

Australia-Indonesia: The Quest for a Better Relationship. Could FDI have a Role?

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Summary

Australia's defence planners argue that a strong and productive relationship with Indonesia is critical to Australia's national security. The Defence Department's quest to reorder the relational *status quo* is focused on establishing interdependencies that contribute to Indonesia's economic development and help mitigate threats to Australia's interests. Yet, in practice the relationship is marked by tensions, cultural indifference and limited economic engagement. Australia's formal and person-to-person associations with Indonesia are often problematic and the current commercial engagement is paltry. My thesis uses a deductive secondary source analysis and small *n* semi-structured interview method to establish whether foreign direct investments (FDI) could change those realities. It has three parts. First, I identify why indifference is the hallmark of this bilateral relationship. The core issues are the legacies of Australia's anti-Asian immigration policies, the Non-Aligned Movement, cultural differences, conflicts in East Timor and political ineptness. Second, because there is little IR theory on the conflict mitigating role of FDI, I examine the insights that trade security studies may provide into FDI's likely security effects. I argue that capitalist peace thesis research that has identified causal mechanisms through which *trade* promotes *security* are likely to have equal or stronger effect in the case of *FDI*. Third, I review Indonesia's published economic development plans which demonstrate a need for substantial foreign direct investments. Based on the precedent of OECD member support for FDI ventures and the likely provisions of an Indonesia-Australia Comprehensive Economic Partnership Agreement (CEPA), I argue that a government economic diplomacy initiative could facilitate Australian corporate efforts to meet many of Indonesia's FDI requirements. My conclusion is that there is potential for Australian FDI to build economic interdependence, support Indonesia's economic development and help counter the poverty and political exclusion that fosters

extremist violence. That outcome aligns with Australian Defence Department assessments that a faltering Indonesia could become a well-armed, unfriendly, authoritarian nationalist near-neighbour, whereas an economically strong, democratic Indonesia would be a security asset for Australia and the region.

Declaration

I certify that the work in this thesis entitled *Australia-Indonesia: The Quest for a Better Relationship. Could FDI have a Role?* has not previously been submitted for a degree nor has it been submitted as part of the requirements for a degree to any other university or institution other than Macquarie University.

I also certify that the thesis is an original piece of research and that it has been written by me. Any help or assistance that I have received in my research work and in the preparation of this thesis itself has been appropriately acknowledged. Professional editing of the thesis has been conducted by Dr Sandey Fitzgerald according to ASEP guidelines.

In addition, I certify that all information sources and literature used are indicated and acknowledged in the thesis.



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Abbreviations

AANZFTA	ASEAN-Australia-New Zealand Free Trade Agreement
ACOLA	Australian Council of Learned Academies
ANZUS	Australia, New Zealand, United States Security (Treaty)
AIIB	Asian Infrastructure Investment Bank
AJBCC	Australia Japan Business Co-operation Committee
APEC	Asia-Pacific Economic Cooperation
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
BITs	Bilateral Investment Treaties
BKPM	Badan Koordinasi Penanaman Modal (Indonesian Investment Coordinating Board)
BPG	Business Partnership Group
CEPA	Comprehensive Economic Partnership Agreement
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
DE	Developing Economy
DFAT	Department of Foreign Affairs and Trade
DPT	Democratic Peace Theory

EDFI	European Development Finance Institution
EEC	European Economic Community
EEZ	Exclusive Economic Zone
EITI	Extractive Industries Transparency Initiative
EIU	The Economist Intelligence Unit
EU	European Union
EYGM	Ernst & Young Global Limited
FDI	Foreign Direct Investment
FPA	Foreign Policy Analysis Theory
FPI	Foreign Portfolio Investment
FTA	Free Trade Agreement
GFC	Global Financial Crisis (2008)
GDP	Gross Domestic Product
GLOBE	Global Leadership and Organizational Behavior Effectiveness
GNI	Gross National Income
GVC	Global Value Chain
IA CEPA	Indonesia-Australia Comprehensive Economic Partnership Agreement
IBRD	International Bank for Reconstruction and Development (World Bank)
IDEA	Integrated Data for Events Analysis

IGO	Intergovernmental organisation
IMF	International Monetary Fund
IR	International Relations
IS	Islamic State
ISI	Import Substitution Industrialisation
JCLEC	Jakarta Centre for Law Enforcement Cooperation
JI	Jemaah Islamiyah
MID	Militarised interstate disputes
MNC	Multinational Corporation
MNE	Multinational Enterprise – includes unincorporated entities
MP3EI	Indonesian Masterplan for Acceleration and Expansion of Indonesia's Economic Development 2011-2025
MSRP	Methodology of Scientific Research Programmes
NAFTA	North American Free Trade Agreement
NALSS	National Asian Language and Studies in Schools
NAM	Non-Aligned Movement
NGO	Non-government organisation
NTS	Non-traditional security
OBOR	One Belt, One Road program

ODA	Official Development Assistance
OECD	The Organisation for Economic Co-operation and Development
OFDI	Outward direct investors
OLI	Ownership, Location, Internalisation
OPEC	Organisation of Petroleum Exporting Countries
OPIC	Overseas Private Investment Corporation (US)
PPIP	Public Private Infrastructure Partnership
PPP	Purchasing power parity
PRC	People's Republic of China
R&D	Research and Development
RCEP	Regional Comprehensive Economic Partnership
RPJPN	Rencana Pembangunan Jangka Panjang (National Long Term Development Plan)
SME	Small and Medium Enterprise
SOE	State-owned Enterprise
TICPI	Transparency International Corruption Perception Index
TPP	Trans-Pacific Partnership
TPP-11	Comprehensive and Progressive Agreement for Trans-Pacific Partnership Agreement
UN	United Nations

UNCTAD	United Nations Conference on Trade and Development
UNHCR	United Nations High Commissioner for Refugees
UNU-WIDER	United Nations University World Institute for Development Economics Research
WHO	World health Organisation
WTO	World Trade Organization
WWF	World Wide Fund for Nature

Chapter 1 Introduction

1.1 Context

‘Australia has spent too much time with the wrong mindset about Indonesia. For more than 50 years Australians have seen Indonesia as a threat, militarily, while in fact we should see Indonesia as an important bridge for Australia’s security interests’ (Leahy cited in Sumber 2015).

This assessment by Peter Leahy, a former Chief of the Australian Army (2002-2008) and current Director of Canberra University’s National Security Institute, captures the quandary in Australia’s faltering efforts to strengthen bilateral relations with Indonesia. Leahy articulates a long-standing view that Indonesia is the region ‘from or through which’ a military threat to Australia could arise (Dibb 1986, p. 48). Leahy’s call to build closer security links with Indonesia is echoed by Hugh White, Professor of Strategic Studies at the Australian National University:

Large and close but poor and weak, Indonesia holds a shadowy place in Australia’s world view. We have never known quite what to make of it, or how seriously to take it. Soon there will be no option but to take it very seriously indeed because Indonesia is changing fast. In the Asian century, it may matter to Australia as much as China and the US (White 2013, p. 30).

Australia’s *2016 Defence White Paper* takes a similar view, describing the relationship with Indonesia as both ‘vital’ and ‘critical’ to Australia’s national security (Commonwealth of

Australia 2016a, pp. 59, 125). This thesis is positioned at the junction of these security and economic assessments. Its goal is to examine how economic diplomacy and foreign direct investment might contribute to a ‘strong and productive’ cultural and economic engagement between Australia and Indonesia. I examine if co-mingled Australian government and private sector investments might generate such an engagement and contribute to fortifying this critical defence relationship.

Notwithstanding the Defence Department’s forthright call to strengthen this relationship, purposeful pursuit of that objective is largely the preserve of a few leading Australian academic, security and business professionals. In practice there is little political or popular regard for the need to establish a resilient bilateral defence or commercial relationship with a burgeoning neighbour whose border reaches to within two hundred kilometres of North Queensland.

My ambition to build awareness of the national security and economic implications of Indonesia’s emergence as a substantial Asian regional power is not motivated by the prospect of an imminent military conflict. Rather, it is motivated by the prospect of non-traditional security (NTS) threats in the form of terrorism, refugee flows, transnational crime, infectious diseases, cyber-attacks, environmental impacts, piracy or limitations on Australia’s international air and sea trade routes that may originate from Indonesia. Indonesia’s internal security assessment reveals similar concerns for NTS threats to its security, some of which have likely spill-over concerns for Australia. This thesis examines if greater cultural awareness and closer economic engagement could help to mitigate Indonesian sourced NTS threats to Australia’s interests.

Despite some awareness of Indonesia's broad security importance to Australia, as evident in government polemics about 'relocating' Australia in Asia (Capling 2008, p. 605), the 'Asian Century' White Paper (Commonwealth of Australia 2012) and former Prime Minister Abbott's call for 'more Jakarta less Geneva' (Shanahan, 2013), effective engagement with Indonesia remains elusive. In fact, there has been a diplomatic or military crisis in the Australia-Indonesia relationship every decade since Indonesia's independence in the 1940s (Wilson 2017, p. 1). This pattern has been exemplified most recently by Australia's engagement in events leading to East Timor's independence in 2002, wiretapping the phones of Indonesia's President and his wife in 2009, banning live cattle exports to Indonesia in 2011, and Australia's clamorous politicising of drug courier executions in 2015.

The cultural, racial, political and social traditions that provide the ontological frame for this thesis and contribute to the antipathies that underlie this bilateral relationship are reviewed in Chapters 3 and 4. Two markers are particularly significant. First is the 1955 Bandung Conference that gave rise in 1961 to the Non-Aligned Movement (NAM). NAM principles underlie Indonesia's avoidance of all formal defense pacts and are evident in President Yudiyono's 2009 foreign policy ambition of 'a million friends and zero enemies' (Piccone & Yusman 2014). The second is the legacy of Australia's racially discriminatory White Australia policy. This pre-Federation policy, abolished in the 1970s, was cited in a 2010 address to the Australian Parliament by President Yudiyono as the source of *Australia-phobia* – 'a belief by some in Indonesia that the White Australia policy still persisted and that Australia harboured ill intentions toward Indonesia' (Kelly 2010).

Attitudinal studies demonstrate that the task of building a resilient, mutually trusting relationship with Indonesia is demanding. Public polling of Australian attitudes since the 1940s reveals a consistent tension between an ambition for closer relations and a deep suspicion of Indonesia as a threat to Australia's security (Sobocinska, 2015, p. 5). Threat perception levels reached unprecedented heights following the 2002 Bali bombing in which eighty-eight Australians died (Sobocinska, 20015, p. 38). Yet the equivocal nature of this relationship is evident in annual public surveys where more than 40% of respondents consider Australia's relationship with Indonesia to be 'very important' (Oliver 2016, pp. 15-18).

Building Leahy's missing relationship bridge and transcending the prevailing community equivocation is a multifaceted process that will require a more complex cultural and economic interdependence with Indonesia. My thesis seeks to make a small contribution to that process by examining an economic diplomacy initiative that could enhance the bilateral economic relationship. Australia's current commercial indifference leaves it with minimal trade and direct investment engagement with Indonesia. In economic terms alone, this is a foregone opportunity to access an economy already comparable to Australia's in purchasing power parity terms (World Bank 2018) and growing at double the rate of Australia. In addition to realising some of this commercial potential, might greater bilateral investment in Indonesia help banish the 'shadows' that Professor White describes in the Australia-Indonesia relationship? My research explores the potential for deeper economic interdependence to play a part in redressing the prevailing 'edgy and fractious' bilateral relationship (White 2013, p. 32).

Australia has historically been dependent on large inward flows of capital for its own economic development. Those inflows have three forms – debt in the form of foreign borrowings, overseas portfolio or share market investments and foreign direct investments (FDI). FDI is defined by an offshore investor owning more than 10% of the equity capital in an enterprise and being actively engaged in its management. Despite the long history of reliance on inward FDI, in recent decades Australian companies themselves have become substantial outward direct investors (OFDI). As a result, Australia is now a significant OFDI investor and the value of outward and inward FDI stock is now broadly similar.

1.2 My research questions

My interest in researching the subject of FDI and the theoretical basis on which it might contribute to deepening the Australia-Indonesia bilateral relationship is motivated by personal experience of positive home and host country cultural and investment outcomes that flowed from Asian corporate FDI ventures in the early 2000s. Simultaneously, in Indonesia there were recurrent security and broader government-to-government crises. Extremist attacks killed almost 100 Australians and three major diplomatic disputes led to the withdrawal of senior consular representatives. The conjunction of investment ventures that had demonstrable micro-level Asian relationship building benefits with an apparently deteriorating Indonesian security relationship gave rise to my overarching research question:

What role, if any, might Australian FDI play in strengthening the Australian-Indonesian security relationship?

Despite Australia's Embassy in Jakarta being Australia's largest overseas diplomatic mission,¹ the Australia-Indonesia bilateral relationship is neither close nor commercially interdependent. In the face of Indonesia's ten-fold population superiority and its ascent to GDP equivalence with Australia,² it is the Australian government's lack of emphasis on the prospective economic and security significance of Asia's emerging *Third Giant* (Reid 2012), that has motivated me to explore three questions in this thesis. The first was to identify the primary factors that constrained Australia's seemingly ineffectual political, cultural and commercial engagement with Indonesia; second, was to examine the national security consequences of that shortcoming and third was to assess if FDI could have a part in mollifying this fractious bilateral relationship.

These three sub-questions provide the structural frame for my thesis:

1. What accounts for Australia's lack of effective bilateral political and economic engagement with Indonesia?
2. Why is a strong and productive relationship with Indonesia critical to Australia's national security?³
3. Could FDI as an Australian economic diplomacy initiative help mitigate Indonesian sourced threats to Australia's security?

¹ <http://indonesia.embassy.gov.au/jakt/aboutus.html>

² In terms of purchasing power parity (PPP)

³ '[A] strong and productive relationship with Indonesia is critical to Australia's national security,' (Commonwealth of Australia 2016a, p.125)

For clarity, I emphasise that my focus on the role of foreign direct investments does not assume that FDI by itself can directly mitigate potential conflicts. Rather, as is illustrated in the analysis, the objective is to assess whether FDI in developing countries such as Indonesia can *facilitate* the bilateral cultural awareness, economic growth, economic openness and global economic integration that can contribute to obviating terrorist and other NTS activity, while acknowledging that in some circumstances FDI can itself be a source of bilateral tension.

1.3 The significance and contribution of the research

1.3.1 An FDI security hypothesis

A prior question before addressing my central research puzzle is to establish if foreign direct investments have an impact on transnational relationships. When I commenced this project, I planned to apply established IR theory on the transnational security impacts of direct investment to an analysis of the Australia-Indonesia bilateral security relationship. That ambition faltered at the first step when I discovered there was very little academic literature exploring FDI's influence on security. Notwithstanding the extensive literature on trade and its impacts on transnational relationships there is a puzzling lack of equivalent research into the security impacts of foreign direct investments. As a consequence, I develop an FDI-security hypothesis in relation to the issue of FDI and transnational conflict as a prerequisite step in the analysis of my primary research questions. The absence of concerted research exploring the individuated role of FDI may be attributed to IR scholars' practice of combining trade and direct investment as if their relational outcomes are coterminous. I argue

that, since direct investments appear to have an independent impact on security outcomes, the assumption of synchronous impacts should be revisited.

Conventional trade-security theories were also developed at a time when trade and direct investment flows were primarily between developed, security-allied states. As will be illustrated in Chapter 7, there was little cause to account for any potential difference in the relational impacts of those flows with that of trade (Gartzke & Hewitt 2010). Since the 1980s, however, the scale of direct investment flows and their concentration in developed world economies has been transformed to the extent that about half of all new FDI is now directed to developing economies (UNCTAD 2016, Annex table 01).

The task of theorising post-1980s' FDI security impacts is challenging. Trade-security theorists base their findings on trade and conflict data extending up to 150 years (Bremer 1992; Oneal & Russett 1999). That contrasts with the small post-1980s' literature on FDI-security impacts (Bussmann 2010; Lee & Mitchell 2012) which is limited to less than three decades of often inconsistent FDI data in a period with few armed conflicts between significant FDI recipient states.

Nevertheless, there are reasons to argue that trade and FDI may produce different relational outcomes. Chapter 7 presents a *prima facie* hypothesis concerning FDI's security effects which I deduce by taking established trade-security principles and considering their potential application to the impact of FDI. First, I identify the causal mechanisms through which trade has been shown to impact bilateral security relationships and second, I map those mechanisms against the initial and continuing functions of a bilateral direct investment. The

analysis demonstrates that most, but not all, of the causal mechanisms identified in the capitalist peace literature apply equally or more strongly in an independent FDI-security setting.

1.3.2 Cultural distance, FDI and bilateral relationship building

The impact of cultural differences on corporate and political relationship outcomes is another focus of analysis. Previous studies have examined aspects of the Australia-Indonesia cultural divide (Reisinger & Turner 1997; Jones 2007; Mangundjaya 2010; Irawanto et al. 2011; Hofstede 2011), but there appears to be no precedent for applying that knowledge to the selection of Indonesia as an FDI location.

That absence is relevant to my analysis because of the possibility of path dependency. Internationalisation studies on the effect of trade and FDI indicate that early investment experiences influence subsequent offshore investment location decisions (Eriksson, Majkard and Sharma 2000). Does that explain why about 50% of Australia's FDI stocks are located in the UK, the US and New Zealand (DFAT 2017c)? That question is answered in Chapter 3 but my analysis extends beyond FDI issues and highlights the importance of *ASEAN Way* awareness in decision-making by Australian corporate executives, politicians and policy advisers.

1.3.3 The Australia-Indonesia security perspective

Australia's 2016 *Defence White Paper* states that 'a strong and productive relationship with Indonesia is critical to Australia's national security' (Commonwealth of Australia 2016a, p. 125), but why that is so and how it might be achieved is not explained. Analysis in Chapter 5

establishes several likely explanations for this claim even though security professionals indicate that Indonesia does not represent a foreseeable threat to Australia's sovereign security.

Nevertheless, there are other threats to Australia's national interests that could originate in Indonesia. Characterised as non-traditional security (NTS) threats, these include acts of terrorist violence, 'illegal' immigration, human and narcotics trafficking, piracy, human or animal disease epidemics. Indeed, the Indonesian Defence Department's internal assessment also identifies terrorism and radicalism, separatism, revolt, border violations, piracy, theft of natural resources, pandemics, cyber warfare, espionage, narcotics and natural disasters as NTS threats to Indonesia's national security (Ministry of Defence of the Republic of Indonesia 2015, p. 25).

1.3.4 FDI as an economic diplomacy initiative

In Chapter 9 I examine the potential for Australian FDI in Indonesia to help forestall the realisation of those potential NTS threats to Australia's interests. My premise is that private sector engagement is essential if Indonesia's long-term, sustainable economic growth and poverty eradication objectives are to be achieved. Jobs, economic growth and increased local taxes are the key to achieving those objectives and FDI can deliver those outcomes. With only 1% of Australia's OFDI currently located in Indonesia and little more than 10% of total Australian OFDI located in all of East Asia,⁴ the opportunities could be significant.

⁴ 'East Asia' is defined as the ASEAN-10 plus China, Hong Kong SAR, Korea, Japan and Taiwan.

Is there a credible economic diplomacy initiative that might encourage greater Australian OFDI to Indonesia? Chapter 9 provides three grounds on which state intervention in the seemingly competitive global FDI market might be justified: first, there are longstanding precedents of state interventions by most OECD members in this market; second, there is developing recognition of the role a state's 'patient capital' has in OFDI and other markets; third, the co-mingling of state development aid funding with private sector OFDI serves to meet otherwise unfulfilled global development objectives.

1.4 Epistemology and methodology

The analytical approach and research design used to address my research questions follows the established social science pathway from a description of the ontological domain to an explanation of the epistemological enquiry premise, to an account of the methodology and method through which the research is implemented (Hay 2002, p. 63). The overarching objective of that process is to establish whether FDI could play a role in mitigating Indonesian-sourced threats to Australia's security. If FDI does mitigate threats, the finding could have broader application in other contexts; however, my focus is on the Australia-Indonesia relationship.

My thesis is bounded by the following perceptual considerations:

- The Australia-Indonesia bilateral relationship has historically been fractious.
- The past security relationship was less consequential because Australia considered itself to have military and economic superiority.

- Indonesia is now approaching economic equality and is a potential source of non-traditional security threats to Australia.
- Non-traditional security threats include transnational crime, terrorism, information security, climate change, pandemics, natural disasters and interdiction of air and sea transport routes (Walsh 2011).
- Indonesia has a national development plan and is seeking substantial inward foreign investment to support its potential economic growth.
- Indonesia's development plan presents significant FDI investment opportunities for Australian companies.
- Australia is a substantial global foreign investor but less than 1% of that investment is currently in Indonesia.
- Australian direct investment to Indonesia could be significant to the total level of Indonesian inward FDI and have noticeable economic development impacts.
- Cultural issues and limited awareness of opportunities are likely reasons for Australian FDI in Indonesia being economically sub-optimal.

