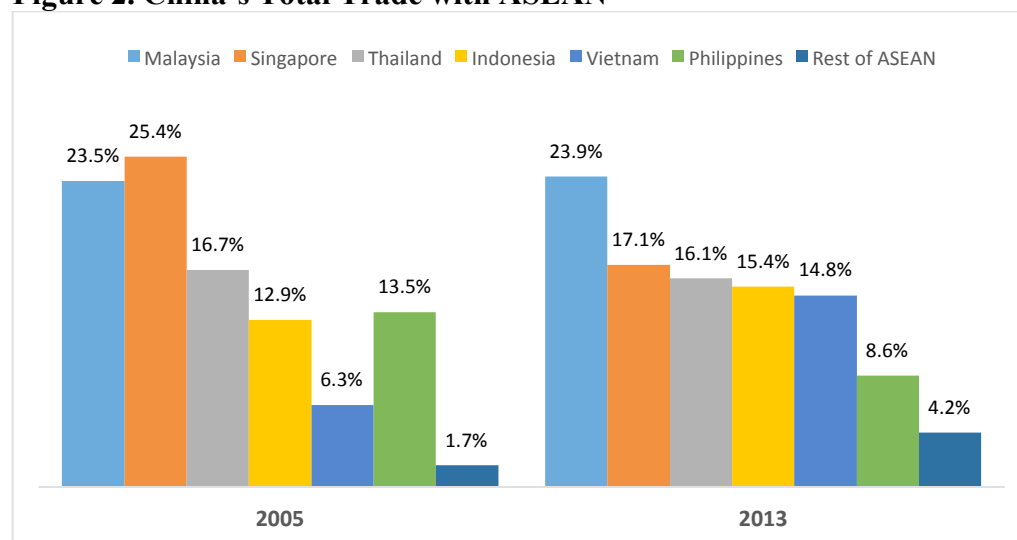
In light of this, China presents an untapped opportunity for Indonesia to revive its labour-intensive manufacturing industry (lower secondary industry) through foreign direct investment and skills transfer in the following industries: agriculture, electronics, machinery and transportation including ships. China, with its past experiences and expertise, can offer the type of FDI that can have significant spillover benefits in terms of improved productivity and technology and management practices in Indonesia. This can be a powerful force for growth and reform in Indonesia.

Indonesia is the largest market in ASEAN with the largest population and largest GDP, and in consequence has the strongest domestic demand in ASEAN. Additionally, AFTA, ACFTA and AEC will further facilitate Indonesia's market access in ASEAN. This makes Indonesia as a crucial link for China to deepen its economic ties in ASEAN. Nevertheless, while China

¹¹ "Indonesia, China forge comprehensive strategic partnership in various field," *Antara News*, October 7, 2013, accessed on December 11, 2014, <http://www.antaranews.com/en/news/91035/indonesia-china-forge-comprehensive-strategic-partnership-in-various-field>

is consistently ranked as Indonesia’s second largest trading partner, if not the largest, Indonesia’s portion in China’s total trade with ASEAN is still less than that of Malaysia, Singapore, and Thailand (Figure 2).

Figure 2. China’s Total Trade with ASEAN



Source: UN COMTRADE

In terms of FDI flows, the latest data from UNCTAD’s Bilateral FDI Statistics shows that ASEAN received 6.1 billion USD, or only around 6.95%, of China’s total outward flow of FDI in 2012. Of this amount, Singapore received around 25% of China’s FDI to ASEAN, which reached slightly over 1.5 billion USD, while Indonesia received around 22%, or slightly over 1.3 billion USD. Furthermore, the total value of China’s FDI stocks in Indonesia is much lower than those in Thailand, Malaysia and Singapore, while Japan remains Indonesia’s largest investor. Therefore, MSR initiatives could serve as a channel to boost China’s investment in Indonesia

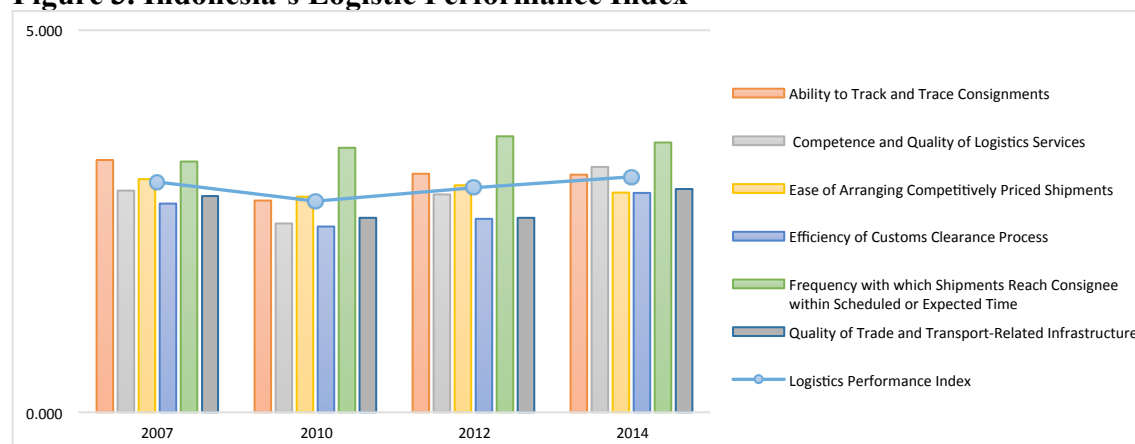
2.3.2 Infrastructure Development in Indonesia

Indonesia can benefit from the grand plan for infrastructure development inside the MSR initiatives. Infrastructure development is crucial for Indonesian economy in three ways. Firstly, development in transportation and logistics infrastructure, energy infrastructure, water management infrastructure (for irrigation and public consumption), as well as ICT infrastructure will increase Indonesia’s competitiveness. Evidently, the performance of the logistics sector is strongly correlated to trade performance, and an efficient logistic sector facilitates trade and minimizes costs of exporting and importing, which ultimately increases the value of exports. A strong correlation between trade performance and logistics sector

performance was also found in China and Hong Kong.¹² Singapore and Hong Kong have grown rich in part because their investment in the logistics service sector have led to more trade.¹³ Meanwhile, China's economy was driven by its exports, which caused large changes to its logistics services network with new flows of raw materials, component parts, and final products.

In Indonesia, the performance of logistics sector remains less than satisfactory. As indicated by the World Bank's Logistic Performance Index (LPI) in Figure 3, wherein an LPI of 5 represents the highest possible performance in the logistics sector, Indonesia's LPI always falls within the range of 2.8 to 3.08. Based on this index, the efficiency of the customs clearance process and the quality of trade and transport-related infrastructure has led to the worst performance of logistics sector throughout the years.

Figure 3. Indonesia's Logistic Performance Index



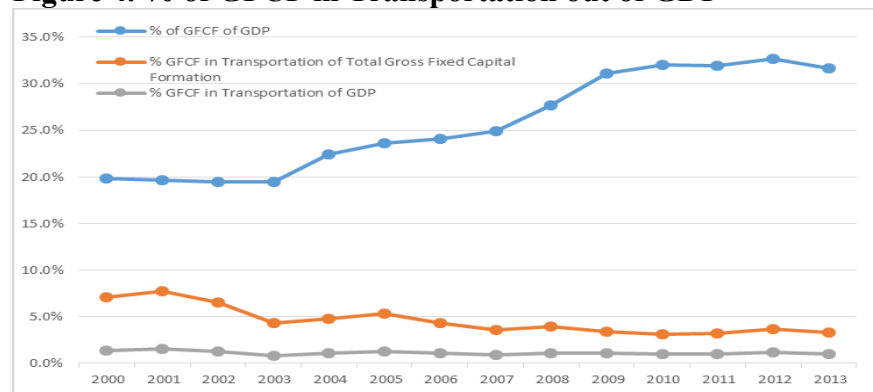
Source: CEIC

Needless to say, the efficiency of logistics systems depends on the efficiency of the transportation sector. In recent years, there has not been significant investment in transportation infrastructure. As is evident in Figure 4, the contribution of Gross Fixed Capital Formation (GFCF) in transportation has always been small, despite the increasing share of GFCF contribution to GDP. By 2013, GFCF in transportation was around 3.3% out of total GFCF.