My research design draws on theories from different disciplines to develop new FDI-security understandings that are both justified and sustainable. This epistemological approach is consistent with Robert Keohane's belief that the role of political scientists is to create 'causal inferences' about what can be observed in political practice (Keohane 2008, p. 362). My objective is to identify if FDI has threat mitigating attributes, and to assess if those attributes can contribute to lessening Indonesian-sourced NTS threats to Australia's interests. My focus

is on identifying the complex interaction of economic and political variables that might give rise to that outcome (Kurki 2006, p. 202).

My approach is to examine transnational security theories from different academic domains in order to identify how trade's relationship with conflict is understood in each discipline, and to employ that as the frame on which to construct my alternative FDI-security hypothesis. The following examples illustrate the scope of this epistemological enquiry:

- In security studies literature, what contribution does poverty and political repression make to the potential for transnational violence?
- In the literature of international business and development economics what contribution to host country economic development and international political integration can be attributed to (selective) FDI?
- How might security threat mitigating capabilities recognised in IR trade-security theory vary if FDI is substituted for trade as the independent variable?
- Does IR trade-security theory or Foreign Policy Analysis theory anticipate that FDI executives may indirectly impact foreign policy by influencing home and host country political elites?
- How in international business and cultural studies theory is cultural distance and path dependence found to impact FDI location selection decisions?

The conjunction of my starting perceptions and this cross-disciplinary analytical approach determined the thesis methodology. But how is it possible to maintain the coherence of such an interdisciplinary approach?

My answer is to engage Rudra Sil and Peter Katzenstein's analytical eclecticism to provide the overarching methodological discipline and to obviate the risk of 'theoretical incoherence' and incommensurability that could result from the integration of theories from these diverse disciplines. This process, which is detailed in the following chapter, enables findings in diverse research literatures to be aggregated while still upholding the research principles on which each separate theory is founded (Sil and Katzenstein 2010, pp. 411-414). Analytical eclecticism is also consistent with my pragmatic research orientation.

Focus on cultural difference and the role of human agency led to the inclusion of Foreign Policy Analysis (FPA) in my analysis. The FPA approach, validated by the inclusion of small *n* elite interview findings, serves to elucidate the complexity and accommodate the conjectures of human and institutional agency inherent in my research. The FPA methodology makes two important contributions to my analysis. It provides the basis on which to objectivise the observations of FDI's relational impacts on home and host country elites, and it provides the rigour to establish the real or generalisable knowledge that can be deduced from those impacts. Details of the history, development and application of FPA theory are set out in Chapter 2.

1.5 Research methods

The research methods I use to examine each of the three research sub-questions are different. The method used in the first question to account for Australia's desultory political and economic engagement with Indonesia is primarily a deductive analysis of interdisciplinary secondary source literatures. I use the Uppsala models of internationalisation (Johanson &

Vahlne 1977) and Hofstede's cultural distance indicator studies (Hofstede 2011) to provide the theoretical and empirical markers of cultural distance and to highlight the need for Australia's political and corporate elites to appreciate the relational significance of these cultural differences.

To examine the second sub-question regarding the security imperative for Australia to develop a 'strong and productive relationship with Indonesia' (Commonwealth of Australia 2016a, p.125), I begin by applying Baldwin's (1997) five step method of security threat analysis to establish Australia's national security ideal. I then identify the national policy settings that are designed to defend those security interests. The process identifies marked asymmetric differences in bilateral security relevance. For Australia, Indonesia is a source of near-term NTS threats and long-term military uncertainty, whereas Indonesia has scant regard for Australia as a security concern.

The method used to answer my third sub-question concerning the possibility that FDI might help mitigate Indonesian-sourced threats to Australian security has two parts. The first is to substitute FDI for trade as the independent variable in six established trade-security theory applications where threat mitigating outcomes have been established. The resultant FDI findings are necessarily inferential. However, this method is necessary because, unlike trade-security theory where empirical findings are based on long duration trade and conflict data, FDI's salience as a security issue can only be assessed from examination of post-1980s' investment flows. The short duration and absence of conflict events precludes comparative analysis based on specific FDI data.

The second part of this analysis involved interviewing a small sample of Australian public officials, private sector executives and academic representatives with Indonesian expertise during a series of semi-structured face-to-face interviews.⁵ Those interviewed were ‘elites’ based on their having ‘close proximity to power or particular expertise’ (Lilleker 2003, p. 207). The method used to conduct the interviews was based on Jeffrey Berry’s guide to elite interview techniques (Berry 2002, pp. 679-682).

Seven interview informants were selected because of their prominence in a particular aspect of the Australia-Indonesia relationship. Subjects were approached directly by phone or email. Policy officials were identified from published biographical data detailing their current or former experience in Indonesia. Likewise, MNC executives were selected from the small list of Australian executives with knowledge of substantial Indonesian FDI ventures. No selected informant declined to participate and none of them were known to the author. Open-ended questions on the influence of economic diplomacy, cultural difference, path dependence and direct investment on the Australia-Indonesia relationship provoked a range of assessments that are referenced in the following chapters. A specimen of the semi-structured interview questionnaire is in Appendix V.

The interviews expose my secondary source findings to a robust ‘reality check.’ As illustrated by examples reported in the following chapters, interviews were a necessary element of my research because the role of FDI in transnational relationships is a

⁵ Two interviews were not face-to-face – one respondent chose to respond in writing to the questionnaire and a Jakarta based respondent was interviewed by phone.

contemporary issue that is not widely examined and on which there are few published papers. Interviews are not a conclusive research method, though as noted below, the interviews did reveal some disparities between my research findings and the professional assessments of individual experts.

1.6 Limitations of the Research

This study has the following limitations. First is the possibility of bias notwithstanding my efforts to ensure impartiality and the fair representation of contested arguments. My experience of positive cultural engagement and personal learning by corporate staff as well as home and host country officials associated with certain Asian FDI projects does create a risk that I might privilege evidence that supports my own perspective.

Second, the focus of this study is on the broad security effects of Australian direct investments in Indonesia. At any one time there are other examples of human agency engagements by Australian government, non-government and private sector parties with Indonesian counterparts that similarly impact the Australia-Indonesia security relationship. Ann Capling (2008, pp. 602-3) cites papers by scholars who have examined the contribution health, human rights, justice and other regional institutions, along with trade, tourism, migration, education exchanges, and cultural insights from literature, films, art and music, have made to Australia's engagement with Asia (Goldsworthy 2003; Gurry 1995; Cooper et al. 1993). A senior Australian Defence Force officer argues persuasively that defence diplomacy is also a source of human agency designed to 'build trust and common ground through increased familiarity and cooperation' (Wilson 2017, p.2). Each of these

engagements is acknowledged, but their impacts individually and collectively on the bilateral security relationship are beyond the scope of this analysis.

Third, Indonesia's 2001 'big bang' devolution of substantial administrative responsibility to over 500 regional administrations has had corruption consequences that have impacted on Indonesia's merit as an investment destination. This issue is not addressed, as corruption is a contingency that must be managed by direct investors in most Asian countries. The fact that in 2014 direct investors from developed economies in the European Union and the USA accounted for 40% of total FDI stocks in ASEAN confirms that it is not by itself an insurmountable impediment to the direct investment process (Kawai & Naknoi 2017, p. 649). Nevertheless, there are two aspects of corruption that are potentially adverse to Australia's ambition to sustain Indonesia's economic development. The first is that Indonesia's low (though slowly improving) rating in the annual Transparency International Corruption Perception Index may constrain the technological development of Indonesia's economy.⁶ A study of corruption impacts on FDI joint ventures in former Soviet countries during the 1990s identified an inverse correlation between the technological sophistication of projects and the level of corruption. High state corruption equated with low technology investments and low value-added joint venture projects. Some high technology projects did occur but usually only as wholly foreign-owned ventures that delivered few of the possible FDI spin-off benefits to the local economy (Smarzynska & Wei 2000, pp. 1-14).

⁶ https://www.transparency.org/news/feature/corruption_perceptions_index_2016

Equally negative, is the prospect that FDI inflows to Indonesia could become dominated by countries that themselves have pervasive commercial corruption. Details are provided in Chapter 8 of potentially positive governance spin-off effects in cases where FDI flows from low corruption developed countries to high corruption developing countries (Habib & Zurawicki 2002, p. 303). An untested argument is that the high proportion of post-Soeharto FDI inflows from the US, UK and The Netherlands has contributed to Indonesia's slowly improving corruption perception rating. However, the prevalence of developed country FDI inflows to Indonesia has been substantially offset in recent years by FDI from states such as China, Hong Kong and Malaysia, which have much higher corruption perception ratings. That trend has the potential to limit improvements in Indonesia's corruption rating, its commercial governance regime and its transition to a higher value-added economy.⁷

There are also two Indonesian regulatory issues with potential significance for Australian direct investors that are not analysed in detail. They are excluded because their impacts are not unique to Australian investors and besides, the presence of large and successful investments by corporations from other developed economies (US, UK, The Netherlands) confirms that they are not intractable issues. First is the Indonesian regulatory regime for inward direct investments. This is not analysed because BKPM, the regulatory coordinating board, is successful in providing a whole of (national) government service to prospective foreign direct investors regardless of their domicile. Second, all direct investors in the Asian region must address the complexity of many, often overlapping, Free Trade Agreements and

⁷ A broader analysis of corruption's impact on FDI in Indonesia was the subject of a previous thesis by the author (McCormack 2015).

Bilateral Investment Treaties (BITs). Described as a *noodle bowl* of bilateral, plurilateral and regional agreements (Lin 2011), this is an issue that has uncertain implications because home and host parties may be subject to BIT regimes that have incompatible provisions.

Finally, as the geographic region called ‘Asia’ is ill-defined, my use of the term refers to the combination of two better defined sub-regions – East Asia,⁸ and Southeast Asia.⁹ In aggregate the member states of those groups constitute my broad definition of Asia (Terada 2003, p. 256). As a result, the term Asia as used in this thesis excludes the states of Central Asia (*the ‘stans’*) as well as Turkey, Russia and all Middle East countries.

1.7 The thesis structure

There are ten chapters in this thesis. Chapter 2 sets out the theoretical tenets on which the thesis relies: neoliberal institutionalism, Asian area studies, Foreign Policy Analysis and analytical eclecticism. The first research question, which seeks to account for Australia’s ineffectual political and economic engagement with Indonesia, is addressed in Chapters 3 and 4. The analysis highlights why the Australia-Indonesia cultural divide and enduring legacies of history combine to impede the development of a productive bilateral relationship. Chapter 5 analyses the Indonesian military and non-traditional security threats to Australia and answers my second question concerning Australia’s need to develop a strong and productive relationship with Indonesia.

⁸ East Asia: China, Japan, Hong Kong, South Korea, Taiwan.

⁹ Southeast Asia (ASEAN): Indonesia, Thailand, Philippines, Malaysia, Vietnam, Singapore, Myanmar, Cambodia, Laos, Brunei.

The following four chapters address the last sub-question and establish if there is potential for FDI to contribute to Australia's economic diplomacy initiatives. Chapter 6 sets out the development and progressive refinement of trade-security theory. Chapter 7 draws on findings from the trade-security analysis as the basis for developing an FDI-security hypothesis. Six causal mechanisms from the trade-security literature are used to illustrate how, with one exception, those mechanisms collectively provide the basis for an FDI-security hypothesis. Chapter 8 analyses the merit of FDI as an economic development strategy in developing economies and identifies the conditions under which FDI can produce either positive or negative development outcomes. It establishes that Indonesia has detailed national development plans that set out requirements for substantial foreign direct investments.

Chapter 9 combines the finding that FDI has positive security externalities with Indonesia's established requirement for large FDI inflows and asks what can be done to overcome the dearth of Australian FDI engagement in Indonesia. The answer provides what appears to be a politically and economically feasible policy initiative that would enable Australian companies to pursue commercially attractive FDI ventures and contribute to building a stronger Australia-Indonesia relationship. The final chapter brings together the implications of the answers to my three research questions and highlights the opportunity for scholars to further this FDI-security research and pursue the development of an empirically grounded FDI-security theory.

In summary, Australian security analysts recognise that a strong and productive relationship with Indonesia is vital to Australia's national security. Economic analysts demonstrate that

investment opportunities abound. Each of these perspectives sustains a case for Indonesia's significance to Australia but it is the potential to connect these two perspectives that spurs my research interest.

Chapter 2. What theoretical traditions support this thesis?

2.1 Introduction

British philosopher Isaiah Berlin's essay title 'The fox knows many things, but the hedgehog knows one big thing' provides the basis on which Berlin distinguishes between authors as conceptual pluralists (foxes) and those seeking an all-embracing unitary truth (hedgehogs).¹ This ancient Greek witticism is commonly used as a heuristic to differentiate the reasoning styles or cognitive approach to other intellectual issues. Political science 'hedgehogs' are said to pursue a single, parsimonious approach and rely on 'powerful abstractions to organise messy facts' whereas pluralist 'foxes' draw on 'many things they know from disparate sources and theoretical traditions' (Tetlock 2005, p. 73). This thesis is the work of a 'fox' rather than a 'hedgehog.'

There are four core theoretical traditions that guide my research: 1) *Neoliberal Institutionalism* which provides a general account of the working of the international system. It enables my analysis to proceed on the basis that international institution-based cooperation and regional integration are now core characteristics of international politics. That tradition of structural theorising is complemented, rather than contradicted by recourse to narrower reductionist explanations of state behaviour drawn from individual disciplines of cultural analysis, security and economics; 2) *Asian Area Studies* which identifies the impact Asian

¹ <https://www.theguardian.com/books/2016/aug/08/100-best-nonfiction-books-isaiah-berlin-the-hedgehog-and-the-fox-robert-mccrum>

regional norms, especially the so called ‘ASEAN Way,’ have on regional relationships;² 3) *Foreign Policy Analysis* which provides an agent focused theory and method to examine the impact FDI related sub-national agents (business, non-government organisations, individuals, public opinion, etc.) can have on foreign relations outcomes; 4) *Analytic Eclecticism* which guides how I integrate research findings from different disciplines and maintain commensurability.

The following sections of this chapter set out details of the respective theoretical traditions and the context in which each tradition enables a range of theories from within that tradition to combine and sustain my overall thesis argument. In brief, the four theoretical traditions determine ‘how’ my thesis is constructed. They establish how the traditions integrate and how there are within each tradition particular theories that I draw on to sustain my argument. This methodology has three impacts on my thesis structure. The first is to constrain the ontological frame of my thesis construction. Notwithstanding my pluralist approach there are limits to the range of theories on which my argument is based and the four core traditions integrate the selected theory domains and determine the scope of my theoretical sources. The other two impacts of this methodology are structural. My structural approach is to separate the literature review of the overarching theoretical traditions from the specific application of individual theories selected from within the different overarching traditions. Consequently, the following sections of this chapter provide a literature review of the overarching traditions.

² ‘ASEAN Way’ – an imprecise term that refers to a set of ASEAN rules and procedural norms for decision-making that emphasise informal consultation and consensus combined with the principle of non-interference, territorial integrity, and peaceful settlement of conflict (Jones, 2010, p. 480)

In addition, a review of literature relevant to each individual theory is set out in the relevant chapter where each theory is utilised.

The analytical focus of this thesis is on how sub-national economic connections influence state behaviour within the context of the state's broader systemic functions. My particular interest is in the impact trans-national corporate agents might have on a state's bilateral relationships and exercise of power. On the agent-structure continuum, my analysis emphasises an agential rather than structuralist account of transnational relationships and, I argue, the potential impact on transnational relationships of sub-state-level actors such as MNCs which is under-represented in the literature. The focal point of my analysis is the likely impact recent substantial changes in transnational investment flows by MNCs can have on foreign policy making and bilateral relationship outcomes in general and on the Australia-Indonesia relationship in particular.

I argue that non-commercial considerations such as cultural difference and cultural path dependency impact FDI location selection choices by MNCs. In turn those choices impact on relationship outcomes because they can determine whether or not complex interdependencies develop in the important issue-area of trade and finance (Keohane & Nye 1977, pp. 24-25). My thesis is that the sparsely researched impact of post-Cold War 'new generation' FDI is building broader interdependencies that support pacific bilateral relationships in general, and that these could enhance the Australia-Indonesia relationship.

2.2: Neoliberal Institutionalism

Neoliberal institutionalism outlines how international politics and the conduct of transnational economic and political institutions are impacted by the supranational governance regimes of international institutions (Stein 2008, p. 217). Expressed more prosaically, it identifies such institutions as being transnational ‘agreements or contracts between actors that reduce uncertainty, lower transaction costs, and solve collective-action problems’ (Grieco & Ikenberry 2003, p. 116). My thesis takes this neoliberal institutional theory premise as the structural base from which the agential analysis of FDI and its transnational relationship effects is developed.

The following section traces the development of neoliberal institutional theory from its 1980s origins through several iterations of empirical refinement and illustrates the practical application of that theory in a pending Australia-Indonesia partnership agreement. It also identifies a nuanced Asian regional intuitionism that is evident in the informal, non-confrontational, consensus-building norms epitomised by the ‘ASEAN Way.’

2.2.1: Neoliberal institutional theory

Robert Keohane is the IR scholar most often associated with the development of institutional theory. Keohane questions why states do, or do not, engage in cooperative behaviours, and in circumstances where they do cooperate, he examines what effect that cooperation has on their relationship (Keohane 1984). Keohane’s early analysis of cooperative behaviour came in the context of Cold War theorising where realist perspectives of states competing to maximise wealth and power were pervasive in International Relations scholarship. Neorealist

scholars typically represent the international system as anarchic owing to the absence of an authoritative power able to enact and enforce rules of state behaviour. They hold that transnational rules and norms have a limited causal role in interstate relations (Waltz 1979, p. 107). Keohane accepted the realists' anarchic world view and the assumption that states were self-interested rational actors, but nonetheless argued there was 'solid empirical evidence of cooperation among states' (Herbert 1996, pp. 226-227).

In the eyes of neoliberal institutionalists, cooperation among states is clearly evident in the range of international organisations established following the Second World War. These include the United Nations (UN), the International Bank for Reconstruction and Development (World Bank), the International Monetary Fund (IMF) and most particularly the formation of the European Economic Community. European integration, where states are conceding aspects of governance to a new authority, therefore implies some transcendence of the realist self-interest and anarchic system assumptions, albeit under circumstances of an implicit US security guarantee (Stein 2008, pp. 202-203).

Neoliberal institutionalism not only acknowledges the formal model of international organisations that are characterised by physical assets and personnel structures, it also recognises the role of international 'regimes' – defined by Steven Krasner as 'principles, norms, rules, and decision-making procedures around which actor expectations converge in a given issue-area' – in shaping standards of appropriate behaviour (Krasner 1982, p. 185). Formal organisations are now augmented by a multitude of specific issue-area regimes. These range from global air services agreements and the universal postal convention in the trade arena to an Antarctic Treaty System and agreements for protection of the stratospheric

ozone layer in the environmental regime. In the security domain there is a nuclear non-proliferation treaty and a convention for the suppression of terrorist financing, and in relation to human rights there are a wide range of international treaties from the initial 1948 UN Universal Declaration on Human Rights through to ASEAN's 2010 Intergovernmental Commission on Human Rights (Hasenclever et al. 2000, pp. 3-4).

Keohane and Nye previously coined the term 'complex interdependence' to represent the transnational relationships created by engagements facilitated through international institutions. They argue that the resultant interdependence gives rise to several potentialities. Foremost is the development of linkages between states and non-state institutional actors. Those linkages expand the channels for interaction between states and serve to diminish or remove the divide of low-versus-high politics in transnational relationships. Keohane and Nye argue that in conditions of complex interdependence, transnational interactions occur through multiple channels, foreign policy priorities consist of 'multiple issues that are not arranged in a clear or consistent hierarchy,' and military force is not especially significant (Keohane & Nye 1977, pp. 24-25). Subsequent US empirical research developed formal theories that progressively refined their understanding of international cooperation and the role of institutions, including regimes. That evolution provides progressively greater appreciation of why it is that states create and comply with international agreements.

First generation empiricists looked to the prisoner's dilemma and game theoretical modelling to provide a response to Keohane's question concerning when and why states will cooperate. It is unnecessary to examine the modelling process in detail, but, as users of the prisoner's dilemma model know, defection or non-compliance is frequently the logical choice for

individual participants, even though mutual cooperation would deliver a superior overall outcome. However, when the prisoner's dilemma situation is adapted to better reflect a real world transnational agreement, the outcomes change. In those circumstances, where in practice an agreement exposes counterparties to multiple iterations of the model's dilemma, actors recognise the rewards of cooperative behaviour and the 'prisoners' (states) realise that the greatest system benefits accrue from compliance. The realisation comes from the fact that compliance with the agreement is a recurring experience and a state's defection decision exposes it to reputational damage and creates system inefficiency. Such damage is significant because it compromises continued relations with all parties to an agreement (Gilligan & Johns 2012, pp. 223-226).

Institutional theory was thus challenged by neorealist academics on the basis that states seek relative gains. Their premise is that state A will not cooperate if it anticipates its opposite number (state B) will derive greater benefit from an agreement in circumstances where B can use the additional benefit against the interests of A (Grieco 1993, p. 162). Neoliberal scholars look to patterns of cooperation over time – a repetitive test model – and find that the 'shadow of the future' promotes greater cooperation (Thies 2004).

The second generation of empirical modelling was inaugurated in a 1993 paper by Robert Powell titled 'Guns, butter and anarchy.' Using an infinite-horizon model in which two states must continually decide how to allocate their resources and whether to attack the other state, Powell establishes that a peaceful equilibrium condition develops to ensure neither state attacks (Powell 1993). Again, the detailed modelling process was not directly relevant to the subject of Australia-Indonesia relations, but Powell's germane conclusion was that 'anarchy

has little if any significance distinctively related to international politics and ... the problem of absolute versus relative gains is superfluous' (Powell 1993, p. 115). That conclusion is contested, and further research has established that there are circumstances in which the relative or absolute distribution of gains from transnational agreements does matter. For example, in circumstances where the prevailing relationship is already strained, or where the agreement is specifically security related (Grieco 1993), or if agreement benefits are readily convertible to security advantages, then states will seek relative gains from trans-state agreements (Grieco 1993; Glaser 1995; Morrow 1997).

Nevertheless, neoliberal institutionalist scholars were not persuaded by the realist analysis and sustained the perspective that most states allocate trans-state agreement benefits with regard to absolute gains and not just relative gain. That is apparent in circumstances where levels of trans-state interdependence are sufficiently high that the cost of disruption precludes a resort to conflict, or when a state can increase its military expenditure to counter any cooperative agreement benefit derived by another state (Powell 1999, p. 77). States also enter into cooperative agreements such as trade treaties in circumstances where security is not impacted, and positive consumption outcomes are envisaged (Morrow 1997, p.28). This reading thus aligns institutional theory with Keohane's original observation that states in an anarchic world do create and comply with international agreements (Gilligan & Johns 2012, p. 227).

Third generation institutional theorists are addressing the question of *how* states can cooperate. Complex modelling of four aspects of trans-state relations is being used to refine the current theoretical constructs. The four key issues are:

- How do states resolve the distribution of systemic gains from cooperative agreements?
- How to determine the depth of a state's commitment to cooperate?
- Should there be grounds on which states have flexible participation in a trans-state agreement? If so, how are they facilitated?
- How can greater global multilateralism be accommodated in trans-state cooperation agreements? (Gilligan & Johns 2012, p. 228).

An explanation of the role of these four foundational considerations in trans-state agreements is set out below, but the practical application of this institutional theory to my thesis is more fully developed in Chapter 9. In that chapter each of the above four issues is identified as an integral aspect of the protracted but potentially very beneficial Indonesia-Australia Comprehensive Economic Partnership Agreement (CEPA).

Application of the first issue, allocating systemic gains from trans-state agreements, is illustrated in Lisa Blaydes' (2004) analysis of the OPEC oil cartel. Blaydes' analysis centers on how producing states accommodated the needs of certain low-income states during a 1980s' oil price collapse, and illustrates how systemic benefits are distributed in practice. While the OECD case provides a graphic example of systemic benefit, its anti-competitive effect is not representative of the primary purpose of trans-state cooperation agreements. What it highlights is why the issue of allocating systemic gains from such agreements is an integral part of institutional theory and why in practice, resolution of that issue can entail protracted and detailed negotiations.

The second issue, ascertaining a state's commitment to the provisions of a cooperative agreement, is similarly complex. At one level international law and transnational organisations can be viewed as mediums for effective cooperation because 'almost all nations observe almost all principles of international law and almost all of their obligations almost all the time' (Henkin 1968, p. 47). An alternative assessment is that agreements are hollow unless compliance obligates a behaviour that would not otherwise be adopted by the participant states. As a result, the issue of a state's depth of commitment to an agreement now challenges theorists, especially as it applies to trade related agreements (Johns 2013, pp. 469-470). In practice there is an inverse correlation between the depth of an agreement's impacts and its enforcement rigidity – international trade agreements with, say, deep tariff cut demands are more likely to include flexible compliance provisions (Johns 2013, p. 469).

Agreement flexibility is necessarily the third issue. Rigid compliance and enforcement provisions are inappropriate when uncertainty of future costs and benefits limit the ability of states to make binding long-term commitments. Rosendorf & Milner (2001) and Rosendorf (2005) establish that inclusion of 'escape clauses' in agreements whereby, under certain conditions, states may suspend various obligations can improve the stability of cooperative agreements. Similarly, Johns (2013) reports that in agreements in which small penalties for defection are included, the penalties serve to enhance the flexibility and deepen the level of effective trans-state cooperation.

Finally, Gilligan and Johns have examined the fourth issue: multilateralism and its impact on trans-state cooperation agreements (2012, pp. 231-233). In this context, multilateral agreements are generally depicted as requiring commitments to a broader rather than deeper

set of member preferences, though some elements of both are possible. For example, the World Trade Organisation (WTO) is a multilateral trade regime with provisions that oblige all members to comply with some broad legal principles such as ensuring all members have most-favoured nation status (i.e. all trading partners are treated equally). However, there are also provisions that enable members to agree to deeper, specific product-by-product tariff provisions that reflect a state's individual domestic economic and political needs. Consequently, membership of multilateral trade or other regimes need not impede, and in the case of the proposed Indonesia-Australia CEPA, may even assist the development of bilateral agreements.

In summary, the progression of empirical modelling and attendant theory development illustrate the refinement of neoliberal institutionalism since the 1980s. The theory highlights the potential for there to be systemic benefits from cooperative relationships and for the equitable distribution of those benefits. These findings from game-theory and the body of 'solid empirical evidence of cooperation among states' (Herbert 1996, p. 227) sustain the premise that 'states *should not* (and do not) *always* assume the worst of others' intentions and that states can and should take measures to reduce uncertainty about each other's intentions and thus fear' (Tang 2008, p. 453, original emphasis).

That assessment of the potential for international institutions to impact transnational relationships contrasts markedly with the findings of scholars with other analytical perspectives. Structural realists are arguably the most indifferent to the potential for institutions to impact the international system. Their perspective is represented by the view that states seek to maximise relative power and that the impact of institutions is minimal or

epiphenomenal to the power and wealth of a dominant state (Waltz 1979; Meirsheimer 1994-5). Constructivists on the other hand typically view institutions as central to the international system. They reason that institutions constitute the interests of states because they enable experts and politicians to interact and come to an understanding of how key issues are conceptualised and defined (Chernoff 2008, p 69).

2.3 The ‘ASEAN Way’ and Neoliberal Institutionalism

2.3.1 Australia and Asia

As noted above, the development of most global neoliberal institutions occurred in the era of post-World War II US hegemonic economic and security power. This section looks below the level of global institutions and examines the development of institutions within the Asian region. The objective is to ascertain if there are features of these regional institutions that distinguish them from the broader global regimes. This analysis is necessary because my FDI-security hypothesis is oriented to the Australia-Indonesia bilateral relationship and as demonstrated below, shared institutional membership can be significant in the development and maintenance of pacific relationships. Yet, in the Southeast Asian context, Indonesia is typically at the membership forefront of regional institutions, whereas Australia’s membership is often tangential.

Australia’s broad-scale engagement with Asia began in the 1970s when burgeoning industrial growth in Japan and South Korea generated demand for large volumes of newly discovered Australian iron ore, coal, nickel, bauxite and other mineral resources. Restoration of post-War trade relations with Japan were facilitated by the signing in 1957 of the Japan-Australia

Commerce Agreement. Speaking during his visit to Australia at the time, Japanese Prime Minister Kishi observed that the Commerce Agreement and the Colombo Plan evidenced Australia's 'awakened Asia-mindedness' (Fischer, 1997).

Chapter 3 examines how meaningful institutional relationships were re-established during the 1960s, despite negative perceptions of Japan resulting from its war time attacks on Darwin, Sydney and multiple other locations, as well as its treatment of Australia's 22,000 prisoners of war. Nevertheless, Australia's perceived anti-Asian sentiments were perpetuated by Australian engagement in Cold War anti-communist military actions in Korea (1950-53), Vietnam (1962-75) and in Malaysia (1963-66). Australia's standing in Asia was also marred by the anti-Asian White Australia policy that had persisted since the 1850s' gold rush era. Steps to modify Australia's steadfast opposition to Asian immigration began in 1966 but it was not until 1973 that the policy was abolished (Capling 2008, p. 604).

As a result of those impediments it was three decades after the Japan Commerce pact before Australia's Asian awakening was finally exhibited in a coherent plan for engagement with the Asian region (Gurry 1995). A perceptive analysis of long-term economic opportunities in East Asia set out in the *Garnaut Report* (1989) provided the basis for a Hawke-Keating Government plan for closer Asian alignment. The plan led to major domestic reforms in labour relations, tariffs, immigration and education that positioned Australia to better engage with the Asian region (Capling 2008, p. 606).

However, some aspects of a mid-1990s ambition by the Keating government to transform Australia from 'an Anglophilic outpost' to an 'Asia Pacific Nation' faced popular opposition

(Capling 2008, p. 609) and subsequent Australian Federal governments resiled from the Hawke-Keating support for Asian regional institutional building. Instead they sought to establish bilateral agreements with major trading partners. Together with the strong post-2001 alignment with the US security agenda, these plans constrained Australia's engagement in broader Asian economic and security relations. As a result, Australia has made limited progress in the development of complex interdependent relationships in the region. That is most notably evident in the case of Indonesia following Australia's role in the process that led to East Timor's independence in 2002 (Capling 2008, pp. 611-612).

2.3.2 ASEAN and the 'ASEAN Way'

This section seeks to illustrate how neoliberal institutionalism within the community of ten ASEAN member states has unique qualities that differentiate it from its global counterparts. Later I build on this analysis when I examine why ASEAN is a source of uncertainty in Australia's Asian regional relationships. As will become apparent, culturally based regime differences often test Australian foreign policy makers and corporate officials seeking to engage with their counterparts in Southeast Asia. Such differences in customs and social behaviours are exemplified by the contested concept of the 'ASEAN Way,' which serves to accommodate the widely different norms of its member states (Acharya 2011, pp. 4-5). Consequently, awareness of and preparedness to address these differences is an important aspect of my analysis in Chapter 3.

Academic study of Asian regionalism is 'remarkably new' and until recently was an essentially 'atheoretical' subject area (Acharya 2011, p. 4). Unlike the institutionalised,

legalised and supranational governance role of regional associations in Europe, Asian regionalism is depicted as ‘recent, sovereignty bound, informal and non-legalistic’ with a disdain for great-power led security multilateralism (Acharya 2011, pp. 4-5). The extent of diversity in scholarly assessments of the ‘ASEAN Way’ and its impact on Asian institutional norms can be illustrated by a review of ASEAN and its regional effectiveness.

In this review, my analytical focus is on trade and security rather than issues such as human rights or the physical environment where regional institutions are less developed. What quickly becomes evident is that Asian institutions in general, and Southeast Asian regional institutions in particular, function differently to those in other regions. The circumstances generally considered to account for these institutional differences are the widely dissimilar levels of democracy, governance, and economic living standards between member states. Those differences give rise to ASEAN’s unique institutional qualities and the hallmark ‘ASEAN Way’ of accommodating those differences.

One point of scholarly agreement is recognition of ASEAN as the foremost institution in the region since its formation in 1967. Those most positively disposed towards ASEAN acknowledge its success in expanding cooperation and stabilising relations between previously conflictual member states (Ba 2014b; Eaton & Stubbs 2006; Nesadurai 2008; Acharya 2001). They accept that ASEAN has served as an institutional locus for other Southeast Asian institutions and for a distinct brand of regionalism that contrasts with the conventional European integrationist model. More broadly these scholars perceive Asian regionalism as marked by a commitment to sovereign equality and group unity which is evidenced by principles of non-interference, consensus-based decision making and a ‘non-

binding institutionally minimalist' identity (Ba 2014b; Eaton & Stubbs 2006; Nesadurai 2008; Acharya 2001).

For these pro-ASEAN scholars, negative assessments of ASEAN's role are typically premised on the 'rationalist' conceptions of cooperation and organisation that dominate IR theory. To its detractors, ASEAN's lack of binding contractual commitments, consensus practices and the broadly centrist polity of its member states, renders ASEAN and similar Asian institutions 'nonentities' to realist and liberal theorists (Ba 2014b, pp. 296-297). To Alice Ba, the fact that the 'ASEAN Way' institutional model succeeded in including the major powers of China, Japan, the EU and the United States variously as members of the ASEAN Regional Forum, ASEAN plus Three and the East Asian Summit, is not accepted as a measure of its effectiveness by these critical scholars (Ba 2014b, p. 296). What is more, ASEAN has had a role in building Asian regional institutions such as the forty-nine-member Asia Europe Meeting, the eight-member South Asia Free Trade Agreement, and the thirteen-member Chiang Mai Initiative – a nascent Asian Monetary Fund (Kawai 2015). Nevertheless, as noted below, many scholars do not recognise or conceptualise ASEAN as an alternative model for an effective regional institution (Ba 2014b, pp.295-296).

In contradistinction to Ba's positive expectations of ASEAN and its associated institutions, David Martin Jones and Michael Smith are scornful of any such re-conceptualisation. Writing in 2007, during the fortieth anniversary of ASEAN's formation, the authors describe ASEAN as an essentially intergovernmental organisation focused on trade and economic issues but lacking 'the institutional infrastructure to develop into a 'mature' security community or establish a common identity.' Nor, they conclude, can ASEAN 'despite its

strategic mutations ... mask the reality that weaker states cannot shape the fates of stronger ones' (Martin Jones & Smith 2007, pp. 183-184). What force dictates that such realist ideals should be the measure of ASEAN's quadragenarian success is not evident. Moreover, the authors overlook the fact that ASEAN, established as an association of states for the purpose of maintaining regional order, has, using its own inimitable methods, been unambiguously successful in fulfilling that mandate (Ba 2014b, p. 295).

Nevertheless, albeit in more measured terms, Mark Beeson's introductory essay to a special collection of papers on ASEAN also notes ASEAN's lack of influence outside its own region and questions the efficacy of the 'ASEAN Way' that characterises Southeast Asian institutions (Beeson 2009, p. 333). Beeson cites Acharya's explanation of the 'ASEAN Way' as a decision-making process in which consultation and consensus-building predominate and discretion, informality and non-confrontational bargaining is the procedural norm. This process contrasts with the adversarial posturing, majoritarian and legalistic decision-making style of Western institutions (Beeson 2009, p. 336) where the security and trade expectations of members are essentially aligned and in which liberal institutional theory development has typically been focused (Haggard 2014, p. 46). These aligned Western preferences derive from broadly comparable democratic standards of political freedom, rule of law, separation of powers, shared trade and security goals and generally similar economic living standards across the US-EU-Japan.

Those preferences contrast with the disparate norms for each of the comparators within the ten ASEAN member states. Singapore may sustain comparison with a developed Western democracy whereas Laos and Vietnam remain overtly communist. Importantly, only

Singapore, Brunei, Malaysia, and Thailand have a level of GNI/head above the World Bank's lower-middle income threshold of US\$3,955 pa.³ Such disparity in Asian political and economic development must give rise to discordant policy preferences for states in the region because there are different 'sovereignty cost' impacts when members seek to align their policies.⁴ Therefore, in Asia, where policy diversity is the norm, the creation of and access to the benefit of public goods generated by the policy alignment process is considered to be a recurring source of tension (Haggard 2014, p. 48).

Nevertheless, the mechanisms by which the tensions of sovereignty cost and benefit allocation are accommodated illustrate how the ASEAN Way decision-making process impacts organisational outcomes. ASEAN's discreet, informal, non-confrontational consensus-building norm has enabled states to limit sovereignty cost impacts while maintaining a level of diversity in their economic and foreign policy preferences (Haggard 2014, pp. 49-50). Although there are indications that rigid adherence to ASEAN's founding principles may limit its future ability to engage effectively or collectively with issues such as the South China Sea territorial dispute and the seemingly closer alignment of Laos and Cambodia with the People's Republic of China (PRC). Nevertheless, the ASEAN Way principles of socialisation, consensus decision making through quiet diplomacy, and

³ <<https://blogs.worldbank.org/opendata/new-country-classifications-income-level-2017-2018>>

⁴ *Sovereignty costs* is generally used in legal and political-science literature to refer to reductions in state autonomy, or, more precisely, to intervention in the domestic authority structure (Hathaway 2008, p. 120).

sovereign equality are likely to remain the most effective form of multilateral Asian engagement in the context of very dissimilar state interests.⁵

As such, I argue that ASEAN and its hallmark ASEAN Way practice is a workable exception to the Western theoretical neoliberal institutional model considered in the previous section. Four key differences illustrate ASEAN's exceptionalism and highlight how ASEAN practices vary from the Western institutional model of trans-state relationships on which the theory is framed (Gilligan & Johns 2012, p. 228). First, identification of mechanisms for the creation and distribution of systemic gains is scarcely relevant because ASEAN practices enable member states to minimise sovereignty impacts and retain their widely different policy preferences. For example, capitalist, democratic Singapore is a fellow ASEAN member with communist, single-party Vietnam. Second, ASEAN's consensus-based institutional character results in the theoretical test of formal cooperation commitments being largely irrelevant. The third institutional indicator, flexibility of member commitment to trans-state agreements, is also not particularly meaningful within ASEAN. Given the consensual hallmark of the 'ASEAN Way' there are few formal sanction provisions even in major agreements such as the Cooperation Agreement on Intellectual Property and the ASEAN Free Trade Area Agreement. However, such agreements typically do have conciliation mechanisms for the resolution of disputes that may occur between member states.

⁵ The impact on ASEAN's capacity to achieve consensus on such issues due to the seemingly closer alignment of Laos and Cambodia with the Peoples Republic of China (PRC) is examined in Chapter 9.

The fourth ASEAN exception to the neoliberal institutional model is the impact of multilateralism and it gives rise to perhaps the biggest test of ASEAN's prevailing *modus operandi* (Gilligan & Johns 2012, p. 228). Nevertheless, the ASEAN institutional framework operates according to regional norms that ensure policy outcomes are consistent with ASEAN members' interests. In its unique way '... ASEAN, through entrepreneurial and intellectual leadership, has established the infrastructure and ideational basis for regional consultation and decision making' (Stubbs 2014, p. 537).

Despite these strengths, ASEAN is, of course, far from perfect. This is recognised by the members themselves. But Singapore's Ambassador-at-Large Bilahari Kausikan's comment in 2015 is apposite: using the metaphor of ASEAN being a cow rather than a horse, he observed that:

[A] cow will never become a horse ... we should consider how we can improve the bovine breed; how we can make a better cow, rather than scolding it for not being able to run as fast as a horse (Kausikan 2015).

A recurring element of my analysis is that ASEAN and arguably pan-Asian institutional norms that preference consultation, consensus-building and non-confrontational bargaining are a reality that few Australian politicians, policy makers and corporate executives appear to accept. However, a sign that this may be changing can be found in reports from the

Indonesia-Australia Comprehensive Economic Partnership Agreement where negotiations between key stakeholders have achieved consensus outcomes on a wide range of issues.⁶

2.4 Foreign Policy Analysis

As its title suggests Foreign Policy Analysis (FPA) is the study of foreign policy making, implementation and adaption over time, but for its theorists the analysis is far richer. That richness is evident in this expansive definition which describes FPA as a:

[C]omplex, multilayered process, consisting of the objectives that governments pursue in their relations with other governments and their choice of means to attain these objectives. ... Thus foreign policy encompasses the complicated communications within government and amongst its diverse agents, plus the perceptions and misperceptions, the images of other countries, and the ideologies and personal dispositions of everyone involved. An important part of the study of foreign policy has been the nature and impact of domestic politics (Kubáľková 2001, pp. 17-18).

The status of Foreign Policy Analysis theory is contested and at times is seen as marginal to the established corpus of IR theory (Kaarbo 2015, p. 192). Juliet Kaarbo challenges that view and maintains rather that in IR theory the role of domestic politics and actors' decision-making choices are 'undertheorised and underdeveloped' (Kaarbo 2015, p. 189). As such

⁶ CEPA provisions are examined in Chapter 9.