¹² The proof for this can be seen with Singapore and Hong Kong, the two countries that have grown rich partly because their investment in the logistics service sector led to more trade (Carruthers, Bajpai and Hummels 2003). Meanwhile, China's economy was driven by its exports, which caused large changes to its logistics services network with new flows of raw materials, parts and final products (Lee and Rodriguez 2006 and Frankel 1998).

¹³ Jitendra Bajpaj, Robin Carruthers, and David Hummels, "Trade and Logistics: An East Asian Perspective.", 2003.

Figure 4. % of GFCF in Transportation out of GDP



Source: National Account

On the other hand, some efforts to protect Indonesia's transportation sector, especially shipping industry, is evident in the cabotage law implemented in 2011. There was a dramatic increase in the share of domestic players making up Indonesia's shipping industry for both domestic freight and international freight after the implementation of cabotage principle in 2011.¹⁴ However, foreign suppliers continue to dominate import and export activities, even though local suppliers have started to dominate domestic transport.

While the cabotage approach encouraged the production of smaller capacity ships for inter-island trade, it has placed Indonesian ships at a comparative disadvantage in terms of competing for trade in maritime services, which in turns increased the country's dependence on foreign liner carriers for international trade. This dependence on foreign liner carriers has caused a growing gap between Indonesian imports and exports of transport services. Based on Eurostat data, the deficit in freight more than doubled after the implementation of the cabotage principle, rising to €7.27 billion in 2012 from €3.21 billion in 2009. This growing gap between imports and exports of transport services is likely to continue as the Indonesian economy continues to grow. Therefore, protectionist measures will not be enough to boost the nation's transportation sector, and a strong infrastructure system will be needed.

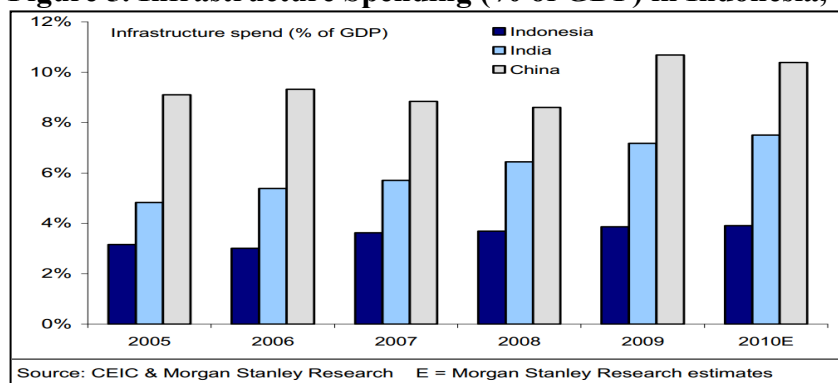
Secondly, infrastructure development is needed to address the current supply constraint problem in Indonesia. The latest assessment of Indonesia's competitiveness that was released by the World Economic Forum showed that infrastructure development in Indonesia failed to keep up with the economy's robust macroeconomic expansion. While Indonesia was ranked at 34th out of 144 countries in macroeconomic environment category, Indonesia's performance in terms of infrastructure was ranked at 56th. If left as it is, the supply constraint

¹⁴ Frost & Sullivan's Indonesia Shipping Outlook 2011

problem will guarantee an overheated economy, which will then lead to high inflation and a high current account deficit. Thirdly, infrastructural problems in many sectors act as obstacles for attracting FDI and boosting industrial growth. In short, inadequate infrastructure will cost Indonesia's long-term economic growth. Therefore, more investment in infrastructure is needed.

Nevertheless, the value of investment for infrastructure in Indonesia has always lagged far behind that of China and India, as indicated by Figure 5. Although the portion of investment in infrastructure has increased steadily in Indonesia and India, Indonesia has not been able to catch up with India's spending.

Figure 5. Infrastructure Spending (% of GDP) in Indonesia, China and India

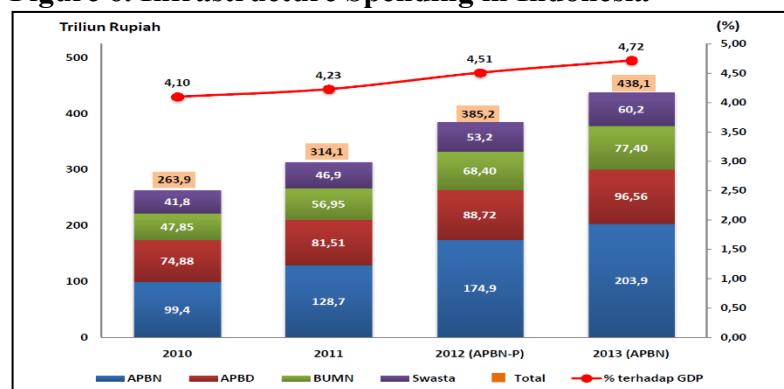


Source: CEIC and Morgan Stanley Research

There are two main obstacles for investing in Indonesia's infrastructure. First, financial resources are lacking. Technically, this lack of financial resource could be resolved by increasing private sector participation. Nevertheless, Indonesia has still not managed to create an investment climate conducive to attracting foreign and domestic investors¹⁵. The Doing Business Report 2015 ranked Indonesia as 114th in terms of business environment, much lower than the benchmark rank of the East Asia and Pacific region at 92, and the rankings of both China and Philippines.

¹⁵ For example, land disputes impede infrastructure projects. At the end of 2011, the government and parliament approved the new Land Acquisition Law (UU No. 2/2012) in order to speed up the land acquisition process.

Figure 6. Infrastructure Spending in Indonesia



Source: Bappenas

Secondly, infrastructure spending has always made up a relatively small portion of GDP (Figure 6). By 2013, infrastructure spending was close to 5% of GDP – the minimum amount needed to support an economic growth rate of over 7%. A large portion of funds for infrastructure come from the national budget (Figure 6), while private sector participation remains the low. In addition, mismanagement, corruption and incompetence have created a lack of financial resources available for infrastructure maintenance, resulting in inadequate infrastructure.

2.3.3 Political and Security

As mentioned previously, Indonesia and China has established various cooperation frameworks within the ASEAN-centred regional security architecture. Nevertheless, various tensions also color the regional scene. Territorial disputes in South China Sea continue to threaten Asia-Pacific security and stability, which have been the backbone of prosperity for countries in the region. The first is the recent tension between China and Vietnam over the oilrig incident. After some heated arguments, China has eventually removed the oilrig that triggered the dispute in the first place on July.¹⁶ The second is the issuance of controversial Chinese passports with a map of dotted line in the South China Sea in 2012 and declaration of Air Defense Identification Zone (ADIZ) in the East China Sea in 2013.