FPA's contribution is to demonstrate the impacts of agent decision-making on foreign policy developments. In this thesis I seek to integrate FPA with my analytic eclecticist methodology (Kaarbo 2015, pp. 207-209).

More specifically, FPA facilitates a focus on the possible contribution of foreign investors to home and host country foreign policy making and bilateral security relationship outcomes. It acknowledges that human decision makers acting singly or in groups are central to what transpires between nations (Hudson 2005, p. 1). This human agency perspective takes IR analysis beyond the level of theoretical abstraction that exemplifies structural IR theory which models the international system using the assumption that the state is a rational actor. Valerie Hudson maintains that FPA compels both a multifactorial and multilevel assessment of the influences on decision-makers and the decision-making of foreign policy (Hudson 2005, p. 2). Hudson's conclusion is that the scope of FPA's assessments require the integration of information and capabilities from many different disciplines. FPA theorists must adopt a multi- and inter-disciplinary assessment of the human agency influences on the foreign policy making process.

Hudson's perspective positions human agency in FPA theory as obviating the role of 'the state' in the foreign policy making process (Hudson 2005, pp. 1-2). In that context FPA methodology enables the role of 'the state' to be disaggregated so that the impact on foreign policy settings by actors such as transnational corporate executives can be studied.⁷ This

⁷ *Actor* – an entity with 'the ability or capacity ... to act consciously and in so doing to attempt to realise his or her intentions (Hay 2002, p. 94).

contrasts with the unitary rational actor assumptions of core neorealist, institutionalist and Wendtian constructivist IR theories that align human actions with those of the state (Baumann & Stengel 2014, p. 491). FPA theory is based on the premise that human decision makers individually or in groups are ‘the ground of all that happens in international relations’ (Hudson 2005, p. 2).⁸ A central challenge for my research is to establish if Australian foreign policy agents such as corporate executives, politicians, bureaucrats, professional advisers and others engaged in foreign direct investments projects can help to improve the quality of Australia’s bilateral relationship with Indonesia. FPA helps meet the challenge by extending the frame of transnational relationship analysis to include the agency of those non-state FDI decision makers acting either collectively or individually (Hudson 2005, p. 4).

Two dimensions of FPA theory are particularly important to my research. The first is FPA’s expansion of the number of potential home and host country foreign policy actors incorporated in my analytical purview. In a *globalised* world there are humans who represent *state actors* – in Australia this category includes government ministers and bureaucrats acting alone or collectively along with members of state and federal law enforcement agencies and the armed services. It also incorporates officials representing *international actors* such as ASEAN, APEC, UNHCR, the World Trade Organisation, IMF and the Asian Infrastructure Investment Bank. Then there are *transnational NGO actors*. These include the Red Cross, WWF, religious groups and, indirectly, terrorist and criminal networks. Then, most significantly, there are *private actors* such as national media and most notably, large and

⁸ A ‘ground’ means the conceptualization of the fundamental or foundational level at which phenomena in the field of study occur (Hudson 2005, p. 1).

small business organisations with transnational associations (Baumann & Stengel 2014, pp. 491-493).⁹ In practice, the distinction between these categories is not always clear cut. For example, in the planning and implementation of a transnational public-private infrastructure partnership, home and host country government officials at different levels must engage with local and offshore company executives for a venture to proceed (Baumann & Stengel 2010, p. 500). In my analysis of the potential impact of FDI on the Australia-Indonesia relationship, actors from each of the *state*, *international* and *private* domains are represented.

The second dimension of FPA's role in my analysis is a response to Hudson's call for theorists to adopt a multifactorial, multilevel assessment process to integrate information and capabilities from different academic disciplines (Hudson 2005, pp. 1-2). As is discussed below, I respond to that call by adopting an eclecticist approach which serves to aggregate the effects of those different actors, identified in the context of their original disciplines, into the national foreign policy position (Hudson 2007, p. 6).

Another aspect of the call for greater emphasis on the role of human agency and its challenge to the status quo in IR theory is the so-called 'practice turn' emphasis of some IR theorists (Pouliot 2008; Adler & Pouliot 2011; Acuto & Curtis 2013; Adler-Nissen 2013; Cornut 2015; Bueger & Gadinger 2014; 2015). A notable feature of practice turn reasoning is its significant (though generally unacknowledged) parallels with Foreign Policy Analysis. While there is no established IR 'practice theory,' various theories are premised on an acceptance

⁹ The authors note though that with a few exceptions foreign policy analysts focus on state actors (Baumann & Stengel 2014, p. 511)

that social realities ‘are constituted by human beings acting in and on the world’ (Cornut 2015, p. 1). Practice theory’s alignment with FPA methodology is especially apparent when ‘practice’ orientation is described as ‘the stuff that drives the world and makes it ‘hang together’’ (Bueger & Gadinger 2015, p. 449). Expressed differently, practices are what actors do. Constructivists argue that the analysis of practices enables IR scholars to overcome the theoretical impasse between agency and structure and between ideas and materiality (Reus-Smit 2013a, pp. 238-239).

Development of my thesis within the FPA and practice rubrics requires the assembly of cross-disciplinary theory and practical understandings of transnational dealings in the domains of security, culture and international business. The appropriate methodology for aggregating and analyzing findings from those diverse domains is analytical eclecticism.

2.5 Analytic Eclecticism

As indicated below, Rudra Sil and Peter Katzenstein propose analytic eclecticism as a way that International Relations scholars can examine practical research questions. As this is an interdisciplinary thesis that draws on research from several fields, eclecticism ensures that the analysis is disciplined. Sil and Katzenstein depict analytic eclecticism as:

[A]n intellectual stance that supports efforts to complement, engage, and selectively utilize theoretical constructs embedded in contending research traditions to build complex arguments that bear on substantive problems of interest to both scholars and practitioners (Sil & Katzenstein 2010, p.411, original emphasis).

More specifically, the challenge facing the eclectic use of theory is how to retain the ontological and epistemological integrity of findings drawn from different disciplines when those findings are used in a cross-disciplinary analysis. Sil and Katzenstein emphasise that the commitment to maintain the ‘constructs embedded in contending research’ is what provides analytical integrity to the eclectic process. As such, analytic eclecticism is not a unique or alternative research model. Rather, it is a mechanism by which the diverse theoretical perspectives required to ‘grasp the manifold complexities’ of cross-disciplinary issues can be engaged (Sil & Katzenstein 2010, p. 412).

Analytic eclecticism has three features that are applicable to the theory and application of the possible transnational relationship impacts of foreign direct investments. The first is its pragmatic orientation, which facilitates research that has application in policy and practice. Second is a scope that reflects the everyday influences on international politics which, in this thesis, include the impacts of cultural distance, variations in types of foreign investment and forms of non-traditional security threats. Third is recognition that the possible conflict mitigating causal mechanisms identified by this process are likely to be complex, interactive and possibly context specific (Sil & Katzenstein 2010, p. 412). As such, eclecticism’s syncretic methodology is not motivated by metatheory or universal laws; rather, its objective is mid-range theories that have application within a ‘bounded set of comparable contexts where certain cause-effects recur’ (Merton 1968, pp. 43-44).

Sil and Katzenstein acknowledge the potential for this process to discount established theories in individual disciplines and to create ‘theoretical incoherence’ due to incommensurability between or across the disciplines if theoretical vocabularies are not

interchangeable. Yet, even in circumstances where different research disciplines have different ontological and epistemological groundings, complex findings in one discipline can be validly represented in another. This is most explicit when research findings in unrelated disciplines are substantiated with empirical results and so have a standard that enables the findings to maintain their cross-disciplinary integrity (Sil & Katzenstein 2010, pp. 412-415).

Critics of this eclectic research process raise questions that might challenge its appropriateness for use in a doctoral thesis, in part because of an implied empirical partiality in its application (Reus-Smit 2013, p. 589). Chris Reus-Smit's critique centres on Sil and Katzenstein's grounding of their analysis in the empiricist-oriented tradition of American IR scholarship. For Reus-Smit this orientation limits the application of the eclecticism they espouse to the universe of 'only empirical-theoretic forms of inquiry and knowledge' (Reus-Smit 2013, p. 605). If that is so, Reus-Smit reasons, the eclectic research outcome may be 'valuable knowledge about diverse social and political phenomena' but it will fail to fulfill the Aristotelian or Kantian test of producing 'practical' knowledge, where 'practical' knowledge refers to Kant's conception of knowledge to be that 'through which I represent what ought to be' (Reus-Smit 2013, pp. 601-602).

In Reus-Smit's assessment, Sil and Katzenstein's ambition for eclecticists to produce more practically relevant IR research, which he firmly supports, is not fulfilled. Reus-Smit's claim is based on a supposed failure by Sil and Katzenstein to combine the empirical knowledge, on which he sees eclecticism as founded, with the normative reasoning required to constitute 'practical' knowledge. Importantly though both parties agree that practical knowledge is what is required to make IR scholarship more relevant to 'users' of IR research (Reus-Smit

2013, p. 601). My decision to use analytic eclecticism as the basis for gathering theories from different disciplines is based on two considerations. First, like Reus-Smit and Sil and Katzenstein, my ambition is to develop knowledge that is practical and relevant to policy-makers. Second, I do not accept Reus-Smit's argument that eclecticism is constrained exclusively to empirical applications. Such a reading is at odds with Sil and Katzenstein's own definition of eclecticism as 'any approach that seeks to extricate, translate, and selectively integrate analytic elements ... of *theories or narratives* of substantive problems' (Sil & Katzenstein 2010a, p. 10, emphasis added). This approach enables the 'mix and match' of theoretical approaches in a 'scholarly rigorous and intellectually fruitful manner' (Falkiner 2012, p. 405).

It is the desire to gain practical knowledge and geopolitical understanding that orients my turn to analytic eclecticism. The *mélange* of theory used in this paper to examine whether greater Australia-Indonesia direct investment and economic interdependence can impact bilateral security relations is prototypically eclectic. That eclecticism is evident in Chapter 3 where my analysis engages cultural distance theory from International Business, in Chapter 4 where securitisation theory from the Security Studies domain is engaged, and again when geo-economic tenets from Development Economics are applied in Chapter 9.

2.6 Summary

In summary, this chapter provides the theoretical footings for my examination of the prospect that FDI could contribute to mitigating transnational security threats. My analysis is based on three theoretical traditions: Neoliberal Institutionalism, Foreign Policy Analysis and Analytic

Eclecticism. Individually, these theories do not elucidate the FDI-security puzzle but in combination, the three constructs enable me to analyse a range of issues that are aggregated into a multifactorial examination of FDI's security threat impacts.

Neoliberal institutional theory guides my analysis of the role of non-state agents including MNCs. In its regional variant, institutional theory identifies the need for Australian institutions, government and private, to better understand and accommodate Asian institutional norms, non-Western values and cultural differences. FPA provides the theoretical premise on which the role of non-state agency is accommodated in the analysis of foreign policy theory and foreign relations outcomes. Finally, eclecticism facilitates the aggregation of research from different disciplines and enables likely security consequences to be deduced.

Based on these theoretical traditions, the next two chapters look to answer my first research question – why is there a bilateral Australia-Indonesia relationship divide? Given the disparity in their traditions and current socio-economic development the lack of affinity may seem predictable, but there are other causes. The next chapter identifies aspects of this divide beyond the obvious differences as a first step in the process of identifying how the prevailing relationship gulf might be bridged.

Chapter 3: How wide is the cultural divide?

3.1 Introduction

No two neighbours are as unlike – that was Australian Foreign Minister Gareth Evans' 1991 assessment of Australia and Indonesia. The assessment was based on differences in language, culture, religion, history, ethnicity, population size and their respective political and legal systems. Evans also considered that despite being neighbours, the fact that they did not share at least some of these essential characteristics meant that the two countries were so disassociated they may as well have been half a world apart (Evans & Grant 1991).

What impact does this cultural divide have on the level of bilateral political and economic engagement? That is the principle question addressed in this chapter. The answer, when combined with ensuing analysis of differences in bilateral security and commercial issues, resolves my first thesis sub-question – what accounts for Australia's lack of political and economic engagement with Indonesian?

I argue that trust-based consensus decision making, which is paramount to relationship building in Javanese society, is a significant impediment to bilateral relationship building. Resolution of personal or other differences in Indonesia centers on a custom of mutual assistance (*gotong royong*) and consultation (*musyawarah*) as the process by which consensus (*mufakat*) is achieved. The foundational importance of these Javanese cultural

norms is such that they are embedded in the national political system as one of Indonesia's five constitutional principles (*Pancasila*).¹

This chapter begins with an International Business based application of cultural distance theory to examine this bilateral relationship. That understanding informs my subsequent analysis of the theoretical and empirical consequences of the seeming disregard Australian politicians and policy makers have for Indonesian cultural norms. That disdain reflects a lack of 'intellectual engagement' (Fitzgerald 1997, p. 2) with Asian cultures and has a part in explaining why Australia's relationship with its proximate and increasingly important Asian neighbor remains 'edgy and fractious' (White 2013, p. 32). The chapter concludes more positively with the example of post-World War II Japan as an example of Australia's success as a cross cultural bridge builder. One element in that success is the Australia Japan Business Co-operation Committee's contribution to the multi-faceted bilateral relationship building program that makes Japan perhaps Australia's most robust Asian relationship.

3.2 Cultural distance awareness – the theory

Cultural distance theory has its origins in the Uppsala internationalisation models which examined the foreign market access preferences of Swedish firms pursuing offshore trade opportunities (Johanson & Vahlne 1977; Johanson & Wiedersheim-Paul 1975). While Management and International Business literature analysis of culture may lack the rigour of

¹ Article 2 of the 1945 Constitution provides for *mufakat* (unanimous consent) decision making. It remains the post reformasi norm though on occasions legislation is now passed by majority vote (Kawamura 2011, pp. 5-6).

Cross-Cultural Psychology or Sociology (Kitayama & Uskul, 2011), the literature nevertheless provides a framework within which to analyse some of the societal challenges and impacts of Asian trade and FDI. The complexity of ‘culture’ as a concept is reflected by the fact that it has more than 160 definitions, yet the most widely accepted definition is attributed to Edward Tylor and dates from 1871. Tylor described culture as:

[T]hat complex whole which includes knowledge, belief, art, morals, law, custom and any other capabilities and habits acquired by man as a member of society (cited in Craig & Douglas 2006, p. 323).

When the study of culture is appropriated to Management and International Business literature the emphasis is on a narrower definition of national culture and specifically on the ability to represent differences between cultures in the guise of ‘cultural distance.’ In somewhat similar vein, ‘psychic distance’ is represented as the *perceived* cultural distance between two or more cultures based on the subjective assessment of an individual or small group of individuals (Evans & Mavondo, 2002; Ciszewska-Minaric & Trapczynski, 2016).

Subjective psychic distance perceptions are acknowledged in the business literature to have a role in the selection of offshore investment locations by the management of MNCs (Sousa & Bradley 2008, pp. 470-472). The consequence in practice is that FDI decisions may be based on the poorly informed perceptions of individual executives. Because Asia generally, including Indonesia, is culturally distant from Australia, building basic cultural awareness and overcoming management subjectivity is integral to my premise that Australian FDI in Indonesia could offer substantial commercial and diplomatic rewards.

Cultural distance studies are sometimes credited with ‘opening management’s eyes’ to the importance of cross-cultural management issues (Trompenaars 1993, p. iii). They demonstrate how path dependency leads trans-national corporations to favour trade and investments in markets that are close in terms of cultural distance before pursuing opportunities in less familiar cultural environs (Eriksson, Majkard & Sharma 2000). This path dependency pattern of trade and investment may explain Australia’s history of skewed FDI flows to New Zealand, the United Kingdom and the U.S.A that are detailed in Chapter 9.

Path dependence in this context is defined as the influence the stock of accumulated knowledge has in shaping the internationalisation trajectory of a firm, given the bounded rationality of any corporate actor. Threshold location decisions are pivotal to gathering the elements of experiential knowledge that shape a firm’s future transnational pathway. Those decisions are typically based on three considerations: first, an appreciation of the institutional rules, norms, values, language and business practices of the host country; second, awareness of the market, the customers and competitor circumstances in the new location; and third, an assessment of the firm’s in-house capability to operate internationally (Eriksson et al. 2000, pp. 309-310).

Two of those path determinants are corporation specific. Building market awareness is essentially data driven and specific to each corporation’s product or service offering, while the development of cross-border operational capabilities is a matter of management competence. My focus is not on those issues. My engagement with this theory centres on the first consideration – the role of host country culture in transnational corporate development. The analysis highlights the path dependent character of Australia’s existing Anglo-anchored

FDI preference and contrasts it with the cultural challenges that arise when Australian companies venture into Asia, and into Indonesia specifically. Importantly, it also shows, through the example of Australia's relationship with Japan, that cultural divides can be traversed.

Early research on the issue of cultural distance awareness is based on a landmark cultural difference study by Kogut and Singh (1988) that produced index measures of cultural distance between fifty-four countries. Richard Fletcher and Jenifer Bohn subsequently used this data to produce an index of Australia's cultural distance from the other fifty-three countries in the Kogut and Singh study (Fletcher & Bohn 1998, p. 56).

Although the Fletcher & Bohn study is dated, cultural persistence (Knafo et al. 2011, p 179) makes it likely that the indicative measures of cultural differences between Australia and other countries identified in the study have endured. Fletcher and Bohn's research demonstrates that Australia has a negligible cultural difference from the United States, while China and Panama are the most culturally remote. Unsurprisingly the paper also positions Australia as culturally distant from the major ASEAN member states, especially the Philippines, Thailand, Singapore and Indonesia, which are closely grouped in this study (Fletcher & Bohn 1998, p. 56).

At their core, studies of cultural distance in International Business and Management are based on a narrow formulation of culture that looks to variations in a small number of national values, norms or attitudes for its coherence. The studies differ in the traits selected but they serve to produce national cultural taxonomies which in turn provide the basis for

setting out empirical indices of relative cultural difference or distance (Ronen & Shenkar 2013, pp. 867-868). Furthermore, some studies aggregate findings of cultural likeness amongst cohorts of countries into maps or other representations of cultural clusters such as the World Values Map (Inglehart & Welzel, 2010) and the GLOBE (Global Leadership and Organizational Behavior Effectiveness) project (House et al., 2004).

The GLOBE project for example is a large *n* survey of middle managers across sixty-two societies designed to examine management style effectiveness, using nine cultural variables across ten groups of culturally alike societies. The ten culturally alike societies reflect strong cultural similarities based primarily on Geert Hofstede's hallmark cultural dimensions. Those dimensions are: power inequality, individualism, gender orientation, uncertainty avoidance, time orientation (short V long) and gratification attitude (indulgence V restraint) (Hofstede 2011, p. 8). Table 3.1 below lists the member countries in each of the ten culturally alike societies.

Group	Countries
Anglo	Australia, Canada, England, Ireland, New Zealand, South Africa (white), United States
Latin Europe	France, Israel, Italy, Portugal, Spain, Switzerland (French speaking)
Nordic Europe	Denmark, Finland, Sweden
Germanic Europe	Austria, Germany, Netherlands, Switzerland
Eastern Europe	Albania, Georgia, Greece, Hungary, Kazakhstan, Poland, Russia, Slovenia
Latin America	Argentina, Bolivia, Brazil, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Mexico, Venezuela
Sub Saharan Africa	Namibia, Nigeria, South Africa (black), Zambia, Zimbabwe
Middle East	Egypt, Kuwait, Morocco, Qatar, Turkey
Southern Asia	India, Indonesia, Iran, Malaysia, Philippines, Thailand
Confucian Asia	China, Hong Kong, Japan, Singapore, South Korea, Taiwan

Table 3.1 The GLOBE Cultural Groups (House et al. 2004 cited in Brewer & Sherrieff 2007, p. 118)

Outcomes of the management effectiveness aspect of the GLOBE project are not directly relevant to my thesis, but data from the project does provide a useful measure of indicative cultural distances between the ten culturally differentiated groups (Brewer & Sherriff 2007, p. 118). One not surprising finding is confirmation of the cultural disparity between the Anglo group and both the Confucian and Southern Asian groupings. The Southern Asian cohort which includes Indonesia is assessed as more remote from the Anglo than the Confucian group. Respectively, the Confucian and Southern Asian groups are the eighth and ninth most remote groups from the Australian cultural cohort (Brewer & Sherriff 2007, p. 119).

Understanding the traits that give rise to the Anglo and hence Australian cultural difference from the Confucian and the Southern Asian cultural cohort is a significant aspect of the Australia-Indonesia relational challenge. Given that mutual trust is foundational to corporate success in the Confucian and Southern Asian region and that trust is built on cultural and ‘intellectual engagement’ (Fitzgerald 1997, p. 2), I argue that the relational benefits of deeper economic interdependence with Indonesia will not develop without deeper Indonesian cultural awareness (Dick 2015, p. 29).

Two respondents in my research interviews who each have responsibility for aspects of trade and foreign policy implementation in Southeast Asia confirm that Australian executives frequently fail to appreciate local cultural norms. One respondent estimated that one fifth of

his agency's time is needed to help Australians overcome cultural miscommunication issues.² He argues that Australian companies fail to understand the need to build 'mission critical' trust and shared understanding to sustain relationships with local partners. Another respondent criticised Australia's trade development agency for its failure to educate corporate executives on Asian cultural issues.³ This interviewee commented that the issue is only 'touched on briefly' during a Trade Mission's introductory briefing. As a result, Australian executives are often 'shocked' by the seeming disregard for speakers during corporate presentations in Asia, and by social etiquette at dinners and networking functions so that relationship development is limited.

3.3 Measuring the Australia-Indonesia cultural divide

Hofstede's studies that underlie the above cultural group studies also provide an understanding of individual national cultural differences. This subsection employs those studies to better understand the differences between Australia and Indonesia. It examines the markers of individual cultural difference and provides an understanding of the impediments to be overcome in order to build a trust-based relationship. However, before assessing the potential trust and relationship building implications of these markers, I should outline two important caveats. First, the merit of Hofstede's cultural distance construct and its measurement is contested by some scholars, including Mariola Ciszewska-Mlinaric and Piotr Trapczynski (2016, p. 3), and Thomas Hutzschenreuter et al. (2016, pp. 163-164). Second,

² M1, 22 May 2017. Telephone interview

³ M2, 16 May 2017. Face-to-face interview

the implication in Hofstede's study that there is a single Indonesian national culture is misleading as this archipelagic country sustains numerous separate cultural groups, especially on the outer islands. However, it appears that Hofstede's analysis is based on the majority Javanese population and attribution of common cultural characteristics to the Javanese as representative of the predominant indigenous business group in Indonesia is credible (Mangundjaya 2010).

The characteristics on which Hofstede's cultural differences are based are:

- **Power distance** – the degree of societal acceptance of unequal power distribution – a low score equates to a low national acceptance of power inequality.
- **Individualism** – identifies the degree of societal orientation towards self-dependence or its opposite collective-dependence. A high score signifies a highly individualistic society.
- **Term orientation** – points to a society's preference for long term historical and traditional practices or its acceptance of short term societal change. High scores indicate a preference for tradition and distrust of change.
- **Uncertainty avoidance** – denotes the degree to which a society seeks to limit rather than accept ambiguity. A low score indicates a pragmatic society that accommodates ambiguity.

- **Masculinity** (sic) – indicates the disposition of a society towards personal competition, achievement and success over caring and quality of life. A high score indicates a masculine success-driven society.
- **Indulgence** – reveals the prevailing attitude towards gratification of desires. A high score reflects a society's willingness to indulge personal ambitions (Hofstede 2011, pp. 9-16).

Table 3.2 below provides details of the Australian and Indonesian country readings for the six dimensions on which the above Cultural Groupings are based.

Country	Individualism	Long Term Orientation	Power Distance	Uncertainty Avoidance	Masculinity	Indulgence
Australia*	90	21	36	51	61	71
Indonesia**	14	62	78	48	46	38

Table 3.2 Hofstede Cultural Distance Index Measures – Australia-Indonesia⁴

The three highlighted index measures in the table, *individualism*, *term orientation* and *power distribution*, are issues of significant cultural difference that confront Australians seeking to build enduring relations in Indonesia and Asia generally. Two of Hofstede's measures, *uncertainty avoidance* and what he terms *masculinity* are similar in both Australian and Javanese communities and do not present cultural barriers to social or business engagement. Issues relating to the Hofstede's *indulgence* measure are remote from my FDI focus. As a

⁴ *<https://geert-hofstede.com/australia.html>; **<https://geert-hofstede.com/indonesia.html>

result, my focus is on the three measures of greatest cultural distance highlighted in the table: *individualism*, *term orientation* and *power distribution*.

The most dissimilar index measure and the issue most likely to limit Australian MNCs' development of direct investment relationships in Javanese society is *individualism*. Executive assertiveness and overt verbal disagreement is an Anglo and thus Australian behavioral norm, but that mode of expression conflicts with the Javanese pursuit of consensus, in-group decision making and infrequent use of the personal pronoun 'I'. In Javanese tradition assertiveness is regarded as *kasar*, meaning 'coarse, impolite and inconsiderate,' and at odds with the value of *lair* or 'appropriate behaviour' The ideal of Javanese society is 'calm appearance, appropriate dress, peaceful social interactions, respect for authority and unity with leadership' (Irawanto et al. 2011, pp. 127-128; Mangundjaya 2010, pp. 61-62; Hofstede 2011, p. 11).

Aspects of the Javanese harmony ideal are also evident in Hofstede's representation of the *term orientation* difference between Australia and Indonesia. Indonesia's rating on this measure points to a preference for tradition and a distrust of change. During the three-decade long Soeharto presidency, Javanese values became 'a fundamental influence' in the country's bureaucracy and major organisations (Irawanto et al. 2011, p. 133). The legacy persists in a rigid hierarchical public sector where 'outsiders' seeking to build a relationship need to have judicious regard for local cultural traditions. For individuals, local and foreign, observance of this tradition is shown by consistent personal reliability and relational dependability in all circumstances (Irawanto et al. 2011, p.133).

The third significant aspect of Hofstede's index that impinges on the relationship building endeavors of Australians in Indonesia is *power distance*. This cultural difference is manifest in the deep level of respect accorded to older people in formal and informal exchanges that is known as *hormat* or recognition of superior rank. In commercial exchanges it may be evidenced by doubt in the credibility attributed to young Anglo executives. Other power distance issues that impact non-nationals in Indonesia are local acceptance of social and economic inequality, and the presence of corrupt practices. Hofstede associates these traits with high levels of power inequality (Irawanto et al. 2011, pp. 129-133).

Management literature does not provide an authoritative commentary on the practical effects of these cultural differences on the operational requirements of an Australian company's activities in Indonesia. As a proxy I have included a summary of a 2017 paper by Carl Hinze of the effects these same cultural differences have on business exchanges in China. The justification for selecting this proxy is based on the substantial similarities between Indonesia and China on the three most relevant cultural characteristics: *individualism*, *term orientation* and *power distribution*. These similarities are evident in the following table of Cultural Distance Index Measures for Indonesia and China.

Country	Individualism	Long Term Orientation	Power Distance	Uncertainty Avoidance	Masculinity	Indulgence
Indonesia**	14	62	78	48	46	38
China***	20	87	80	30	66	24

Table 3.3 Hofstede Cultural Distance Index Measures – Indonesia-China⁵

The degree of correlation in these Index Measures indicates the likelihood of a close correlation in business practices between Indonesian and Chinese executives. As such, Australian executives need to accommodate a range of equivalent differences when doing business in either country. A practical understanding of the impact these differences have in commercial relationships is set out in Table 3.4 below. Prepared by Carl Hinze, a Chinese sociolinguistics scholar and legal adviser on Chinese investment banking and law, it provides an informed, matter-of-fact synopsis of business relationship expectations for Australian executives in China (Hinze 2017).

	In Australia	In China
Status and hierarchy	Management of many Australia businesses tends to be fairly 'flat'. Information and responsibility can flow sideways and upwards in an organization.	Management of most Chinese businesses is hierarchical. Information is passed down on an 'as needs' basis.
Contracts	Contracts are a core component of commercial relationships.	Contracts are much less important than trusted relationships.
Business style	Business people are often direct and do not hesitate to discuss upfront what they need and want.	Business people are often indirect guarded and reluctant to explain their interests or ultimate desires. They rarely, if ever, 'cut to the chase' in meetings.
Relationships	Trust extends to outsiders as easily as trust of one's in-group. Personal relationships are important, but not critical, for getting on in life.	Ties of reciprocity are fundamental. Individuals seek refuge in their in-group networks of relationships of trust. Foreign business partners rarely form part of the in-group.
The role of government	Although business lobby groups are capable of influencing government, there is a clear demarcation between	Government is pervasive and involved in most aspects of business.

⁵ **<https://geert-hofstede.com/indonesia.html>; ***<https://geert-hofstede.com/china.html>.

	business and government.	
The pace of business	Transactions move fast and the expectation is that deals are done quickly.	Business often requires a long lead time and a long courting process, with many meetings, banquets, business trips or social events.

Table 3.4 Doing business in Australia and China (Hinze 2015, pp. 3-4)

Hinze elaborates his view on business plans and contracts in China and observes that China is ‘a country ruled by people not by law.’ As such, business success in China requires FDI investors to align their objectives with government policies and develop relationships of trust with key government agencies and business partners (2015, pp. 2-3). Indications of that perspective being equally applicable in Indonesia are apparent in a presentation by barrister Campbell Bridge SC to an Asialink Business, *State of the Nation: Indonesia* forum in 2017.⁶ Bridge, the only non-Indonesian legal practitioner accredited as an Arbitrator and Mediator in Indonesia, depicts contracts in Indonesia as akin to guidelines for an operational relationship and the basis for future negotiations if circumstances change. Western trained legal and business specialists accustomed to the relative certainty of ‘black letter law’ find it difficult to replace that certainty with dependence, in large part, on a mutual trust-based relationship. Failure to accommodate this and other differences identified by Hinze (2015 pp. 3-4) contribute to the tensions that characterise the Australia-Indonesia relationship.

This review of cultural distance theory has sought to explain behaviours that create misunderstandings and potentially damaging impacts on bilateral relationships at the corporate and government level. The following section details numerous examples of adverse

⁶ *State of the Nation: Indonesia*, 2017 presentation Asialink Business, Sydney 17 May.

Australian government actions that compromise the potential to develop the desired strong and productive relationship with Indonesia.

3.4 Indifference to Asian cultures

Complacency is the enemy of opportunity especially when it's comfortably cushioned by the smug self-satisfied superiority that distinguishes Australia's approach to all things Asian (Behm 2016).

3.4.1. Australian Government cultural indifference

Notwithstanding the body of research on cultural engagement discussed above there are many examples of complacency and apparent indifference by Australian politicians and policy makers for the national cultural characteristics of Asian states such as Indonesia. This section sets out several examples of that complacency because these events go some way to explaining why Australia has a fractious relationship with Indonesia (White 2013, p. 32).

Disregard for the basics of effective relationship building is evident in two recent Asian focused Australian Government policy statements. First is the 2012 *Australia in the Asian Century* White Paper. This Gillard Labor government paper details the breadth of Asian economic opportunities and exhorts Australian private and public organisations to develop 'Asian capabilities' to exploit these prospects. The goal is to position Australia as a '...nation that is fully part of our region and open to the world' (Commonwealth of Australia 2012, p. 1). While the Paper supports the need for social and cultural links in the region it does so in the context of an ability to 'unlock large economic and social gains' rather than build long term mutually beneficial economic and security outcomes.

This overweening preference for Australia's pecuniary interest over the economic and cultural wellbeing of Asian host countries also dominates the 2014 Economic Diplomacy policy that replaced the Asian Century White Paper. The policy identifies economic diplomacy as the 'core of Australia's international engagement.' It asserts that whereas 'the goal of traditional diplomacy is peace, the goal of economic diplomacy is prosperity' (DFAT 2014). As such, according to Dick:

The policy's narrow economic focus shows a profound disregard for the interests of commercial counterparts. The word trust occurs only twice in the Economic Diplomacy policy statement and the word mutual never even appears (Dick 2015, p. 30, emphasis added).

While both these policy positions present rational economic aspirations, they ignore the need for Australian government and corporate elites to develop the requisite level of understanding of Asia which Garnaut (1989, p. 100) and Fitzgerald (1997, p. 2) had previously highlighted. This conclusion is reinforced by Tim Lindsey's assessment, set out in the following chapter, that Indonesian elites reading the 2017 Australian Foreign Policy White Paper could conclude that Australia does not see their country as important (Lindsey 2017b, p.4).

3.4.2 Asian language learning

The dearth of Asian language and cultural studies in Australian schools and universities is further evidence of indifference to Garnaut's appeal for Australian science, art and business professionals to build greater understanding of and engagement with the Asian region (1989, p. 320). Despite calls in 2008 for a 'reinvigoration of Asian literacy' (Commonwealth of

Australia 2008, pp 35-36), funding for the 1990s' National Asian Language and Studies in Schools (NALSS) program that encouraged student engagement in Asian literacy was suspended in 2012. Whether attributable to that decision or not, the fact is that Asian Studies enrollments as evident in the number of NSW Higher School Certificate students enrolled in Indonesian language studies have plunged. The number fell from a peak above 700 in the 1980s to just 70 in 2016 (Munro, 2016). Meanwhile, University level enrollments fell 40% between 2004 and 2010 and six universities have closed their Indonesian studies program (Hill 2012).

As highlighted below, the paucity of Indonesian language student enrollments contrasts with the scale of Japanese language students at both secondary and tertiary institutions. In total over 360,000 students in Australia are studying Japanese (Commonwealth of Australia 2017d, p. 1). This long standing program, supported by government and industry since the 1960s, illustrates the potential scale of bilateral language learning engagement and concomitant cross cultural learning benefits available from an equivalently supported Indonesian studies program.

3.4.3 Australian political indifference

There are numerous examples of Australia's disregard for 'ASEAN Way' standards of decision-making, where consultation, discreteness, informality and non-confrontation should be paramount (Beeson 2009, p. 336). A recent damaging example is the injudicious manner in which a ban on live cattle exports to Indonesia was imposed in 2011. Despite Australia's privileged status as the exclusive provider of live cattle imports to Indonesia, accounting for

25% of the nation's total beef consumption needs, Australia imposed a unilateral ban on the trade without any prior advice or consultation with the Indonesian authorities. Motivated by Australian domestic political pressure, the ban impacted Indonesia's food security, caused beef supply shortages and impinged on macroeconomic stability (Blanchet & Zeller 2012, pp. 55-59).

In Indonesia the embargo's impacts were both immediate and enduring. The immediate effect was market 'chaos' as beef prices escalated and distribution controls triggered widespread protests in Surabaya, Malang and Jakarta (Soesilowati 2016, pp. 14-15). Dependence on live cattle to meet consumption needs is high because inadequate freezer capacity and unreliable power supply in many parts of Indonesia precludes access to alternative frozen beef imports. Import dependence is exacerbated further by the inability of domestic live cattle production to meet the nation's demand. The enduring effects of the ban include Indonesian initiatives to secure alternative beef import sources and a call to prioritise 'high-value Asian partnerships over low-value unsustainable trade relations with Australia' (Marthinus 2015, p. 4). The level of offence is reflected in Marthinus' assessment that Indonesian has the dilemma of 'dependence mixed in with disrespect when dealing with Australia.' Indonesia's ambition is to secure its food security because a 'begging bowl made in Australia will not suffice' (Marthinus 2015, pp. 3-4).

Had the cattle export ban been a one-off event its importance to the trust and consensus building that motivates Asian relationships could have been minimised, but in practice the ban is one in a pattern of events that have revealed Australia's cultural indifference. This indifference was further demonstrated in Australia's engagement with Indonesia during the

2013-15 government of Prime Minister Abbott. There are three aspects to what Dick (2015b, p. 2) terms Abbott's 'woeful lack of skill in international relations' in his dealings with Indonesia. The first was Abbott's tenacious commitment to a 'turn back the boats' 2013 election policy which entailed abandoning joint naval action to stop the flow of refugees from Indonesia to Australia. Bilateral responsibility was replaced by Australia's secretive unilateral Operation Sovereign Borders. Abbott's policy met its domestic political objectives, but the adverse foreign relations impact of a rebuff to the Indonesian navy, several (or many) Australian naval 'tow back' incursions into Indonesian territorial waters, and Australia's disregard for the many thousands of asylum seekers left in Indonesia without any offer of financial or other assistance, is enduring (Dick 2015b, pp. 2-3).

Abbott's second foreign policy shortcoming was demonstrated in the course of several efforts to secure clemency for convicted Australian drug traffickers Andrew Chan and Myuran Sukumaran. Foremost was the improbable assertion by Abbott that Indonesia had some obligation to meet Australia's request for compassion in appreciation for the substantial practical and financial assistance provided following the 2004 tsunami disaster. This demand caused strong critical press and social media reactions in Indonesia (Kristanti 2016, p. 91). Abbott's third failing was to oversee Australia's shrill megaphone diplomacy criticising Indonesia's capital punishment regime. The criticism gave rise to a perception in Indonesia of Australian interference in a domestic issue that was being conducted in accordance Indonesian law (Dick 2015b, p. 3). The death of Chan and Sukumaran contrasts with the eleventh-hour reprieve granted to a Philippine woman following an ASEAN style 'quiet diplomacy' representation by the then Philippine President Aquino to his Indonesian

counterpart (Topsfield 2015). Circumstances of the respective cases may have been different, but the success of the culturally appropriate Philippine clemency plea in achieving a reprieve while maintaining friendly relations is incontestable.

3.4.4 The bilateral relationship consequences

This list of negative impacts on the Australia-Indonesian relationship, which are not offset by countervailing positives, provides some understanding of why Australian institutions, government and non-government, can have difficulties developing interdependent relations with their Indonesian counterparts. One assessment is that the relationship is characterised by diplomatic exchanges in which ‘Australian demands aimed at deflecting domestic political pressure ... are met by Indonesia’s resentful acquiescence’ (White 2013, p. 32).

That depiction of the Australia-Indonesia relationship has some empirical support. An AsianBarometer 2006-08 survey in fourteen Asian countries of public perception of Australia’s influence in their country reveals that regard for Australia in Indonesia is worse than in other countries. The survey sample includes ASEAN members (except Brunei and Burma/Myanmar) plus Japan, China, Taiwan, Korea, India and Hong Kong. Although the survey findings are dated, the distinctly adverse difference in the Indonesian public’s perception of Australia sets it apart from other countries. Having regard for events since 2008, it is unlikely that public perceptions of Australia in Indonesia have become more positive.

The AsianBarometer survey reported that 29% of Indonesian respondents rated Australia’s influence on their country as *good* which is the lowest of all fourteen survey results. That

compares with Australia's *good* ratings of 36% in China, 49% in Malaysia and the most positive of 66% in the Philippines. More significantly it is Indonesia's perceptions of Australia as a *bad* influence that is most revealing. Over 28% of the Indonesian public rated the influence of Australia as bad compared to the next highest negative perception of Australia which is 12% in India and Malaysia (cited in Goldsmith & Linley 2012, p. 536). The survey does not interrogate the issue of what respondents mean by a *good* or *bad* influence. Nor does it provide any evidence of perception differences between sectors of the public by education, occupation or other variables, but what it does indicate is that unlike in every other country in the survey, Indonesian policy makers do not have a positive or indifferent public when dealing with Australia (Goldsmith & Linley 2012, p. 546).

Finally, a more tempered interpretation of the bilateral relationship is that there exists in both Indonesia and Australia a number of public servants and private citizens who have educational, professional or personal connections that help sustain the relationship between this 'odd couple' of Southeast Asian countries. Nevertheless, the perceptions of the majority of Indonesians and Australians who have no personal or professional connection with the other country are often ambivalent, confused or deeply suspicious (Lindsey 2006, p 2). While the perceptions may be mistaken they are sufficiently strong that politicians, journalists and others can exploit these adverse perceptions for populist purposes. Tim Lindsey's advice is to 'buckle up and brace yourself for continued bilateral crises for the foreseeable future. But don't worry too much about them – most of them will not lead to real conflict' (Lindsey 2006, p 2). In fact, Lindsey concludes they may be a sign of a stronger relationship being developed based on a depth and complexity that should have developed much earlier.

(Lindsey 2006, p 2). A decade later Lindsey's assessment was less sanguine when he observes that the defeat of Governor Ahok in the 2017 Jakarta elections had 'shaken the country's self-identity as a tolerant, pluralist society and bodes ill for the future' (Lindsey 2017).