The events above have increased the unease among countries in the region on China's ascendancy, notwithstanding Indonesia. While Indonesia so far is not a claimant to the South China Sea dispute, and also since ADIZ is not applied in the South China Sea region, however, the Indonesian government has carefully observed those incidents taking place so

¹⁶"Beijing removes South China Sea oil rig," *The Guardian*, July 16, 2014, accessed on August 22, 2014, <http://www.theguardian.com/world/2014/jul/16/beijing-re-moves-south-china-sea-oil-rig>

far. This, for example, has been expressed by the Indonesian Foreign Minister Marty Natalegawa that Indonesia was ‘disappointed’ with China’s deployment of oil off contested waters with Vietnam in South China Sea.¹⁷ Foreign Minister Marty also called China’s issuance of controversial passport ‘disingenuous, like testing the waters to see the reaction of its neighbors.’¹⁸ On the case of ADIZ in the East China Sea, while Indonesia did not register strong objections, unlike Japan, the United States, and South Korea, but it stressed that it would not accept such zone in the South China Sea, signaling China has crossed the line in East China Sea with the ADIZ.¹⁹ Efforts by ASEAN and China to elevate the existing Declaration of Conduct (DoC) in South China Sea into a more binding agreement such as Code of Conduct (CoC) have unfortunately been far from successful. Yet, several early results have already been achieved in the first document on commonalities, joint maritime research, senior officials’ hotline for maritime emergencies, and rescue hotline.²⁰

There is an opportunity that the 21st Maritime Silk Road initiative could be a part of the bigger Maritime Partnership between China and Indonesia. The idea to establish Maritime Partnership Initiative as proposed by Dr. Rizal Sukma can be the framework for maritime cooperation with external potential partners. First, this initiative will provide an alternative platform for maritime states, which possess distinctiveness on maritime-oriented policies and capacities to discuss together on how to pursue their interests at sea in a transparent, peaceful, and cooperative manner. Second, this framework will be effective to focus in dealing non-traditional security challenges at sea since the members have special capacities and resources as maritime countries. In this case, China, for example, has shown its capacities to fight against piracy in the Gulf of Aden, which will be very useful to be utilized in the future.

¹⁷ Siahaan, Tito Summa. “Indonesia ‘Disappointed’ With China Over South China Sea Oil Rigs: Marty,” *The Jakarta Globe*, May 10, 2014, accessed on December 11, 2014, <http://thejakartaglobe.beritasatu.com/news/indonesia-disappointed-china-south-china-sea-oil-rigs-marty/>

¹⁸ Sukma, Rizal. “Insight: ASEAN, China, and the chance of a collision at sea,” *The Jakarta Post*, December 13, 2012, accessed on December 11, 2014, <http://www.thejakartapost.com/news/2012/12/13/insight-asean-china-and-chance-a-collision-sea.html>

¹⁹ Hussain, Zakir. “Indonesia tells China it will not accept an air defense zone over South China Sea: Marty,” *The Straits Times*, February 18, 2014, accessed on December 11, 2014, <http://www.straitstimes.com/breaking-news/se-asia/story/indonesia-will-not-accept-china-air-defence-zone-over-south-china-sea-ma>

²⁰ Xiuping, Yang. “Change, unchanged in China-ASEAN ties,” *The Jakarta Post*, December 15, 2014, accessed on December 16, 2014, <http://www.thejakartapost.com/news/2014/12/15/change-unchanged-china-asean-ties.html>

3. Indonesia's Perspective and Expectation of the MSR Initiative

3.1 Economic Perspective: Opportunities and Challenges

The MSR Initiative is presented at an important juncture of Indonesia's economic development. A few years earlier Indonesia launched a master plan for long-term economic development, known with its Indonesian abbreviation as MP3EI. MP3EI is an ambitious plan, aiming at propelling Indonesia into the top ten economies by 2025. The plan has three pillars: the development of economic corridors or growth centers, strengthening connectivity and, development of human resource and, national science and technology.

Under the plan, Indonesia is divided into six economic corridors. Each of the corridors will become a center for distinct economic activities based on its perceived comparative advantages. They are:

1. Sumatra is a center for production and processing of natural resources as well as the nation's energy reserves
2. Java as a driver for national industry and service provision
3. Kalimantan a center for production and processing of national mining and energy reserves
4. Sulawesi as a center for production and processing of agricultural, plantation, fishery, oil & gas, and mining
5. Bali and Nusa Tenggara as a gateway for tourism as well as national food support
6. Papua and Maluku Islands as a center for development of food, fisheries, energy, and national mining

To facilitate movements of goods, services and people across the country, MP3EI aims at strengthening the country's connectivity. It will include developing, among other components, national logistic system, national transportation system and, information and communication technology.

MP3EI also recognizes that Indonesia can no longer rely solely on the availability cheap labor. It is inevitable that the Indonesia should strengthen its knowledge-based economy which relies primarily on innovations as the engine of economic growth. This will, in turn, require a large pool of well-educated, highly-skilled workforce and, hence, human resources development.

Since the launching of the MPEI the government has changed hand, from President Susilo Bambang Yudhoyono to President Joko Widodo (hereafter, President Jokowi). It is unclear at this juncture whether the new government will implement the master plan, or whether it will decide to develop a new economic plan. Recently, President Jokowi has come up with a new vision or initiative known as Global Maritime Fulcrum (*Poros Maritim*, GMF) initiative.

Like the MSR, the GMF is yet to be elaborated further. Nevertheless, judging from what has been said so far, it will consist of, among other things, the development of sea highway and, presumably also, maritime-based economy in general. The development of sea highway is expected to include the development of ports in various parts of the country as well as expanding and modernizing the country's shipping industry. Meanwhile, marine-based economy also includes, among other components, boat/ship building, repair and maintenance infrastructure and services, fishing, offshore oil and gas exploration and extraction, other resources extraction and use, marine tourism and recreational activities, marine environment management. The GMF initiative is also expected to include an endorsement of the national connectivity development program. That is, to facilitate movements of goods, services and people across the country, it is necessary that Indonesia strengthening its national connectivity.

The GMF is essentially a 'rediscovery' of Indonesia's identity as maritime country. For a long time Indonesia has been managed as if it is a continental country which it is not. Indonesia consists of around 17000 islands, between 2000 and 4000 of them are inhabited. Additionally, about two third of the country's territory is water.

There are a number of possible reasons for the benign neglect of the country's maritime nature. First, Indonesia's population is concentrated in a few large islands. According to 2010 census, out of 237 million Indonesian in 2010 around 57.5 percent of live in Java, 21.3 percent in Sumatra, 7.3 percent in Sulawesi and 5.8 percent in Kalimantan. The rest is scattered in other islands. It is often the case with a country with an uneven distribution of population that economic development, including manufacturing industry and infrastructure development, tends to concentrate where most of the people settle. Indonesia is no exception; the country's economic development has been concentrated particularly in Java, Bali and, to some extent, in Sumatra and South Sulawesi.

Second, investment in marine infrastructure such as port and in marine transportation is expensive. This problem is exacerbated further by two factors. The first one is the uneven

distribution of population and the concentration of economic development in a few islands discussed above. As a result, quite often, ships carrying cargoes from say, Java to the eastern part of the country, are virtually empty in their return voyage. It is one reason why the logistics cost is very high in Indonesia, estimated to be around a quarter of the country's GDP.

The second factor is, until recently PT Pelabuhan Indonesia (PT Pelindo) has the monopoly over the development and management of the country's ports. Arguably, absent competition and contestability, PT Pelindo could and might, in fact, have managed the country's ports in an inefficient way. The cabotage policy is often mentioned as another contributing factor for the high logistics cost. But the policy was introduced only recently and so far there has not been any study, at least not to this author's knowledge, which provides a solid proof that the logistics cost has indeed risen since the introduction of the policy and that the cobatage policy has a direct bearing on the increase.

3.1.1 Interviews and FGD

It is against the above background that we conducted our interviews and focal group discussion (FGD) with various stakeholders. The main objective is to hear directly from the stakeholders their views about the proposed MSR and how it would affect Indonesia's economic plan, including the GMF initiative. We are mindful of the fact that both the MSR and the GMF initiatives are still, at best, unclear. In addition, it is should also be stated that Indonesia, as a member of ASEAN, also takes part in the implementation of the Master Plan on ASEAN Connectivity and which many stakeholders are well aware of. Being an immediate neighbor of ASEAN, China has, by default, involved in some of the master plan projects, such as the Singapore-Kunming Rail Link project, as well.

There is a wide range of views emerge from the interviews and FGD which, in part, reflects the stakeholders' different background but, in part, also arguably due to inadequate information available about the issues at hand, particularly about the MSR itself. As often the case, when people were asked their opinion about something that they have very little information about, their views tend to vary a lot. However, once they were given additional information, their opinions are likely to converge. It should be mentioned from the outset that none of the stakeholders involved in the FGD or interviews were against Indonesia's involvement in the MSR. In general, the stakeholders' views reflect their expectations as well as their wishes about the MSR.

On Trade Relations

One pessimistic view about the prospect of improving trade between Indonesia and China comes from a prominent businessman. He argues that the two countries are essentially competing with each other rather than complementing one another. Some other stakeholders have a more positive view, albeit often with some qualifications. For instance, it has been suggested that, instead of the current practice whereby Indonesia is exporting raw materials to China, it would be better if, prior to exporting, those raw materials are processed in Indonesia using Chinese technology. Presumably, this would entail China's investment in Indonesia. Another suggestion is for China and Indonesia to explore the prospect of co-branding, i.e., to develop and produce joint products which target the US and EU markets.

On investment

There are a number of issues raised concerning China's investment in Indonesia. First, on direct investment from China (FDI), it has been pointed out that China's FDI in Indonesia is low compared to that from Japan, Korea and Singapore. Most people would like to see an increase in Chinese companies' investment, especially by relocating their production base to Indonesia, similar to the relocation of companies from Japan and Korea in the past. In particular, it has been suggested that in line with the MSR and the GMF, China should invest in shipbuilding and related industries. For instance, China can invest in shipyards deemed essential for shipbuilding, maintenance and repair as well as in ship engine industry, etc. It has also been alluded that China might be more willing to transfer its shipbuilding and related technologies than, say, Japan or Korea. It remains to be seen whether this indeed is the case. It should be noted that in order to achieve the GMF vision, Indonesia would need to modernize and expand its maritime fleets. In other words, Indonesia is expected to demand a large number of ships of various size in the coming years.

Second, on investment in infrastructure. There appears to be fairly general agreement that the investment in infrastructure development, including in the port sector leaves something to be desired. President Jokowi has acknowledged as much in his speech in Beijing as he invited investors from APEC countries, from China in particular, to invest in infrastructure development including in the port sector. It has been suggested that for investment in the port sector, the government may use build-operate-and-transfer (BOT) or build-operate-lease-and-transfer scheme. Another scheme, a joint venture scheme with a 51% domestic – 49% foreign split is deemed ineffective. It has been tried in the airport sector but has failed to attract

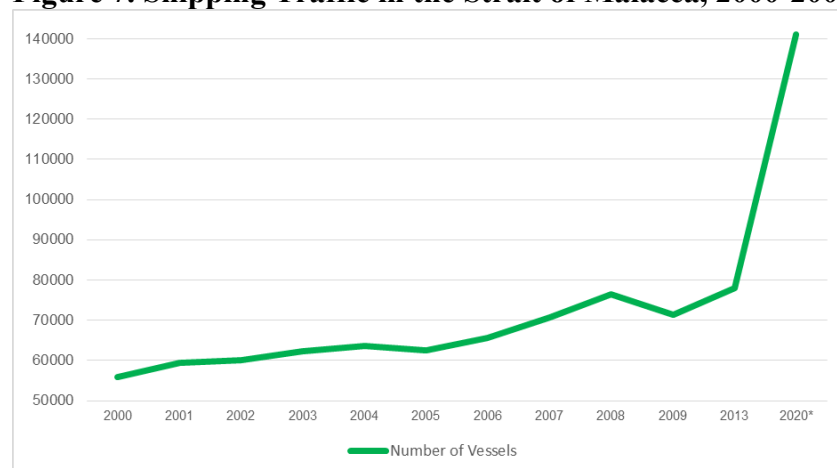
domestic investors. In fact, it was foreign investors that could not find domestic counterparts who were willing to invest their share.

Third, the failure of the 10,000 Mw power projects in which Chinese companies were involved is also brought up during interviews and FGD. The aim is primarily to identify lessons learnt from the debacle. A number of views emerge. One view rests the blame on the Chinese companies involved in the projects which, according to this view, were relatively small and did not have a good track record to begin with. This was reflected in their failure to secure bank financing for the project. Another view blames Indonesia's state-owned power company (PT PLN) instead. According to this view, PT PLN was more interested in reducing the project costs but in the process disregarded the importance of such issues as licensing and prudent due diligence processes. Land acquisition has also been identified as a main inhibiting factor in most infrastructure projects.

On Connectivity

One of the main components of the MSR is connectivity. Since the MSR was offered to ASEAN, it has been suggested that ASEAN should make sure that the connectivity component is compatible with the Master Plan on ASEAN Connectivity. It has also been alluded that Indonesia may want to redesign its own connectivity plan so as to make it more compatible with that of ASEAN Connectivity.

Figure 7. Shipping Traffic in the Strait of Malacca, 2000-2009 (With the Year 2020)



*Projection for year 2020

Source: Modified from Port Klang VTS

On an Asian Infrastructure Investment Bank

In addition to the MSR initiative, China is also attempting to establish Asian Infrastructure Investment Bank (AIIB) and invited a number of countries including Indonesia to participate

in the founding of the bank. After a long delay, recently Indonesia has finally signed a memorandum of understanding to join the AIIB as one of the founding members. Understandably, given Indonesia's huge demand for infrastructure funds, most of the stakeholders have expressed their support for Indonesia's participation in the AIIB. It should be mentioned all the interviews and FGD were held prior to Indonesia's decision to join the bank.

On Other Issues

A number of other issues were brought up during the interviews and FGD. First, the number vessels traveled through the Malacca Strait has increased steadily in recent years. In 2000, the number was 55,957 vessels; by 2013 the number has increased to 77,973 vessels (Figure 7). Given the trend, the number of vessels that will pass through the strait is predicted to reach 141,000 in 2020 as depicted in the graph above.

Figure 8. Alternative Shipping Lanes in Indonesia



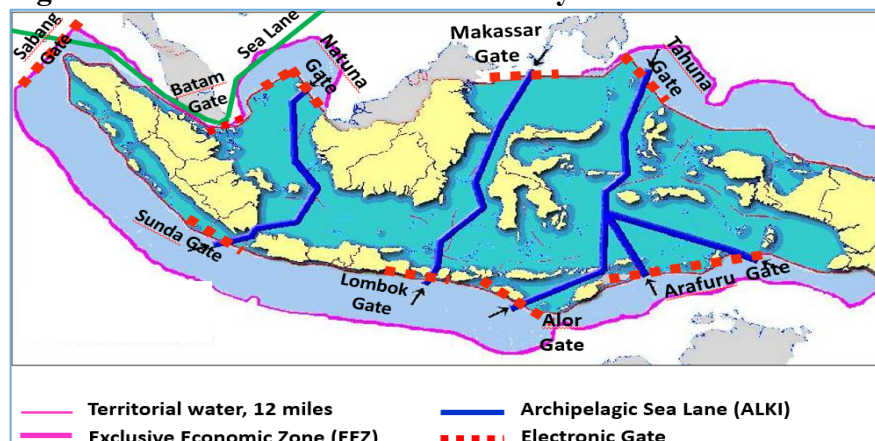
Source: Harry Budiarto, personal communication

There are alternative shipping lanes for ships travelling between South China Sea and Indian Ocean to the Malacca Strait, i.e., the Sunda Strait and, the Lombok Strait and the Sulawesi Strait. Indonesia has been promoting these two routes as alternative to an increasingly crowded Malacca Strait. However, there are a number of reasons why most ships will continue to sail through Malacca Strait. The most important reason is cost. Ships will have to bear extra costs due to additional steaming time as they have to travel extra distance should they decide to pass through the Sunda Strait or the Lombok Strait (see the map above).