3.5 Bridging the cultural divide

This chapter has so far examined evidence of Australia's cultural distance from Indonesia and Asia in general. It concludes by seeking to establish if there is evidence of cultural distance-reducing mechanisms that can be pursued to change psychic or cultural distance perceptions. Two decades ago Stephen Fitzgerald appealed to Australian politicians, policy makers and other institutional actors to develop and respond to Indonesia within the context of an understanding of the forces at work within their society (Fitzgerald 1997, p. 2). The enduring failure to respond to that appeal contrasts markedly with Australia's successful reversal of its relationship with Japan following World War II. The hallmarks of that transition, which is probably Australia's most successful cultural bridge-building experience, are examined below in order to demonstrate how FDI and its attendant complex interdependence might contribute to developing improved cultural and economic relations with Indonesia

3.5.1 Australia's rapprochement with Japan

The magnitude of the relational transition that occurred between the former intense World War II adversaries, Australia and Japan, in the decades following the war illustrates how cultural appreciation and economic interdependence can benefit a bilateral relationship. The

post-war period which began with deep-seated anti-Japanese hostility matured to the point where the Australia–Japan partnership is described as the ‘closest and most mature in Asia, and fundamentally important to both countries’ strategic and economic interests’ (DFAT 2017a). Moreover, that standing is reciprocated in Japan’s assessment of Australia as its second most important security partner after the United States (DFAT 2017b).

Understanding the influences that enabled this cultural and military divide to be bridged is instructional. It reinforces my objective of testing whether FDI can play some part in bridging a transnational cultural and security divide. Whether or not the example of Japan can be cited as a replicable model is contestable, though, because Japan had been a British ally in World War I, and by the 1930s had become Australia’s third largest trading partner (DFAT 2008). Nevertheless, the World War II bombing of both Darwin and Sydney, combined with maltreatment of many thousands of Australian POWs, created deep anti-Japanese enmity. Furthermore, there were no traditional or cultural alignments that disposed either country towards rapprochement. It is notable that in the *GLOBE Cultural Group Analysis* (Table 3.1 above) Japan is positioned in the Confucian Asia group which is the most culturally remote group from Australia, even more remote than the Southern Asia group in which Indonesia is positioned. Australia’s post-war relationship reversal with Japan was a long-term process. It began in a formal sense with a bilateral Trade Agreement in 1957.

The Trade Agreement was followed in 1962 by the formation of the Australia Japan Business Co-operation Committee (AJBCC), which supplemented government-to-government contact with elite senior executive level bilateral corporate engagement. As will be highlighted in a later chapter, the AJBCC example supports the idea that corporate actors may have agency in

bilateral relations, especially in this example where annual corporate Chief Executive Conferences have been held every year for the past fifty-five years. From the outset AJBCC's agency role supplemented other Government initiatives and it served to establish closer ties between businesses in both countries and break down barriers to understanding (Australian Tradelinks 2017).

AJBCC also contributed directly to the development of a range of cultural relations programs. In conjunction with the Australia Japan Foundation,⁷ AJBCC funded English language teaching programs for Japanese language professionals who trained teachers in the skills and methods of English language teaching. It also conducted a two-way corporate exchange program for younger business executives (Australian Tradelinks 2017). There were also two notable Government to Government foreign relations initiatives. One was the launch of a culturally oriented Treaty of Friendship and Cooperation in 1976. The other was the adoption in 2007 of a Joint Declaration on Security Cooperation (DFAT 2017b).

Finally, one expert interviewee pointed to an anecdotal example of FDI's potential to contribute to bilateral understanding in the unlikely impact ski field developments by the Australian Lend Lease Corporation have had on tourism and its related benefits. The Lend Lease construction company was established in Australia by European migrants who were contracted to build housing for the Snowy Mountains Hydro-Electric Scheme in the early 1950s.⁸ That led to the company's development of Australia's first major ski resort at

⁷ Est. 1976 – a cultural council supporting people-to-people links underpinning this relationship.

⁸ <http://dusseldorp.org.au/about-us/gj-aka-dick-dusseldorp/>

Thredbo, NSW during the 1960s. One of my research interview respondents who lived in Japan as a senior Australian trade relations representative, noted that following the 1972 Winter Olympic Games at Sapporo, Lend Lease commenced building ski resort projects in Japan.⁹ Extensive tourism marketing in Australia of those Japanese ventures during the 1980s and 1990s created ‘an appreciation of Japan by influential Australians.’ Along with other factors, that appreciation contributes to almost 400,000 Australians visiting Japan annually, a substantial proportion of whom go for the skiing.¹⁰ However, when asked to compare the relationship impact of Japanese skiers with the one million Australian tourists to Bali each year, this interview respondent did not anticipate a comparable benefit. He reasoned that Bali provides little awareness of core Indonesian (Javanese) culture and for most of the visitors, cultural difference was not a notable issue.¹¹

3.5.2 Japanese FDI in Australia – the cultural bridge?

By the 1970s Japan’s economic resurgence had positioned it as global centre of heavy industries including steel, chemicals, automobiles and shipbuilding. It had a rapidly growing demand for imported coal and iron ore at a time that coincided with discovery in Australia of extensive high-grade reserves of those commodities. According to one review, Japan’s demand for imports of these resources ‘virtually underwrote the mineral development of Australia during this period’ (Robinson 1977, p. 21). By 1980 the scale of these inward direct

⁹ M2, 16 May 2017. Face-to-face interview

¹⁰ <http://www.abc.net.au/news/2018-01-16/australia-and-japan-reverse-tourism-relationship/9332518>

¹¹ M2, 16 May 2017. Face-to-face interview

investments to Australia positioned Japan as Australia's third largest inward foreign direct investor, a position it still maintains (DFAT 2017c, p. 73).¹²

What links the impact of this strong investment and resultant export earning benefit to the issue of complex interdependence and relationship building is the government and private cultural initiatives to which it gave rise. For example, a government sponsored sister-city relationship program that began in 1963 to link Yamatotakada in Nara prefecture with Lismore, NSW, is now one of 108 such counterpart relationships (SCA 2016). The program typically provides at least annual exchanges of local government officials and students that result in the promotion of art and sporting engagements (de Kretser 2010, p 18). However, probably the most important plank in building this cultural bridge was Australian school and tertiary level curriculum emphasis on Japanese language and cultural education courses. By the early 2000s the study of Japanese in Australian schools and universities exceeded all other languages. Australia was second only to South Korea in terms of both percentage and total number of students learning Japanese. In 2008 more than 350,000 Australian school students were enrolled in Japanese language classes (de Kretser 2010, pp. 27-28). That enrolment was about double the number of students learning the Indonesian language (Kohler 2010, p. 20).

Impetus for Japanese language learning developed in the 1970s as a result of Australian government investments in promoting the teaching of Japanese, motivated by the growing economic and strategic importance of the Australia-Japan relationship. The initiative created

¹² Excluding aggregated FDI holdings in Australia via the Netherlands tax haven.

a national corpus of teachers with good resources and provided opportunities for students and teachers to travel to Japan (de Kretser 2010, p. 7). Language skills built culture awareness, and an understanding of Japan's contribution to global fashion, art, architecture and popular entertainment (de Kretser 2010, p. 7).

Japan's investment in Australia's resource development projects is an example of direct investment as a mechanism through which economic and cultural interdependence emerged, and highlights the role of inward FDI. Analysis in Chapter 9 will illustrate that Australian FDI in Indonesia could have essentially equivalent economic and cultural impacts on the Australia-Indonesia relationship. A feature of the Australian-Japanese cultural distance compressing factors is that they are consistent with Fitzgerald's assessment that Australia's success in building institutional engagement in Asia requires effective 'intellectual engagement' with the region's cultures (Fitzgerald 1997, p. 2). The Japanese example illustrates the potential for the benefits of intellectual engagement and relationship building to flow from a greater Australian interdependence with Indonesia including those that flow from direct investment projects.

3.6 Summary

This chapter demonstrates the reality of a cultural divide between Australia and Indonesia. Cultural distance studies centred on Hofstede's index measures identify *individualism*, *term orientation* and *power distribution* as the characteristics that sustain this cultural difference. In order to build and sustain trust-based relationships between the two countries, Australian political and corporate leaders would need to acknowledge and act to overcome these

differences. Examples of failures by Australian leaders to consider cultural differences in their dealings with Indonesia are recurrent and substantial. Unsurprisingly such actions are reflected in Australia's adverse standing in surveys of Indonesian public perception and, I argue, account in some part for the lack of effective bilateral engagement.

In practice though, these core elements of cultural differences are not unique to Indonesia. They are common to other Asian states such as Japan, South Korea and Malaysia with which Australia has developed and sustains effective relationships. The process by which the deeply fractured relationship with Japan following World War II was transformed provides an instructive example of the potential for a deep cultural divide to be bridged.

The following chapter looks to Australia's foreign policy deliberations process, and evidence of a policy focus on developing a strong and productive relationship with Indonesia. Such a focus would align with the security priority accorded to Indonesia in the 2016 Department of Defence White Paper.

Chapter 4: Foreign Policy preferences – do they enhance the bilateral relationship?

4.1 Introduction

The previous chapter identified cultural difference and a seeming lack of regard by Australian political, policy and corporate officials for Asian cultural considerations as a likely source of friction in the Australia-Indonesia relationship. Nevertheless, the example of Australia's rapprochement with Japan demonstrates that concerted economic, educational and tourist engagement can help to ameliorate even deep-seated antagonisms. Why then has there not been more progress in bridging the apparently less challenging Australia-Indonesia divide? That is the crux of my first research question and this chapter looks to identify whether, in addition to cultural factors, there are specific foreign policy considerations that act to sustain this divide.

My review of Australian and Indonesian foreign policy preferences identifies both long standing and recent disjunctures in these policies. One example is the impact of Australia's six-decade long US great power alignment and Indonesia's equally long-standing commitment to the Non-Aligned Movement and disavowal of any such alignment. As a result, Australia seeks to promote US primacy in Southeast Asian regional fora, whereas Indonesia pursues a multilateral regional emphasis centred on the interests of the ASEAN community. An example of the paradoxical outcome from these contrary foreign policy ambitions is the recent provision of similar but uncoordinated responses to Chinese actions in the South China Sea.

This chapter begins with an examination of foreign policy making's unique 'high politics' status, especially in the current context of Asian regional uncertainty associated with China's increased territorial assertiveness. The Australian Government's *2017 Foreign Policy White Paper* (2017a) provides an up-to-date context in which to address Australia's foreign policy engagement with Indonesia. Likewise, Indonesia's recent annual Foreign Policy Review provides a forthright though less detailed summary of its policy priorities. The statements reveal obvious differences in strategic vision and very little policy congruence, despite the responses to the South China Sea issue suggesting shared interests. My assessment is based on the foreign policy analysis theory discussed in Chapter 2 and takes examples from Australian and Indonesian Foreign Policy statements to demonstrate the responsiveness of each state to these regional developments.

The second section of the chapter examines several legacy issues that negatively impact the Australia-Indonesia relationship, together with two adverse events that have had some improbable positive outcomes. This is followed by a high-level review of the respective Australian and Indonesian government's foreign policy ambitions. While I generally find these incongruent, my review does identify at least one prospect for deeper bilateral engagement. The chapter concludes with an assessment of the relational implications of these foreign policy considerations. Despite the negative legacies and marked differences in policy priorities, it seems that ambivalence rather than foreign policy animus contributes more to the recurrently fractious Australia-Indonesia relationship.

4.2 Foreign policy principles

Foreign policy, once known as ‘high politics,’ has a special status in government because of its role in national self-preservation and the maintenance of core values (Evans & Newnham 1998, pp. 225-226). In the Westminster system it is one of only a few functions that are managed by the executive branch of government (Gyngell & Wesley 2007, p. 144).¹ Allan Gyngell and Michael Wesley attribute that distinction to a need for governments to react quickly to complex overseas developments unhindered by normal domestic parliamentary debate. Furthermore, those issues are often too sensitive for parliamentary and public scrutiny. As a result, it is considered that only the executive has the capacity to respond quickly and maintain the secrecy required for ‘effective, clear and consistent foreign policy’ (Gyngell & Wesley 2007, p. 145).

But what is ‘foreign policy’? There is no resolved definition, though the *Dictionary of International Relations* characterises it as a boundary activity that seeks to reconcile transnational demands from the global environment with those of the domestic community (cited in Evans & Newnham 1998, pp. 179-180). The analysis of foreign policy making is generally approached from a regional perspective and, consistent with that practice, Australia generally prioritises regional relations because those relationships are more likely to be the source of conflict than wider global politics (Evans & Newnham 1998, pp. 179-180).

¹ In the Westminster system Bagehot identifies the Cabinet as ‘a committee of the legislative body selected to be the executive body’ (Bagehot 1963, p. 66)

Foreign policy objectives at any particular time may be as narrow or extensive as policy-makers determine (Evans & Newnham 1998, pp. 344-345), but when it comes to implementation it is questionable whether foreign policy in most states, including the USA and the UK, is part of a unified policy-making system (Evans & Newnham 1998, p. 180). Likewise, in Australia foreign policy making and implementation occurs in a world that may be 'difficult, wilful and resistant' and where policy practitioners are often 'sceptical of high-sounding (foreign policy) schemes and principles' presented by either academics or the public (Gyngell & Wesley 2007, pp. 7-8). Such representations are usually judged by policy makers to lack the necessary detail or knowledge of a foreign counterpart's perspective.

Australia's *2017 Foreign Policy White Paper* emphasises regional developments. In the fourteen years since publication of the previous White Paper, China has become a global geopolitical power and produced strong new regional tensions. The White Paper emphasises Australia's commitment to strong and constructive ties with China and an ambition to strengthen a Comprehensive Strategic Partnership established in 2014 (Commonwealth of Australia 2017a, p 4). How that might be achieved is unclear as only the barest details of likely foreign policy initiatives are provided.

The White Paper's regional focus and the impact of China's ascent may also underlie Australia's commitment to 'new economic and security cooperation' with the Indo-Pacific middle power democracies: India, Japan, Indonesia and the Republic of Korea.² The

² 'Indo-Pacific' – the region ranging from the eastern Indian Ocean to the Pacific Ocean connected by Southeast Asia, including India, North Asia and the United States (Commonwealth of Australia 2017a, p 1).

proposed cooperation arrangement is represented in the White Paper as an initiative that has 'first order importance to Australia' (Commonwealth of Australia 2017a, p 40). This reorientation away from the previous 'Asia-Pacific' emphasis with its implicit US security assurance has two potentially significant foreign policy implications. One possibility is a widening of Australia's regional security ambit through deeper engagement with India. That outcome would reinforce Australia's ambition to promote deeper economic engagement with India because of its emergence as an economic power that could counter China's regional dominance.

The other possibility, to align multilaterally with Indo-Pacific states on the basis of their mutual middle power status, may have greater foreign policy significance. Mark Beeson, for example, reasons that Australia's foreign policy ought to be specific in terms of issues, context and geography within the Asian region and that the best way to impact events is to cooperate with other middle powers. Acting alone a middle power has little influence on regional events, but with effective multilateral alignment middle power states may collectively have the potential to influence and possibly force great powers to act with broader consideration (Beeson 2017, p. 1). The White Paper has no details on the status of this initiative or its operational features, but Beeson's theoretical construct would be realised in practice if a meaningful Indo-Pacific middle power cooperation alignment were to be accomplished (Commonwealth of Australia 2017a, p. 40).

The White Paper does not represent the Indo-Pacific initiative as a regional middle power response to increased Chinese influence, but that interpretation seems very plausible. One challenge to that interpretation is to question whether Indonesia has yet emerged as a middle

power state. However, in terms of material capabilities as well as internal and international recognition, it seems clear that Indonesia already ranks as a middle power (Emmers & Teo 2018, pp. 46-48). This is also not an isolated proposal because, as is outlined later in this chapter, Indonesia has proposed a parallel Indo-Pacific middle power initiative with ASEAN as its pivot. Section 4.4 provides a detailed review of Indonesia's foreign policy priorities.

An associated undertaking in the White Paper that could help bridge the gulf of cultural distance between Australia and Indonesia is a promise to pursue new 'people-to-people links to strengthen these (Indo-Pacific) relationships' (Commonwealth of Australia 2017a, p. 40). No details have emerged of what that undertaking means in practice. Nevertheless, strengthening the bilateral relationship with Indonesia must take place in the context of the legacy of several important relationship milestones set out in the following section.

4.3 Legacy issues that impact the Australia-Indonesia relationship

The previous chapter noted a series of actions by Australian politicians and policy makers that reflect a seeming indifference to the cultural imperatives that sustain Indonesian society. This section extends that analysis to other factors that cleave the Australia-Indonesia relationship. Of those, Indonesia's non-aligned geo-political status, the White Australia policy legacy and East Timor's independence appear to have had the most influence on bilateral foreign policy making.

Australia's bilateral relationship with Indonesia was strong and positive when Indonesia emerged from post-war Japanese occupation and resisted attempts by the former Dutch colonial power to reassert its control. Practical support for Indonesian independence came in

the form of Australian waterside workers' actions to hinder the re-supply of Dutch naval vessels engaged in efforts to re-establish control of their former colony. Geopolitically, Australia co-sponsored Indonesia's admission to the United Nations in 1950 (Evans & Grant 1991, p. 186). This early goodwill faded within a decade especially when, in the aftermath of the anti-communist Korean War and heightened Cold War tensions, Indonesia's President Sukarno hosted the socialist-oriented Asian-African Conference in 1955. The conference of twenty-nine mostly ex-colonial Asian and African nations held in Bandung, Indonesia, challenged the prevailing Euro-centric imperial hierarchy with which Prime Minister Menzies' Australian government was strongly aligned. The Conference presaged the formation in 1961 of the Non-Aligned Movement that enabled emerging newly independent 'Third World' countries to have a significant impact on Cold-War geopolitics (Phillips 2015, p. 3).

4.3.1 The Bandung legacy

The Bandung conference and a commitment to the non-aligned principles were pivotal developments in Indonesia's foreign policy history. Their legacy continues to influence Indonesia's domestic and foreign policy preferences. The influence is most evident in Indonesia's disavowal of great power alliances, its refusal to allow foreign military basing in the country, its commitment to regional multilateral relationships and its ambition to insulate the region from great power interference (Phillips 2015, p. 4). Non-aligned principles motivate Indonesia's 'free and active' foreign policy preference, which was first advocated in 1948 by Vice-President Hatta. Hatta described Indonesia's foreign policy strategy as 'rowing between two reefs,' representing its detachment from the capitalist and communist ideologies

of the great powers. During his thirty-two-year autocratic rule, President Soeharto (1967-1998) maintained positive relations with Washington but did not compromise Indonesia's essential neutrality. Indonesia's post-Soeharto foreign policy has also maintained the non-aligned principles, their expression being reformulated in President Yudhoyono's 2009 inauguration address where he depicted Indonesia's foreign policy ideal as 'having a million friends and zero enemies' (Piccone & Yusman 2014, p. 3).

Despite some change in emphasis, non-alignment and multilateralism remain the hallmarks of Indonesian foreign policy. Indonesia has steadfastly resisted all formal military alliances, preferring to foster multilateral ASEAN regional cooperation and economic development, and acting to minimise great power engagement in Southeast Asia (Phillips & Hiariej 2016, p. 425). This multilateralist policy ambition was apparent in former Indonesian Foreign Minister Natalegawa's pursuit of a 'dynamic equilibrium' in the Southeast Asian regional order. Since its formation in 1967, the ten-member ASEAN community has been the preeminent multilateral regional institution through which this equilibrium has been pursued, since its consensus decision making process ensures that no one state dominates its proceedings (Pitsuwan 2014, p. 244). Major powers are encouraged to engage with various regional mechanisms rather than individual states.

Indonesia's multilateral 'dynamic equilibrium' ambitions contrast with Australia's security alignment with 'great and powerful friends' (Shephard 1992, p. 1). Australia's enduring commitment to this band-wagoning strategy is demonstrated by six decades of engagement in US military campaigns that have extended from Korea and Vietnam to Iraq and Syria. Moreover, Australia's ambition to secure continuing US regional engagement is evident in

the 2011 announcement that US Marines and other defence assets would be stationed in northern Australia. Notably, this announcement was made without diplomatic consultation with Indonesia, notwithstanding its sensitivity to great power engagement in its region (Phillips & Hiariej 2016, pp. 426-427). Australia's great power band-wagoning orientation sits in contradistinction to Indonesia's multilateralist regional foreign policy ambitions.

Finally, the enduring differences in Australia-Indonesia foreign policy settings are demonstrated in current tensions that arise from China's construction of militarised facilities in the South China Sea and its efforts to limit access to disputed fishing grounds in the region. Australia is not directly a party to these disputes but freedom of navigation in the South China Sea is vital to Australia's commercial interests since more than half its international trade transits through those waters (Wesley 2013, p. 47). As such there are important common grounds for concern by Australia and Indonesia, yet there is no evidence of commonality in their policy responses.

Indonesia's policy response has essentially been conducted within the ASEAN framework and continues its detachment from US engagement in the region. That contrasts with Australia's response which is to support US engagement in efforts to push back against Chinese initiatives. The disparity in these responses is attributed to Indonesia's 'neutralism and South-South cooperation' whereas Australia is fulfilling its commitment to the preservation of the US dominated status quo (Phillips & Hiariej 2016, pp. 430-431). However, appreciation of the Bandung non-alignment legacy and its influence on bilateral relationship building opportunities is not the only legacy issue contributing to this fractious bilateral relationship. Another is the White Australia policy.

4.3.2 The White Australia Policy legacy

This section examines in more detail the background to President Yudhoyono's comment that some Indonesia people are afflicted with 'Australiaphobia' (cited in White 2013, p. 34). Such negative perceptions are not uncommon in the Asian region based on a belief that anti-Asian or White Australia policies persist. This vestige of colonial history has currency notwithstanding Australia's avowed national values of mutual respect and equality of opportunity regardless of race, religion or ethnic background. Cavan Hogue observes that Australians have forgotten the century of official anti-Asian racial discrimination much faster than their regional neighbours. Furthermore, he suggests it is not surprising that people in Asia remain suspicious of Western states including Australia which, as shown in the preceding chapter, often remain indifferent to traditional Asian cultural practices (Hogue 2000, p. 147).

Australia's colonial occupation occurred at a time when Britain's global colonisation was buttressed by the concept of a racial hierarchy. Britain's political and military potency was equated with racial superiority. In that context, the White Australia Policy was designed to sustain white racial integrity separate from the more populous non-white neighbouring countries. Vigorous post-colonial commitment to the White Australia policy is reflected in the racist World War II declaration by Prime Minister Curtin that:

This country shall remain forever the home of the descendants of those people who came here in peace in order to establish in the South Seas an outpost of the British race (Commonwealth of Australia, 2016b, emphasis added).

Passage of the *Immigration Restriction Act 1901*, or White Australia policy, was one of the first pieces of legislation passed by the new Australian Federal Parliament. In practice this Act served to consolidate a fifty-year history of pre-Federation colonial race discrimination legislation. The Act's functionally racist provision prohibited the entry to Australia of any person who failed to write out a dictated passage of fifty words in any European language selected at the discretion of a Customs official (Commonwealth of Australia 2016b). The White Australia policy endured in this form until the 1960s, when the demand for skilled migrants required for burgeoning resource development projects forced the granting of citizenship to a wider group of skilled immigrants. The *Migration Act 1966* removed much of the racial discrimination from immigration assessments, but it was not until 1973 that all vestiges of the Immigration Restriction Act were finally abolished (Commonwealth of Australia 2017b).

Given Australia's long history of discrimination against Asians it is understandable that President Yudhoyono should include it in his list of bilateral misperceptions. Though not stated directly, it is likely the President was also reflecting a concern in Asia at the rise of anti-Asian immigration statements by minority nationalist politicians and the growing electoral success of the overtly racist One Nation party. As noted in section 3.4.4 the majority perception in Indonesia amongst those who have no personal or professional connection with Australia ranges from ambivalent to confused or deeply suspicious (Lindsey 2006, p 2). Nevertheless, the legacy of those two significant and mutually reinforcing counterforces to Australia's ambition to build a strong and productive relationship with Indonesia has been compounded by other more recent events.

4.3.3 East Timor, West Papua and the deputy sheriff

In the context of foreign policy analysis, Indonesia's commitment to the Non-Aligned Movement principles and the White Australia legacy are essentially structural influences on foreign policy and foreign relations outcomes. However, in this sub-section it is the role of agents, both Indonesian and Australian, that is central to the source of foreign policy outcomes that continue to affect this bilateral relationship.

Australia's role in the history of Indonesia's accession to and loss of sovereignty over the territory of East Timor is a sensitive bilateral relationship issue. The issue has its origin in the complex and contested events that surrounded Indonesia's invasion and annexation of East Timor in 1976, and more particularly Australia's part in East Timor's path to independence in 2002. Several scholars have examined these events in detail (Lawless 1976; Dupont 2000; Simpson 2005; Cleary, 2007). Consequently, a brief recounting of these events will suffice to confirm why President Yudhoyono expressed the view that Australia-Indonesia relations hit an all-time low during the East Timor Independence process (White 2013, p. 34).

The starting point for Indonesia's engagement in East Timor was a 1974 military coup that ended five decades of dictatorial rule in Portugal and foreshadowed independence for Portugal's colonies, including East Timor. A contested process for transition to independent self-government in East Timor was subverted in December 1975 by a large-scale Indonesian military invasion. The military quelled poorly equipped local opposition and in mid-1976 East Timor became the twenty-seventh province of Indonesia.

Historical records indicate that Indonesia's invasion of East Timor was covertly sanctioned by both the US and Australia. The ostensible justification was that East Timor would not be viable as an independent state. However, coming very soon after the US defeat by communist North Vietnam in the Vietnam War, there is another probable geopolitical explanation: the Indonesia invasion overcame the prospect of the socialist-oriented East Timor independence movement establishing what could become the 'Cuba of South East Asia' (Hayden & Lansford 2005, p. 50). American complicity with Indonesia's aggression may have secured a positive disposition towards US geopolitical ambitions by the new Soeharto regime, but Australia was the only country to formally recognise East Timor as a province of Indonesia (DeRouen & Bellamy 2008, p. 329).

Regardless, it was Indonesia's presence in and subsequent exit from East Timor that has become a source of disquiet in the Australia-Indonesia relationship. Indonesian forces remained in East Timor after the invasion, and actions to subdue an armed independence movement led to recurring human rights abuses by the Indonesian army. Australian media reported the abuses and built public sympathy for a Timorese independence movement. The reports resulted in Australian government support for a 1985 UN Commission for Human Rights resolution that condemned Indonesia's human rights violations. The Australian vote provoked strong protests from the Indonesian government and press (Salla 1995, p. 217). The subsequent killing by Indonesian troops of 270 protestors at Santa Cruz cemetery in 1991 shaped even stronger Australian community support for the East Timorese independence movement (Salla 1995, p. 219).

The sudden onset of the 1997/98 Asian Financial Crisis provided the catalyst for events leading to Australia's engagement in the East Timor independence process. The financial crisis caused widespread corporate insolvencies, high unemployment and escalating basic commodity prices across Southeast Asia and especially in Indonesia. Severe domestic unrest caused President Soeharto to resign: that initiated a period of rapid and disorderly transition from dictatorship to democracy in Indonesia (Mydans, 1998).

In the course of this transition the Australian Prime Minister presented the new Indonesian President with an opportunistic proposal to end the East Timorese secessionist violence. In a letter to Indonesia's President Habibie in December 1998, Prime Minister Howard reaffirmed Indonesia's territorial sovereignty over East Timor but also proposed a two-step process intended to quell the secessionist violence. Howard proposed that Indonesia give the province some degree of autonomy and after an unspecified time East Timor should have a right to decide if it wanted to remain an Indonesian province or become independent (White 2008, pp. 71-73). President Habibie unexpectedly proceeded with an alternative proposal to offer East Timor a referendum or act of self-determination on independence. That soon led to territory wide pro-independence violence that pitted poorly armed civilians against pro-Indonesian forces (White 2008, pp. 73-74).

Efforts by the United Nations to stop the violence led to an announcement by President Habibie in September 1999 that he had invited a 'peacekeeping force of friendly nations' to restore order and oversee the transition to independence (Day 2015, p. 675). Within ten days, a 5000-strong UN force of mostly Australian troops under Australian command arrived to

suppress the violence and remain to oversee the transition of Timor Leste to independence in May 2002.

Although Indonesia invited the UN peacekeeping presence it was under duress, and Australia's pivotal role in the independence process produced widespread animosity in Indonesia. Reaction to the loss of its twenty-seventh province caused Indonesia to scrap a diplomatically significant 1995 Australia-Indonesia Security Agreement just four years after its initiation. It also sustained an assessment that Australia had pursued an 'arrogant neo-colonial foreign policy' (Day 2015, p. 675).

The motive for Prime Minister Howard's intervention in an Indonesian sovereign territory issue during the post-Soeharto turmoil is unclear. Possibilities include concerns for human rights, a response to domestic political pressure, or the pursuit of potential economic advantage. There are even signs of economic conspiracy or at least unsavoury conduct concerning Australia's involvement in relation to the globally significant Greater Sunrise gas field located near Timor Leste. Australia's access to this resource had been secured during the Indonesian occupation of East Timor. Paul Cleary (2007) and Charles Scheiner (2006) highlighted the potential for large commercial advantages to be gained by Australia if an agreement to develop the resource could be concluded with a newly independent government. That prospect became a reality when a development agreement was concluded with the new Timor Leste government in 2006. Early indications of Australian impropriety during the agreement negotiations have recently been supported by the discovery that listening devices were installed by the Australian spy agency in the offices of the Timor

Leste ministers responsible for the negotiations (Cleary 2007; Scheiner 2006; Fernandes 2017).

Furthermore, Australia had withdrawn from the jurisdiction of the International Court of Justice in relation to maritime boundary disputes shortly before the complex and highly contested agreement was finalised. That decision served to deny Timor Leste a right of appeal in the event of a dispute arising from the agreement (Hyland 2002). Conspiratorial sentiments were compounded by the subsequent appointment of a politician and Foreign Affairs Department official involved in the negotiations to positions of advantage with the Australian company responsible for the gas field development (Fernandes 2017, p. 72).

Whatever the motive, the impact of East Timor's independence on Australia-Indonesia relations has been enduring. There is a sense in Indonesia that Australia exploited its weakness during the Asian Financial Crisis and was instrumental in the loss of its sovereign territory. That perspective was reinforced in 2005 when then Health Minister Abbott claimed that Australia had 'liberated' East Timor from Indonesia (cited in Monfries 2006, p. 47). That claim, subsequently repeated by other ministers, implied that East Timor's independence was a calculated interference in Indonesia's sovereignty and is regarded by many in Indonesia as 'an especially sharp betrayal' (White 2005, pp 46-47).

Indonesia's protection of its territorial integrity and suspicion of Australia's possible designs on the large, resource rich Indonesian province of West Papua may explain the strong 2006 reaction to Australia's grant of asylum to forty-two West Papuan separatists. Led by a West Papuan independence activist who had been jailed in Indonesia for protest actions, the group

travelled by boat from West Papua to Cape York and secured extensive publicity for their independence cause. Protest banners in Bahasa and English featured in Australian and Indonesian media reports in the period before the group were taken to the Christmas Island detention centre (Day 2015, p. 680).

Despite President Yudhoyono's assurances of their safety in a phone conversation with Prime Minister Howard, requests for political asylum by the protesters were processed and granted to all but one of the group. Following the decision, Yudhoyono claimed Indonesian sovereignty had been 'diminished' (Day 2015, p. 681). Further expressions of strong Indonesian displeasure included the (until then) rare and diplomatically significant withdrawal of the Indonesian Ambassador 'for consultations' and suspension of bilateral cooperation in relation to people smuggling activity (Day 2015, pp. 681-682).³

Australia's standing in Asia was also adversely impacted by an event beyond its control when in 2003 US President Bush portrayed Australia as a 'sheriff' for the US in the Asia-Pacific. This depiction, combined with Prime Minister Howard's acquiescence to a journalist's earlier attribution to him of the title of US 'deputy sheriff,' was widely derided in Asia (*Sydney Morning Herald* 2002). Ann Capling describes the incident as reinforcing a long-held suspicion that Australia was little more than a 'cat's paw' for US interests (Capling 2008, pp. 612-615). That disdain is reflected in a response to the Bush comment by Malaysian Deputy Defence Minister Shafie Apdal:

³ Australian intelligence service phone-tapping of President and Mrs Yudhoyono caused a further withdrawal of the Indonesian Ambassador in 2013.

I suppose America wants a puppet of its own in this region that they can trust who will do whatever they wish. America can appoint anyone to be their representative or their agent, or their puppet in this region ... (cited in Grubel 2003, paras 11-12).

Australia's status with countries in Southeast Asia was also impacted by global tension following the 2001 terrorist attacks in the US and Australia's unequivocal support for subsequent American military adventures in Afghanistan and Iraq. The most direct foreign policy impact followed an intemperate expression by Foreign Minister Downer of support for pre-emptive military action arising from the 'war on terror.' In contrast to Australia's traditional commitment to the principle of state sovereignty, Downer declared that 'outcomes are more important than blind faith in principles of non-intervention, sovereignty and multilateralism.' Moreover, Downer added, 'sovereignty in our view is not absolute. Acting for the benefit of humanity is more important' (Commonwealth of Australia 2003). How the 'benefit of humanity' was to be assessed and by whom was not explained.

This adventurism was compounded by Australia's participation in the 2001 US-led Afghan war and the unsanctioned 2003 invasion of Iraq. The later was viewed as a denigration of the UN and multilateral institutions more broadly. The perception was reinforced when Prime Minister Howard and Foreign Minister Downer both asserted that multilateral institutions such as the UN were ineffective and represented 'internationalism of the lowest common denominator' (Dobell 2003). Both the sovereignty assertions and criticism of multilateralism impacted Australia's relationship with Indonesia and the ASEAN multilateral community, of which Indonesia is a principal member. Indonesia's Vice President Haz and Foreign Minister

Wirajunda judged what Wirajunda called Australia's 'plan to attack neighbouring countries' as alarmist rhetoric (Smith 2003, p. 462).

4.3.4 The improbable positives

During this early 2000s period of strained bilateral relations, the improbable outcome of two tragic events helped to balance Australia's standing in Southeast Asia. The first was the Bali bombing in October 2002, which counted eighty-eight Australians among its 202 victims. In its wake, the police forces of Indonesia, Australia and other regional states embarked on a programme of close co-operation that worked, and has gone on working, most effectively. One outcome was establishment of the Jakarta Centre for Law Enforcement Cooperation. The Centre has trained over 20,000 security officials since it began in 2004. Australian intelligence services now work effectively with counterparts in Indonesia, Malaysia and Singapore, and this practical co-operation has given a boost to closer security relationships at higher levels (Coyne & Vipond 2016).

The other misfortune that had positive bilateral relationship outcomes was a devastating tsunami that struck Aceh province in 2004. Australia's relief and disaster recovery contributions were timely and substantial. President Yudhoyono subsequently acknowledged on several occasions Australia's generosity. One significant positive from Australia's large-scale relief contribution was sustained direct contact and cooperation between Australian NGOs and their Indonesian counterparts. The practical effect was to widen the interaction base between the two countries, especially at the people-to-people level (Sukma 2006, pp. 223-224). This outcome supports my starting intuition that non-state agency, including that

occasioned by everyday commercial interactions, can have significant bilateral relationship benefits.

President Yudhoyono retained his positive perspective, observing that:

Australia and Indonesia have a great future together. We are not just friends. We are strategic partners. We are equal stake-holders in a common future, with much to gain if we get this relationship right and much to lose if we get it wrong (cited in Graham, 2016).

4.3.5 The practical positives

There are other initiatives that may also help to forestall threats to Australia's security. The most direct of these is joint counter-terrorism cooperation and collaboration by Australian Federal and State police with Indonesian counterparts in relation to terrorist intelligence sharing, the security of public transport networks, and disruption of terrorist financing. The centre piece of this bilateral police collaboration is the above noted Jakarta Centre for Law Enforcement Cooperation (JCLEC). By 2012 JCLEC had played a part in Indonesia's arrest of almost 800 terrorist suspects, about 600 of whom have been convicted (Commonwealth of Australia 2013, p. 12).

Another Australian Government backed institution building initiative that has counter terrorism benefits began in 2003 with the formation of the Indonesia-Australia Legal Development Facility with the objective of assisting Indonesia to manage its national *post-reformasi* legal reform process. This major reform of the Indonesian legal system was required because of Indonesia's 2002 devolution of major legislative and judicial powers

from Jakarta to almost 500 regional administrations. Indonesia's judicial system had a history of pervasive corruption and regional devolution had the potential to perpetuate and even accentuate this major institutional deficiency. Nevertheless, judicial reform was an important element in Indonesia's democratic consolidation process in order to avoid political instability and the resurgence of Soeharto-era corruption and cronyism (Cox et al. 2012, pp. 21-23) and the Legal Development Facility was to play a key role in this process. A third five-year iteration of the Facility's program was launched in 2016 with the goal of enhancing 'respect for enforceable rights and rules-based governance systems ... contributing to stability and prosperity in Indonesia and the region' (DFAT 2017d, p. i).

Perhaps Australia's most forthright contribution to development of the robust Indonesian relationship envisaged in the 2016 Defence White Paper has been support for the Philippines' military in the battle to retake the city of Marawi from ISIS extremists. Australia's contribution of two surveillance aircrafts as well as soldiers to train Philippine troops signalled a preparedness to engage directly in counter-terrorist activity in the Southeast Asian region (Shen 2017, p. 2).

4.4 What are Indonesia's Foreign Policy priorities?

To this point the foreign policy focus in this chapter has been on Australia and its interests. This section widens the analysis by addressing two questions: does Indonesia have foreign policy priorities that contribute to the strained Australia-Indonesia bilateral relationship and are there regional middle power initiatives that might moderate relationship tensions?

As noted earlier, Indonesia's security and foreign policy settings are strongly influenced by the Non-Aligned Movement (NAM) ideals of a global order based on 'freedom, lasting peace and social justice' as set out in the Preamble to the Indonesian National Constitution.⁴ On face value Australian policy makers could be expected to endorse those principles, but in practice Indonesia's pursuit of those ideals is a source of significant disparity in the respective foreign policy preferences.

Operational impacts of the NAM principles are obvious in the following review of three Indonesian Ministry for Foreign Affairs annual reviews and other analysis. The annual reviews identify the Widodo government's five foreign policy priorities as managing great power rivalry in Southeast Asia, the role of ASEAN, establishing an Indo-Pacific cooperation umbrella, Indonesia's role as an emissary for global Muslim issues, and protecting Indonesian expatriate workers (Ministry of Foreign Affairs RoI 2018; 2017; 2016; Sheany 2018; Pitsuwan 2014; McRae 2014; Anwar 2010). Of those issues the first two – great power rivalry and the role of ASEAN – are the predictable source of significant Australia-Indonesia foreign policy misalignment. There are, though, other notable but less contentious issues that arise from Indonesia's role in global Muslim affairs and Indonesia's ambition to strengthen democracy in the Southeast Asian region.

Given Indonesia's position as the natural leader of the ASEAN bloc it is not surprising that ASEAN ranks as a key issue in Indonesia's annual foreign policy reviews (Ministry of Foreign Affairs RoI 2018; 2017; 2016). The role enables Indonesia to have regional and

⁴ <http://balitourismboard.or.id/uploads/file/reg1.pdf>

global influence beyond its stand-alone status and is expected to continue until Indonesia has the ability in its own right to project its influence in the region or more broadly (McRae 2014, p. 9). Australia has a Strategic Partnership with ASEAN and it also pursues trade and security initiatives with individual community members (Commonwealth of Australia 2017a, pp. 43-44).

Great power rivalry impacts Indonesia on several fronts, especially in its ASEAN leadership role. Overt regional tension arose from an address by then US Secretary of State Clinton to the 2010 ASEAN Regional Forum. Clinton's presentation emphasised that peace and security in the South China Sea is an American 'national interest' and that the US could play a role in mediating any conflict that might arise. These comments were taken by the Chinese government as an 'attack on China.' Tensions were deepened by President Obama's subsequent 2011 'pivot to Asia' of US military forces and US freedom of navigation actions in disputed areas of the South China Sea (Pitsuwan 2014, p. 244).

Neither Indonesia nor Australia are directly impacted by China's territorial claims in the South China Sea, although China has objected to one aspect of Indonesia's Natuna Sea Exclusive Economic Zone (EEZ) claims. Nevertheless, Indonesia as the principal state within ASEAN, is being pressed by countries in the region to have China accept a binding code of conduct that ensures maritime trade in the region is not disrupted. Indonesia's ambition is to establish a 'dynamic equilibrium' based on regional mechanisms such as the ASEAN Maritime Forum and a series of bilateral and trilateral regional relationships. The desired outcome is a 'web of mutually beneficial relationships' in which a win for one great power need not be at the cost of the other (Poling 2013, p. 2). One step towards that goal was

China's acceptance in 2017 of a negotiating framework for a code of conduct in the disputed South China Sea waters (Sheany 2018, p. 7)

Australia has a shared interest with ASEAN in South China Sea stability because of its importance for maritime trade flows to North Asia, especially to Japan, South Korea and China. However, Australia's emphasis on the issue is restrained by its dichotomous commitment to China as its major trade partner and to America as its key security ally. Consequently, Australia's interests are served by the status quo – a US-oriented 'rules based' solution to Chinese claims in the region (Commonwealth of Australia 2017a, pp. 46-47).