Another reason is the absence of marine electronic highways along these alternative routes that will guide and monitor the movement of ships travelling through the channels. In addition, none of the electronic gates identified in the map below currently exist. An

electronic gate is a place where ships have to report when entering and leaving Indonesian territorial water. If Indonesia is serious about monitoring the movement of ships within its territorial water as well as promoting the use of the Sunda Strait and the Lombok Strait as alternative shipping lanes to Malacca Strait, it should consider the construction of marine electronic highways and electronic gates as a priority.

Figure 9. Indonesia's Electronic Gateway



Source: Harry Budiarto, personal communication

Second, regarding the use of the Chinese currency, Yuan, as alternative to dollar as an instrument of payment in trade and investment as well as foreign reserve, it has been argued that the best way is to let the parties involved decide. They know their own financial need and condition better than the government. It should also be mentioned that Yuan is not yet fully convertible and, hence, not as liquid as the US dollar. It also implies that will be more difficult to exchange a large amount of Yuan with another currency in a short notice than a fully convertible currency such dollar or euro.

Third, regarding employment of foreign nationals in a foreign-funded project, it has been suggested that the government should be explicit on the qualification of foreign nationals that a contractor can bring into the project. One proposal is allow only those that occupy high-level positions, e.g., manager or equivalent.

3.2 Political and Security Perspective

It is encouraging to see how China, by launching the MSR initiative, is interested in reviving the spirit of the ancient Silk Road and its promotion of peace, cooperation, and mutual prosperity in the region. Such an initiative is crucial, especially for coping with the potential

for open armed conflicts to occur due to heightened competition and tension among the major powers of the East Asia region within the past few decades.

However, this grand concept still lacks detailed elaboration, particularly concerning how it is will be operationalized. Therefore, stakeholders, and in particular those from Indonesia, have different concerns, about the MSR initiative. The ability and willingness of the Chinese government to learn from and address these concerns will be crucial in determining how the MSR initiative will be accepted. This subsection describes the concerns from Indonesian elites such as government officials and relevant scholars, about the political and security dimensions of the MSR. In addition, this section also discusses the MSR in relation to Indonesia's vision of a Global Maritime Fulcrum (*Poros Maritim Dunia*, hereafter abbreviated as 'GMF').

3.2.1 Perceptions of the MSR and Maritime State

In general, there are three views about the MSR initiative. The first view argues that the MSR is a 'blessing in disguise,' since the initiative could be compatible with the GMF vision that President Joko Widodo launched at the beginning of his presidency. In a regional context, since MSR promotes further connectivity among countries through its five links (policy, roads, trade, currency, and people). According to one scholar, both the MSR and GMF would address connectivity, safety, and diplomacy. Therefore, there is a potential for this MSR initiative to transform the prolonged dispute over territorial sovereignty, particularly in the South China Sea, using constructive joint activities that will facilitate smooth sea navigation in the area. Such a goal of regional peace, built on the creation of a free and safe maritime passage, is shared by the GMF.

Then, in a national context, some scholars argue that Indonesia should prepare itself to make good use of what will occur under the MSR initiative, such as offers for infrastructure projects and other kinds of investments. These would help Indonesia catch up its capacities and thereby develop into a maritime state, or beyond that, a maritime fulcrum. Instead of worrying too much about the possible impacts of MSR, stakeholders of this group suggest that the government fix the domestic bureaucratic capacities to deal with domestic problems, such as overfishing activities, that damage the marine environment, or to deal with the lack of coordination among the existing government institutions, with corruption, and with the minimal capacities that currently exist to protect national water territory.

In addition to that, the inclusion of the new initiatives, such as the MSR or becoming one of the founding members of the AIIB, are seen as not limiting Indonesia's foreign policy independence. For example, with its participation in AIIB, according to one elite, Indonesia can maintain its participation in existing international financial institutions, such as the World Bank and the Asian Development Bank. In fact, by participating in new initiatives, Indonesia will have more alternatives for serving its national interests. When compared to the previous initiatives, the MSR, according to one elite, is the first proposal that clearly includes Indonesia in its development.²¹

It is also important to note that, according to scholars within this camp, China is fully aware that any instability in Southeast Asia will have a direct impact on China's national interests and its efforts to maintain its economic growth. Therefore, it is quite logical for China to play an active role in the region, allowing these stakeholders to argue that the MSR initiative is genuinely designed to share common benefits and prosperity with all.

The second camp has slightly a different position with the first. In general, this group views MSR as nothing new. As described in the earlier section, there has been a long list of MoUs and agreements already reached bilaterally between Indonesia and China, as well as multilaterally through ASEAN-China framework, in various fields, including trade, investment, and joined initiatives to address humanitarian disasters and transnational challenges, such as sea piracy, and so on. Connectivity, which is the key focus of the MSR, has already been reflected through these earlier agreements and initiatives.

However, these stakeholders draw attention to the existing tensions in the region, such as those stemming from disputes in the South China Sea or the territorial disputes between China and Japan over the Senkaku/Diaoyu islands. While Indonesia is not a claimant party in these disputes, it sees the South China Sea issue, together with the border security issue, as the country main security challenge in the near future.²² China's move to place a state-owned oil-rig HD 981 in Block 143 inside the Vietnam's Exclusive Economic Zone (EEZ) in early May 2014 provoked strong reactions from the Vietnamese, and resulted in a deadly anti-Chinese riot that killed at least 20 people and targeted foreign factories that were perceived as

²¹ For example, the Plan of Action to implement ASEAN-China Strategic Partnership has only addressed the Singapore-Kunming railway network and the China and the Mekong River Basin development cooperation, neither of which included Indonesia.

²² Dicky Christanto, "TNI chief sees S. China sea, borders as imminent challenges", *The Jakarta Post*, 11 April 2014, <http://www.thejakartapost.com/news/2014/04/11/tni-chief-sees-s-china-sea-borders-imminent-challenges.html>

Chinese symbols in the country.²³ Then, around two years ago, a ‘small’ incident such as the issuance of new passport that included a map with dotted line that includes South China Sea area has even triggered a reaction from Indonesian Foreign Minister that called the move as “disingenuous, like testing the waters to see the reaction of its neighbours.”²⁴

Indonesia also criticized the possibility of China to imposing an Air Defence Identification Zone (ADIZ) in the South China Sea, after China did so in the East Asia Sea provoking strong reactions from China’s neighbours in the Northeast region.²⁵ Furthermore, the Chinese gesture to delay the negotiation over the Code of Conduct (CoC) with its ASEAN counterparts, while arguing that the time is not ‘ripe’ for them to do so, has also lead to people questioning China’s good will towards agree on joint cooperation, as opposed to enforcing its own sovereignty over disputed areas. The lack of a CoC, which would serves as a binding mechanism to prevent conflicts and manage crises, continues to make the region more volatile and prone to serious conflicts at any given time.

Therefore, stakeholders within this second camp prefer to take a ‘wait-and-see’ position in regards to the MSR initiative. While the first camp immediately links the MSR with the GMF vision, the second camp recommends refraining from rushing to accept the concept, let alone synchronising the GMF with the MSR, given the conditions discussed above. As elucidated by one official, Indonesia’s agreement to join the MSR should be carefully conveyed in a way in which it will not be perceived as a tacit acknowledgement of the nine-dashed line claim applied by China. It should be noted that, officially, Indonesia has never acknowledged the existence of the nine-dashed line produced by the Chinese government.

Finally, the third camp takes a stronger stance against the MSR initiative. Although they do not bluntly suggest that the Indonesian government reject the MSR proposal, the scholars or officials within this camp clearly require better and more comprehensive elaboration on the motivations behind the initiative, and about the ways in which the Chinese government is planning to implement the MSR in reality. They scrutinize, in particular, attempts to use the MSR to reinvok the ancient Silk Road, since they note that that practice was designed around tributary relations between the centre/superior with the periphery/inferior states.

²³ “Anti-China riot turns deadly in Vietnam”, 15 May 2014,

<http://www.theguardian.com/world/2014/may/15/anti-china-riots-turn-deadly-in-vietnam>

²⁴ Rizal Sukma, “ASEAN, China and the chance of a collision at sea”, *The Jakarta Post*, 13 December 2012.

²⁵ “Indonesia tells China that it will not accept an air defense zone over the South China Sea: Marty”, <http://www.straitstimes.com/breaking-news/se-asia/story/indonesia-will-not-accept-china-air-defence-zone-over-south-china-sea-ma#sthash.qzRGDQyz.dpuf>

According to one scholar, the Chinese kingdom at that time was in the superior position to decide the items and quantities being traded. Therefore, they are concerned that this initiative is designed with the motivation to revive the sentiment of Chinese past glory, which in turn relied on unequal relations with countries that were considered as its periphery states. This view is especially pertinent given that, what with its current development, China is seen as a rising and ascending power.

Moreover, there is an anxiety that this MSR will be used as an instrument to divide countries into a group of those who are favourable (since they joined the MSR) and a group of those who are unfavourable (since they did not join). They are further concerned that, even those countries who are on the favourable list will have to pay certain concessions to China, such as providing access to local markets, which might be disadvantageous for them. In this context, Indonesia has not had sufficient capabilities to explore its own resources, particularly at sea. The implementation of the MSR is feared to give too many concessions and opportunities to explore Indonesia's EEZ, since China has much better maritime technology, and Indonesia is not prepared with the legal instruments to protect itself from exploitive practices.

These stakeholders also see a parallel between the MSR and the 'string of pearls' concept, wherein the MSR would be a part of a strategy to secure China's military and commercial routes at sea, and its sea lines of communications (SLOCs), which in turn is aimed to counter India's expansion in the region. This thinking, although it might not be the dominant view, elevates due to certain observation over the Chinese assertiveness in the region. While the MSR is understood so far as an initiative designed to promote connectivity, there are concerns that it may be used as another instrument to absorb Indonesia's natural resources with a favourable price for the Chinese. This is based on the perception that due to the size of its population and the need to maintain its economic growth, China is in constant hunger for energy resources. What is more worrisome, as China is continuously seeking to expand its energy sources abroad, neighboring countries are keeping a close eye on where China's growing military power is heading. There has been a growing concern that the strong interest to protect its energy security will drive the expansion of China's military influence through upgrading its military capabilities as an effective instrument to support such activity.²⁶

²⁶ David Zweig and Bi Jianhai, "China's Global Hunt for Energy", *Foreign Affairs*, September/October 2005, p. 33.

In regards to the consistent development of China's naval capabilities since the mid-1980s, it is not the military capability itself that invokes concern – since it is well acknowledged that it could be used to provide a public good and help China become a responsible major country – but rather the fact that this naval power can be used to challenge another superpower or major power in the region, as could be done with the United States.²⁷ A Cold War-like situation, although it may not necessarily manifest itself as an armed conflict, would hinder smooth cooperation between countries, as the MSR envisions, and would certainly seriously challenge Indonesian efforts to become a maritime fulcrum.

To summarize, although Indonesia is not in opposition to China's naval expansion, it is important for the Indonesian stakeholders to see consistency in China's actions, which have so far given the impression that China is becoming an assertive power that often flexes its military muscles to enforce its unilateral claims over certain seas that are also claimed by other countries. Indonesia therefore questions whether the application of the MSR initiative will be consistent with China's efforts to improve cooperation within the region - and as such work in tandem to such potential actions the establishment of a CoC in the South China Sea – and thereby reflect that China's rise is a peaceful one that should comfort all actors in the region. Indonesian stakeholders also would like to check whether, within this MSR initiative, China intends to treat invited countries as equal partners, or whether it will apply its historic policy of tributary relations that turns countries, such as Indonesia, into periphery states. If the latter is taking place, then the connectivity that would be established through an MSR would only serve Chinese interests rather than bring common benefits to all. Such a scenario, according to some scholars, needs to be anticipated and ruled out before the MSR can be accepted.

3.2.2 Indonesia's Global Maritime Fulcrum Initiative

With such positive conditions between the two countries, there is always a chance for the MSR to be welcomed, especially given how such initiative fits with Indonesia's vision of becoming a Global Maritime Fulcrum. While the definition of a 'maritime fulcrum' remains vague, in this paper we can nevertheless propose few ideas about this vision that can be used to add some meat to the skeleton of this maritime fulcrum framework.

According to the Webster's New World Dictionary, the word 'fulcrum' has at least two definitions. First, a fulcrum is the support or point of support on which a lever pivots when

²⁷ Rizal Sukma, "Should we fear China's growing naval power?" *The Jakarta Post*, 13 August 2011.

raising or moving something. Second, a fulcrum is a means of exerting influence and pressure.

There are several elements that we can infer from those two definitions. First, a fulcrum can be located at the centre or side of any mechanism, but should serve as a point of support on which other component pivot when moved. Second, interestingly enough, the fulcrum can be used to exert pressure or influence.

In relations to this maritime fulcrum vision, from its geographical location, Indonesia is clearly located at the heart of two oceans: the Indian Ocean and the Pacific Ocean. As an archipelagic state, Indonesia has no option other than playing a role in the global, or at least regional, maritime architecture, since its territorial waters have become the sea-lanes of communications of other countries. Furthermore, as a natural leader, or even as *primus inter pares* in ASEAN, Indonesia carries the responsibility of managing the relations among different countries, including the major powers with interests in these two oceans. In other words, Indonesia should strive, through its foreign policy, to maintain the balance of relations between major powers, middle powers, and even small powers, in order to maintain regional peace and stability. As mentioned on many occasions, Indonesia has a strong interest to maintain freedom of navigation, over which no power should dominate, and to use the seas as a source of opportunities for joint cooperation that glues together different actors, and helps them deal with both traditional and non-traditional challenges at sea.

In a recent informal discussion in Jakarta, former Indonesia Military Chief Agus Suhartono argued that Indonesia's role as a maritime fulcrum has actually taken form since ships and vessels from various countries have travelled through Indonesia waters for centuries. However, he underlined that security and other conveniences, such as good port facilities, are the important factors that will invite countries to further use the sea-lanes in the Indonesian waters.²⁸

Thus, in order to be able to implement foreign policy while acting as a fulcrum, Indonesia must catch up its domestic capabilities and develop the relevant domestic institutions and mechanisms. Fifty years ago, during the Cabinet Dwikora of 1964, Indonesia already had strong institutions to reflect the government's desire establish a strong maritime state.

²⁸ "Maritime axis already take form, needing only infrastructure", *ANTARA News*, 13 September 2014, <http://www.antaranews.com/en/news/95649/maritime-axis-already-take-form-needing-only-infrastructure>

President Soekarno, at that time, created a Coordinating Ministry on Maritime Affairs that coordinates three ministries: the Ministry of Sea Transportation, the Ministry of Fishery and Sea Management, and the Ministry of Maritime Industry. However, the New Order regime that followed diminished the importance of these ministries, and oriented national policy toward a land-based strategy. It is therefore urgent that this maritime compartment be re-established within the new Cabinet of President Jokowi.²⁹

Besides the internal reformation in the political sphere, in the defense aspect, Indonesia seriously needs to modernize its naval capabilities. It is interesting to find that the former President Megawati, who now supports the Jokowi presidency, made a statement during the 50th Anniversary of the Navy Academy in East Java, back in 2001, calling attention to the fact that Indonesia needs to have a strong navy in order to guard its territorial waters, particularly from illegal activities at sea. According to her, the existence of a strong naval force certainly reflects the nations dignity, making the country respected by other states as well.³⁰ It was under her leadership that the country started to modernise its naval capabilities with the goal of creating a “Green-Water Navy” by 2024. A Green-Water Navy blueprint, established in 2005, is of a higher status than a brown-water, or coastal, navy but still below that of a blue-water fleet. This blueprint included a 274-ship force structure, consisting of a strike-force capability of 110 ships, a patrolling force of 66 ships, and a supporting force of 98 ships. In addition, mine-laying vessels and a force level of eight submarines were also included as priorities to achieve by 2024.³¹

According to Juwono Sudarsono, the Indonesian Defence Minister of that time, as of 2006, Indonesian naval capabilities only reached 124 ships, of which only 60% were actually operational. Such poor capabilities were obviously insufficient to monitor Indonesia’s territorial waters from border intrusions related to maritime boundary disputes with the neighbouring countries, or to deal with non-traditional security challenges, such as illegal fishing, piracy, and smuggling activities.³² Therefore, it is very likely that the Jokowi administration is going to return to the original blueprint trajectory, since strong naval capabilities obviously will sustain the realization of a maritime fulcrum vision. For this

²⁹ Soleman B. Ponto, “Welcome Maritime Era”, *Koran Tempo*, 11 September 2014 [Indonesian].

³⁰ “Indonesia in need of strong navy: President”, <http://www.thejakartapost.com/news/2001/09/11/indonesia-need-strong-navy-president.html>

³¹ “Indonesia Navy - A Green-Water Fleet”, <http://www.globalsecurity.org/military/world/indonesia/alri-green-water.htm>

³² Ristian Atriandi Supriyanto, “Naval modernisation: A sea change for Indonesia?”, 30 January 2012, <http://www.nationmultimedia.com/opinion/Naval-modernisation-A-sea-change-for-Indonesia-30174719.html>

development to take place, Indonesia will be certain to need foreign investments and assistance to build its domestic military industries, and will have to receive loans and grants to purchase military equipment from other countries.

Furthermore, in the context of regional cooperation, the idea, as proposed by Rizal Sukma, to establish a Maritime Partnership Initiative should be supported. First, this initiative would provide an alternative platform for maritime states, which share distinctive maritime-oriented policies and capacities, and which should discuss how to pursue their interests at sea in a transparent, peaceful, and cooperative manner. Second, this framework would be effective to focus on dealing with non-traditional security challenges at sea, since the members would have special capacities and resources as maritime countries. In this case, China, for example, has shown its capacities to fight against piracy in Gulf Aden, which would be very useful to be utilized in the future by other parties.

4. Recommendation and Future Agenda

The MSR Initiative was presented amid an important economic transformation in Asia in which, as noted, China has been playing a significant role. Today, China is the world's second largest economy and is expected to maintain its rapid growth, albeit at a lower rate than it has in the recent past. Meanwhile, intra-Asia trade is now the fastest growing regional trade in the world. For instance, trade between ASEAN and China has been booming, especially since the ASEAN-China Free Trade Agreement (ACFTA) came into force in 2010. In 2013 ASEAN trade with China accounted for around 37 percent of its total trade, up from 26 percent in 2000. In contrast, ASEAN trade with the US fell from 20 percent in 2000 to 10 percent in 2011.

From an economic perspective, the MSR Initiative can and should aim to foster existing economic ties between China and ASEAN member countries, including Indonesia. For instance, any initiative to further improve trade relations between ASEAN and China could be done within the ACFTA framework. Similarly and, in a way, more importantly, any effort to increase investment relations between the two could also be done within the ACFTA framework, which has provisions concerning investment. As mentioned earlier, ASEAN currently receives only a small fraction of China's total FDI abroad.

The current political and security relations between Indonesia and China are also relatively positive. The discourse over the possibility that Indonesia will soon have a problem with

China over the Natuna Islands, due to a recent statement from one of the Indonesian elites, has not actually invoked a strong reaction from the government that would disrupt the bilateral relations between the two countries. One analyst argued that such a prediction about the dispute between the two countries is rather misleading since Indonesia is not a claimant to the South China Sea, and has never acknowledged the existence of any dispute with China over the nine-dashed line. Furthermore, he added that Indonesia's increased military capabilities has never been directed to counter the rise of China, but is rather designed to catch up from past lapses and fulfill the minimum requirement of naval strength to ensure that Indonesia's defenses can effectively protect the country.³³ In February 2014, Indonesia allowed Chinese surface vessels and submarines to pass through Indonesia's southern territorial waters when they were returning from anti-piracy training in the Gulf of Aden – an act that can be perceived as a snub against an earlier intrusion by Australian patrol boats into Indonesian territorial waters while trying to intercept suspected asylum seekers. As the TNI spokesman, Rear Admiral Iskandar Sitompul, expressed, the Chinese fleet was passing in a 'normal mode,' and it was in Indonesia's best interests to forge closer relations with China. He even added that such permission was a 'token' of friendship with China.³⁴

Nevertheless, it is important to admit that despite a relatively good relationship between Indonesia and China, it is clear that the trust deficit between the two countries remains high, and will have to be addressed if the MSR is to be welcomed and synchronized with the Indonesian national efforts to materialize a GMF. The Chinese government needs to ensure that the MSR not bring benefits to its own interest at the expense of those of others, but rather that it benefits all countries, bringing prosperity to all, and creating a win-win situation.

Based on the foregoing discussion, we propose the following recommendations.

First, if the MSR initiative is to be welcomed by countries in the region, including Indonesia, the Chinese government needs to engage the invited countries and have them help shape the MSR action plan, instead of coming with a ready-made Term of Reference that invited countries would have accept.

³³ Evan Laksmna, "Why there is no 'new maritime dispute' between Indonesia and China", *The Strategist*, 4 April 2014, <http://www.aspistrategist.org.au/why-there-is-no-new-maritime-dispute-between-indonesia-and-china/>

³⁴ Yuliasri Perdani and Yohanna Ririhena, "RI thumbs its nose at Oz by accommodating Chinese fleet", *The Jakarta Post*, 15 February 2014.

According to the Indonesian elites, such an elaboration or action plan for the creation of the MSR should result from an intensive and sincere discussion with the Indonesian government., which should be engaged in the process to determine the specific issues, projects, and activities needed by the country, and the ways in which these should be conducted in order to bring benefits to both countries. Such a process, if applied, would signal that China is motivated by a desire to treat invited countries as equal partners in the initiative, which would then elevates the level of its acceptance.

So far, the promise of infrastructure projects (building ports, railway system, and electricity powerhouses), which will be funded through the Asian Infrastructure Investment Bank (AIIB), is the only item that has been described so far, but further details about what specific projects are to be proposed, which areas will be targeted, and how the initiative is going to be conducted, are definitely necessary. This is particularly important in order to clarify whether the MSR proposal will develop into a military endeavour, which would be sure to create serious problems, both for Indonesia as well as for countries in region.

In addition to giving ample opportunities for countries to voice their concerns and expectations about the initiative, it is important that China's good intention shown through transparent motivations, objectives, and strategies for the MSR initiative. More importantly, it is crucial that the current Chinese government indicate that it has a strong interest to interact in the new pattern of relations, which would treat countries, both big and small, as equal partners that share common interests to invest in maintaining regional peace and stability through better connectivity between countries and societies. In the Indonesian context, a series of talks could be initiated to discuss the specific areas in which new infrastructure will be built, such as deep sea ports or shipbuilding industries, which would meet both countries' interests, especially since the Indonesian government, is highly motivated to develop the eastern part of its territory.

The second recommendation is to specify how the MSR can support Indonesia in its trajectory to become a maritime state, and eventually a maritime fulcrum in the future.

So far, although it will need to be elaborated further in the near future, it is recommended to follow up the five pillars of the national development agenda and translate them into the Maritime Fulcrum vision.³⁵ The five pillars are (1) to rebuild Indonesia's maritime culture;

³⁵ Speech by President Joko Widodo in the East Asia Summit, Nay Pyi Taw, 12-13 November 2014.

(2) to protect and manage its maritime resources with a focus to ensure the country's food security; (3) prioritize infrastructure development and maritime connectivity by building sea tolls, deep seaports, a logistics and shipbuilding industry, and maritime tourism; (4) to implement maritime diplomacy by inviting partner countries to cooperate in maritime issue, particularly when deal with various sources of conflict at sea, such as illegal fishing, violations of sovereignty, territorial disputes, sea piracy, and marine pollution; and (5) the obligation to build maritime defense capabilities, which are not only aimed to protect Indonesia's territory and resources, but also to share the responsibility to guard navigation safety and maritime security.

In regards to security, the last two pillars are ones under which the MSR initiative can be expanded to help support the national effort to materialize the Maritime Fulcrum vision. As touched upon earlier, China has shown its capacity to counter sea piracy in the Gulf of Aden, but it is also facing serious challenges from marine pollution, and therefore has created strong regulations to deal with the issue. Such capacities can be shared with Indonesian authorities, since Indonesia is still lacking in those capacities. It will also be very useful if China would share knowledge that could help Indonesia set up its first coast guard, since this instrument is very much needed.

Beyond infrastructures, there are also high expectations that, through this MSR initiative, the Chinese government will also invest in the development of human resources in Indonesia, particularly in the maritime field. Due to previous national development direction intended to develop the country as a land power, Indonesia is very much lacking in human capacities that require extensive knowledge to support the development of a maritime state. Indonesia needs to increase the number of experts it has to build up its shipbuilding industry, to, among other tasks, operate seaport facilities effectively, and to conduct extensive exploration in the underwater and seabed resources.

In addition to this, one scholar also wished that the MSR – since it exposes connectivity as its core – become a vehicle to exchange such values as democracy, the peaceful settlement of conflicts, and respect for pluralism in order to facilitate the creation of amity between civilizations.

The third recommendation is that, while both countries are waiting for more elaborations on the concrete structure of the MSR and GMF initiatives, work be

continued to promote the existing bilateral and multilateral agreements to which the countries are already committed First of all, it is important to show better commitment to implement the clauses in the Declaration on the Conduct of Parties (DoC) in the South China Sea, and particularly to reaffirm all parties' respect and commitment to the freedom of navigation in their respective area, and to resolve any territorial disputes by peaceful means without resorting to the use of force. It is crucial to apply self-restraint and not undertake any unilateral action that will complicate or escalate existing disputes. Instead, all parties should be willing to be involved in constructive dialogues, as well as to undertake cooperative activities on marine environmental protection, marine scientific research, safety of navigation and communication at sea, search and rescue operations, and combating transnational crime. Then, regarding security, the 2013 Joint Statement of the Comprehensive Strategic Partnership between Indonesia and China agreed to push forward the cooperation in joint military exercises and training, maritime security, defence industry, and non-traditional security areas. The two leaders also agreed to enhance judicial and law enforcement cooperation and deepen practical cooperation in combating transnational crimes, which certainly include those crimes committed at sea.

Secondly, under this multilateral agreement, it is important to soon enact the items in the 2011-2015 ASEAN-China Plan of Action (PoA) and to later follow-up with the new five years PoA. One of the crucial items of this agreement that is still pending is the negotiation to transform the DoC into a more binding CoC in the South China Sea. This is needed as a key factor to gain significant trust and confidence from countries in the region, including Indonesia, to support the MSR initiative.

Finally, to conclude, several issues must be settled before the MSR can be fully accepted and deemed compatible with GMF vision. It is crucial to harmonize the legal instruments of both Indonesia and China before moving forward with the implementation of joint projects and activities. Furthermore, there is an urgent need, after the internal Indonesian government consolidation to operationalize GMF, to discuss the corridors wherein the MSR can be implemented in such a way as to bring common benefits for all, while at the same time respecting Indonesian sovereignty.

In regards to economic issues, the study also came up with additional recommendations related to five relevant areas.

First, on the connectivity, the MSR should aim at complementing and enhancing ASEAN Connectivity to increase its reach far beyond the ASEAN border so as, whenever possible, also include other non-ASEAN participants of the MSR initiative. At the same time, Indonesia is also working toward improving its domestic connectivity. This will involve improving sea transportation by, among other things, sea toll as well as modernizing and expanding the capacity sea ports around the country. This will require huge investment funds to procure new ships of various size as well as for ports upgrading and for which Indonesia will certainly need investment from abroad. It is in this respect that, from an Indonesian perspective, the MSR initiative can play a pivotal role. It may act as a conduit for Chinese investors to get involved in Indonesia's domestic connectivity development.

To make it successful, the Government of Indonesia might also consider some adjustments on the policy framework related to maritime services. The current policy regime limits the participation of foreign services providers, including, for example, on the implementation of cabotage principle. Offering greater participation for foreign providers in this sector would not only allow better access to investment, it would also create an opportunity for Indonesian providers to increase their capacity and capability through joint operation and technology transfer. Without providing more flexible policy, it would be difficult to expect foreign sources of investment and capital financing to develop Indonesian maritime services, including those come under the MSR, which may jeopardize the grand plan to improve connectivity in the archipelago.

Second, and as corollary of the above, Indonesia is aiming at expanding and modernizing its shipbuilding industry so as to enable it to meet the future domestic demand for ships. Incidentally, China is currently the world largest ship producer a position that until recently held by South Korea. China can help Indonesia to realize its goal by investing in Indonesia's shipbuilding and related industries. Again, this could be done in the context of the MSR initiative. However, Indonesia should also provide greater facilitation for such investments and joint projects to take place. For instance, by allowing greater flexibility and access for foreign investment in ship building sector, or to provide incentives and uncomplicated requirements to start the industry.

Third, as noted Indonesia will have to build electronic highways and electronic gates to guide and monitor the movement of ships along the sea lanes that run through the

country's territorial water. This will require both investment and technology for which China is one of the potential contenders to participate in the project.

Fourth, regarding investment in Indonesia's infrastructure development, if and when the AIIB has been established, any loan for infrastructure development is preferably be channeled through the AIIB. On the one hand, this will help the bank to establish its reputation and credibility. On the other hand, it will also avoid problems that often arise in bilateral investment arrangements. Admittedly, the AIIB will not be able to meet all Indonesia's demand for infrastructure financing. Moreover, Indonesia is not the only country that has a pressing need for large amount of funds for infrastructure development; other prospective members of the AIIB such as India are also in the same situation. Indonesia, therefore, will have to secure funds from alternative sources. One such source is the MSR fund itself. It should be noted that the Chinese government has pledged USD40 billion MSR fund to finance MSR related activities. Another potential source is the private sector.

Related to that, the government of Indonesia should ensure that investors would consider investing in Indonesia, e.g., in the infrastructure development, in the manufacturing sector or in any other sector, is as profitable as investing in any other country. For this, the government should improve investment climate by, among other things, simplifying investment procedures, expediting land acquisition and ensuring transparency in the bidding process for government projects. Equally important is for the government to ensure that all investment contractual agreements be respected by all the parties involved. In addition, the government should also strengthen policy framework related to public private partnership (PPP) in infrastructure development. A better regulatory framework on PPP will facilitate implementation of future action plans under the MSR initiative.

Finally, related to economic activities between Indonesia and China, the two country might also consider the use of their own currencies, both Yuan and Rupiah, as medium of exchange in trade and investment as well as for reserve. One area of MSR touches upon the issue of greater use of Yuan in bilateral economic relation. While the implementation would require various technical mechanisms to support it, the main problem is how to improve economic confidence on the greater utilization of those currencies. The government of both countries might initiate it by allowing their G to G transactions being billed in the currencies, instead of using the US dollar. Diversification of national currency

reserves to allow larger part of Yuan and Rupiah might also improve the trust over those currencies, which hopefully will encourage private sector to use them more intensively.