The complexity and uncertainty in foreign policy responses to Chinese influence was in evidence when, less than two months after publication of the Australian Foreign Policy White Paper's proposed Indo-Pacific cooperation arrangement, President Widodo set down Indonesia's separate vision for the region. Speaking at an ASEAN summit, the President anticipated a 'stable, peaceful and prosperous Indo-Pacific regional architecture based on the principles of openness, transparency and inclusion.' Widodo's proposal positioned ASEAN and India as the 'backbone' of maritime cooperation and argues that ASEAN-led mechanisms such as the East Asian Summit and the Indian Ocean Rim Association would serve to 'bridge and integrate' the Indian and Pacific oceans (Laksmana 2018, p. 1).

Indonesia's efforts to position ASEAN in such a pivotal role is consistent with its pursuit of a non-aligned foreign policy and ambition to ensure that great power rivalry does not diminish ASEAN's, and by association Indonesia's, significance in the region. However, Indonesia's initiative to establish a joint ASEAN-regional middle power alignment appears to confirm an

assessment that ASEAN alone is unable to respond effectively to regional great power rivalry (Beeson 2017, p. 2).

That assessment may reflect another, potentially more significant Indonesian concern: China's direct influence on ASEAN solidarity and ASEAN's norm of cooperation and consensus in its regional dealings. Those ASEAN attributes are foundational to Indonesia's non-aligned foreign policy position and they enable Indonesia to manage its regional relationships while limiting its need for substantial military resources (Andika 2016, p. 5). China's influence on ASEAN's consensus tradition became apparent when the consensus fractured openly in 2016. At issue was a decision by Cambodia to block the release of a supposedly agreed joint statement by ASEAN foreign ministers following a meeting in Laos because the statement expressed concern over Chinese actions in the South China Sea (Webb & Mogato 2016). Cambodia, which is China's closest ASEAN ally and reliant on it for aid and investment, opposed the statement. This was only the second time in ASEAN's five-decade history that consensus had not been reached on a joint statement. It followed a similar objection in 2012 when Cambodia also refused to accept a proposed ASEAN meeting communique. Member concern at this loss of community consensus is reflected in an unattributed comment that: 'Our house is in a mess ... We don't want ASEAN to be like Europe. We want to save ASEAN and be unified again' (cited in Webb & Mogato 2016). The concern is that if either Cambodia or Laos become more responsive to China's foreign policy preferences, then China will develop a de facto veto capability over the consensus tradition of the ASEAN community.

Whatever the motives for the development of separate Australian and Indonesian Indo-Pacific middle power security proposals, their publication indicates a preparedness by both countries to establish new multilateral structures that may better align their security interests. Nevertheless, it is significant that neither of these new regional policy proposals acknowledges the existence of the other.

Indonesia's role as an envoy for transnational Muslim issues is another example of difference in bilateral foreign policy orientation. For example, Indonesia's annual Foreign Policy reviews detail diplomatic and economic support for an independent Palestinian state with East Jerusalem as its capital. To that end, Indonesia is opposed to the building of Jewish settlements in the Occupied Territories and recently initiated an Organisation of Islamic Cooperation emergency summit that called on the US to reverse its decision to support Jerusalem as the capital of Israel on the basis of justice rather than religion. As Foreign Minister Retno explained: 'justice matters and we have to show it' (cited in Sheany 2018, p. 1). Given the close foreign policy alignment with the US, Australia does not support these Indonesian initiatives and along with the US was the only country to oppose a UN investigation of Palestinian deaths arising from the 2018 Gaza protests (Wroe 2018). The issue is unlikely to be a source of Australia-Indonesia disputation but equally it is a modest source of policy disharmony.

Opportunities for Australia to forge closer links with Indonesia may also be impacted by considerations at the operational level. One assessment is that President Widodo, unlike his predecessor, does not acknowledge any special qualities in a relationship with Australia. Tim Lindsey's experience is that Indonesian elites, when speaking at conferences dealing with the

Australia-Indonesian relationship, now say that Australia needs Indonesia much more than the reverse, and that Indonesia should be the senior partner in any bilateral relationship (Lindsey 2017b, p. 3). An example of this 'contest' for superiority may be apparent in the pursuit by both Australia and Indonesia of different ambitions for the increasingly important new Indo-Pacific regional architecture.

Lindsey observes that Indonesian elites reading the Australian Foreign Policy White Paper could conclude that Australia does not see their country as important. And, he disconcertingly adds, 'they probably couldn't care less' (Lindsey 2017b, p. 4). Ideally, though, the contest need not reflect Lindsey's assessment that Indonesia has increasing disdain for the Australian relationship.

4.5 Summary

This review of Australian and Indonesian foreign policy priorities demonstrates that although the two countries have some markedly different policy preferences it would be unreasonable to conclude that these differences generate a level of ideological or historical animus sufficient to account for the repeatedly strained nature of this relationship. Nevertheless, there are important constraints on the prospect for foreign or security policy harmonisation. The foremost constraint is Indonesia's foundational commitment to Non-Aligned Movement principles, especially its Constitutional disavowal of great power alignment. That preference, together with its strong ASEAN based multilateralist regional relationships where 'ASEAN Way' consensus-building, discreetness, informality and non-confrontational bargaining are the procedural norm, sets it apart from Australia.

Those policies contrast with Australia's security and foreign policy based on its commitment to the great power backed ANZUS alliance and associated bilateral and plurilateral regional relationships. Moreover, Australia's potential to provide regional leadership in moderating US-China tensions over territorial claims in the South China Sea is limited by the need, as Australia sees it, to sustain a commercial dependency on China at the same time as a security dependency on the US.

This analysis, along with the cultural differences detailed in the preceding chapter, provides one part of the answer to my first thesis question: what accounts for Australia's lack of effective bilateral political and economic engagement with Indonesia. The findings are that actual or perceived Australian indifference to Indonesian and broader Asian cultural norms are more likely to impact on this relationship than individual political or foreign policy preferences. Australia's laggardly economic engagement in Indonesia has not yet been addressed. I have set that issue aside for analysis in Chapter 9 because it is best examined in conjunction with the security relationship benefits that may be associated with foreign direct investment initiatives. The next chapter begins the analysis necessary to answer my second thesis sub-question: why is a strong and productive relationship with Indonesia critical to Australia's national security?

Chapter 5: Australia's security – is a strong Indonesian relationship vital?

5.1 Introduction

This chapter seeks to answer my second research question: *to what extent is a strong and productive relationship with Indonesia critical to Australia's national security?* The 2016 *Defence White Paper* states that 'a strong and productive relationship with Indonesia is critical to Australia's national security' (Commonwealth of Australia 2016a, p. 125) but presents little analytical justification for that claim. The White Paper points only to a bilateral need to ensure important trade flows through shared maritime domains and combined efforts to counter terrorism in the region (p. 59, p. 125) to explain why this relationship is critical to Australia's security.

If maritime trade flows and counter terrorism cooperation are sufficient conditions to deem a relationship critical to Australia's national security then arguably The Philippines and Malaysia also warrant an equivalent status, but those states are not recognised as being critical to Australia's security. That suggests there are more complex and substantial considerations that elevate Australia's unique security relationship with Indonesia. The purpose of this chapter is to examine what further considerations could be behind the White Paper's assessment of Australia's critical relationship need with Indonesia. Since the analysis considers possible future security outcomes, the conclusions are necessarily uncertain or conditional.

The current Australia-Indonesia bilateral relationship is neither strong nor productive and for most of the past six decades that has been the relationship norm. In an uncommonly blunt address to the Australian Parliament in 2010, Indonesian President Yudhoyono stated:

There are Australians who still see Indonesia as an authoritarian country, as a military dictatorship, as a hotbed of Islamic extremism or even as an expansionist power ... [Likewise] there are in Indonesia people who remain afflicted with Australiaphobia – those who believe that the notion of White Australia still persists, that Australia harbours ill intentions towards Indonesia and is either sympathetic to or supports separatist elements in our country (cited in White 2013, p. 34, original emphasis).

Diplomatic practice may explain why those claims were not contested by Australia. Nevertheless, they reflect a reality that has endured in circumstances where Australia perceived itself to be superior economically and militarily to Indonesia. But that is changing. Indonesia is emerging as the 'third giant' in Asia (Reid 2012) and its emergence as a source of non-traditional security threats (NTS) expands its security significance to Australia.¹ Former Australian Ambassador to Indonesia, John McCarthy states that there is currently a window of opportunity for Australia to engage with Indonesia more effectively and to build a relationship based on Indonesia's newfound economic, geopolitical and domestic political

¹ These include transnational crime, terrorism, disaster relief, information security, climate change, public health epidemics, and maritime issues, <<https://thcasean.org/read/news/168/Talking-ASEAN-on-Addressing-Non-Traditional-Security-Issues-in-Southeast-Asia>>

reality. Seizing the opportunity matters because 'if [Australia] fails to engage, it is Australia that will suffer' (McCarthy & Conley Tyler 2016, p. 1).

There is a longstanding precedent to those assessments of Indonesia's importance to Australia. The 1976 *Defence White Paper* emphasised Australia's 'enduring interest' in ensuring Indonesia's integrity and the exclusion of influence by hostile foreign powers (Commonwealth of Australia 1976, p. 7). A more recent assessment is that a friendly, economically strong, democratic and well-armed Indonesia would be a security asset for Australia and the region, whereas a fragmenting or authoritarian nationalist or extreme Islamist government ruling a well-armed unfriendly Indonesia 'would be a first order strategic challenge for Australia' (Dibb 2012, pp. 27-28).

In order to better understand Australia's security relationship with Indonesia, this chapter begins by establishing an essential distinction between security issues that threaten the sovereignty of a state (*sovereign security*) and security issues that threaten a state's values or well-being (*national security*). The first part of the chapter establishes that Indonesia does not currently constitute a threat to Australia's sovereign security. It also establishes that Australia is not a threat to either Indonesia's sovereign or national security interests. The second part of the chapter provides a wider appreciation of why a strong and productive relationship with Indonesia may nevertheless be considered as critical to Australia's national security. The analysis centres on Indonesia being the source of current and potential non-traditional threats to Australia's national security and, consistent with Indonesia's own national security assessment, establishes that those threats could be exacerbated by adverse political and economic developments in Indonesia.

Terrorism and radicalism are the primary NTS threat concerns to both countries. My analysis of the determinants of terrorism begins with a study by Tim Krieger and Daniel Meierrieks (2011). Four of seven terrorism determinants identified in that study are relevant to my thesis because they relate to economic development issues where FDI might serve to mitigate terrorist activity. Separately, a review of Indonesia's internal security situation reveals that separatist activities concern Indonesian security planners. That prospect has potential spill-over security implications for Australia. The final section of the chapter establishes that there are signs of democratic stagnation and regression in Indonesia that could potentially give rise to Australia's most unwanted relationship outcomes: the emergence of an authoritarian nationalist or even fundamentalist Indonesian government.

Australia's pursuit of a strong bilateral relationship with Indonesia has little reciprocal security significance. Chapter 4 established that Indonesia's foreign and security policy orientation is to a multilateral ASEAN, the Indo-Pacific and north Asia. However, common cause in the Australia-Indonesia relationship would be enhanced by a coordinated middle power response to tensions in the South China Sea and support for Indonesia's post-Soeharto political and economic transition.

5.2 What is security?

Security is an ambiguous concept. In an influential 1952 article Arnold Wolfers' advised scholars not to use the term security without specifications since to do so 'leaves room for confusion' (Wolfers 1952, p. 483). Since the 1950s a diverse mix of ideas has been proposed for inclusion in the rubric of national security. They extend from the narrow realist Cold War

focus on existential military, especially nuclear, threats to national interests (Walt 1991, p. 231) to the wide UN Human Development construct that incorporates 'safety from chronic threats and protection from sudden hurtful disruptions in the patterns of daily life' (UNDP 1994, p. 23).

My analysis seeks to provide clarity and satisfy Wolfers' goal of specifying how the term *security* is used by distinguishing between issues that are deemed to be either *strategic* or *national security* concerns. Operationally the distinction between these security categories is not absolute. The *strategic security* designation applies to threats that imperil 'the preservation of a country's territorial or political integrity' (Krasner 1978, pp. 313-314). That distinguishes it from *national security* where the objective is to protect 'how we live in our community and our sense of well-being' (Leahy 2013, p. 38). There are other security descriptors in the literature (Lockyer 2017, pp. 109-110) but the distinction between security categories is typically based on the distinction between threats to state sovereignty and threats to societal well-being. The following sub-section examines Australia's strategic security in the context of the Australia-Indonesia relationship.

5.2.1 Australia's strategic security

Any threat to Australia's territorial or political integrity would likely arise from another nation state and, in the words of a former Chief of the Australian Army, 'spies, diplomats and the military' provide the means of defence against such threats (Leahy 2013, p. 38). Expressed differently, Australia's primary strategic interest is the defence and preservation of its sovereign territory from a conventional military attack. Provision of strategic security is

the role of Australia's security professionals who assess the source of military aggression that might threaten the nation's sovereignty and determine the likely means by which any hostility would be initiated (Lockyer 2017, p. 119).

Absolute strategic security is impossible to achieve (Baldwin 1997, pp. 14-15) so it is unsurprising that the requirement to protect Australia's *national security* is expressed in general terms. For example, the 2016 Australian *Defence White Paper* depicts the military force requirements to ensure the nation's sovereignty in these terms:

Australia's first Strategic Defence Objective is to deter, deny, and defeat any attempt by a hostile state or non-state actor to attack, threaten or coerce Australia. ... Australians rightly expect that our military force be capable of the self-reliant defence of our territory from attack or coercion by another country. The Government is providing Defence with the capability and resources it needs to be able to decisively respond to military threats to Australia, including incursions into our air, sea and northern approaches (Commonwealth of Australia 2016a, pp. 71-72).

The previous 2013 *Defence White Paper* expresses the sovereign protection goal more broadly as being the capability to 'secure northern approaches and proximate sea lines of communication' and to have a 'secure nearer region, encompassing maritime South East Asia and South Pacific' (Commonwealth of Australia 2013, p. 4). That White Paper also declares an ambition to protect domestic and offshore economic supply chains, physical infrastructure, communication networks and resource projects. These broader threat

protection activities are further extended in the 2016 White Paper and reflect deeper engagement of the military in national security issues and with national security agencies. The military's capabilities are now declared to extend beyond the protection of offshore oil and gas infrastructure; it must also respond to chemical, biological, radiological and nuclear events and be a source of support to other (domestic) agencies to identify and disrupt foreign terrorist threats (Commonwealth of Australia 2016a, p. 72).

5.2.2 Australian and Indonesian – asymmetric security importance

This section establishes that the Australia-Indonesia security relationship is asymmetric. The long history of this asymmetry is revealed by a 1970s epigram in which a visiting Indonesian foreign policy official supposedly depicted Australia's relationship with Indonesia as 'like your appendix, its down there somewhere and you only think about it when it hurts' (Dobell 2014a, p. 2). The asymmetry is based on an Australian perception that Indonesia is a prospective source of long term military uncertainty and near term NTS dangers, whereas Indonesia has scant regard for Australia as a security consideration.

Indonesia's strategic defence significance as a sea and air barrier between Australia and Southeast Asia was first noted in Australia's 1973 Strategic Defence Policy assessment. The assessment notes that Indonesia is 'the country from or through which a conventional military threat to the security of Australian territory could most easily be posed.' The Policy assessment goes on to note that 'Australia's relations with Indonesia are of profound and permanent importance to Australia's national interest' (cited in Fruehling 2009, p. 385).

Indonesia's unique geographic significance to Australia is clearly demonstrated in this unusual cartographic rendering of the south Asian region (in Blaxland 2018, p. 3).



Figure 5.1 An Australia centric regional cartographic rendering (Department of Defence Map, sourced from Blaxland 2018, p. 3).

There are other reasons why Australian defence planners may want a strong and productive relationship with Indonesia. As one realist observed, Australia, unlike Indonesia, is a large country with a small population that has ‘more than its share of the world’s good things’ (Harries 2006). Other assessments examined below point to turbulence in international relations as China and India rise to great power status, or the prospect that an Indonesian election could produce an unfriendly authoritarian nationalist or extreme Islamist regime (Gyngell & Wesley 2007, pp. 235-236). Another prospect is that Indonesia’s presently

dormant secessionist movements will re-emerge, fracture its national unity and cause a regional refugee crisis. Any one of those developments 'would preoccupy us to the exclusion of practically every other defence planning issue' (Dibb 2012, p. 28).

The reality of this asymmetric security relationship is also evident in Richard Tanter's forthright assessment that Australia is much less important in world affairs and world history than Indonesia (Tanter 2012, p. 126). Tanter goes on to observe that, notwithstanding Australia's ANZUS treaty agreement, Indonesia is of much greater strategic importance to the United States than is Australia because of its size and geopolitical significance (Tanter 2012, p. 127).

Conversely, Indonesia's strategic security considerations have little regard for Australia which it views as 'only a minor regional player' (Lockyer 2017, p. 268). Operationally, Indonesia's military capabilities are limited because expenditures in absolute terms are about one-third that of Australia and slightly less than Singapore. Personnel costs account for most of the annual military expenditure so that equipment procurement and capability development is limited (McRae 2014, p. 4). Nevertheless, Australia does have some level of security understanding with Indonesia albeit much less than a formal defence pact. This began with a 1995 security agreement negotiated during a period of bilateral rapprochement led by Prime Minister Keating and President Soeharto. It was described by *The Australian* newspaper's foreign editor as 'one of the most remarkable and uncharacteristic episodes in Australian diplomatic history' (1995, p. 1). In practice the agreement had limited impact before it was abolished by Indonesia in 1999 due to Australia's role in the East Timor independence process.

Some degree of security cooperation was re-established by the 2006 Lombok Treaty (DFAT 2017e) and expanded in a 2012 defence cooperation agreement (Jennings 2013). Indicative of the fragility of this bilateral security relationship is the fact that political tensions have caused Indonesia to temporarily suspend the agreements on two occasions during the last five years. What is more significant to my assessment though is that the Lombok Treaty and the cooperation agreement are both high level agreements. The requirements are for security consultations by political and military leaders rather than mutual defence undertaking (Prameswaran 2017, p. 2).

How should the current status of Australia's sovereign security be assessed? In a detailed security evaluation Adam Lockyer provides three reasons to conclude that there are few risks to Australia's sovereign security (Lockyer 2017, pp. 241-243). The first is that no proximate state in the Indo-Pacific or Melanesian Island regions has sufficient military force to launch a seaborne attack on Australia. In the 1960s Indonesia was a possible exception but Indonesia no longer has the capacity to launch and sustain an attack on the Australian mainland (Lockyer 2017, p. 242). Second, no great power has established military facilities in the Indo-Pacific or Melanesian Island regions from which an attack on Australia could be launched, and third any attempt by a great power to conduct a long-range assault would be resisted by Australia with the probable assistance of a great power (Lockyer 2017, p. 242).

That assessment of Australia's sovereign security aligns with the views of defence planners going back more than three decades:

Australia faces no identifiable direct military threat and there is every prospect that our favourable security circumstances will continue ... there is no conceivable prospect of any power contemplating invasion of our continent and subjugation of our population (Dibb 1986, p.1)

We believe no country at present has either a motive or an intention to attack Australia, and we have no reason to expect that any country will develop such a motive or intention (Commonwealth of Australia 1994, p. 22)

Australia faces no immediate conventional military threat to its territory, nor has it since the Japanese attack in the 1940s ... Australians enjoy a strategic environment which most major powers would gladly endure (Medcalf 2010, p. 184).

While there is no more than a remote prospect of a military attack on Australian territory by another country in the period to 2035, the environment ... will see new complexities and challenges over the next 20 years (Commonwealth of Australia 2016a, p. 40).

The conclusion that Australia is exposed to minimal sovereign security risk indicates that the Defence Department's assessment of a need to establish a strong and productive relationship with Indonesia is based on the existence of significant risks to Australia's *national* security. Yet, apart from a reference to Operation Sovereign Borders as a military-led operation to counter people smuggling (Commonwealth of Australia Defence White Paper 2016a, p. 53) and a broad-ranging commitment to counter-terrorism activities (p. 40), the 2016 *Defence*

White Paper provides little understanding of why the Indonesian relationship is both ‘vital’ (p. 59) and ‘critical’ (p. 125) to Australia’s security.

5.3 Australia’s national security

Further analysis is therefore needed to answer the question of why the relationship with Indonesia is identified as being of such importance to Australia’s security. My analysis begins with an explanation of the amorphous construct called *national security*.

5.3.1 What is *national security*?

As previously indicated, the focus of *national security* is on societal well-being with the objective of protecting ‘how we live in our community and our sense of well-being’ (Leahy 2013, p. 38).² Unlike sovereign security issues, protection of national interests is usually not a direct military responsibility. In Australia responsibility for countering national security threats is diffuse and may include units of the armed forces, the Australian Border Force, Federal or State police, the national intelligence services as well as government and non-government aid and disaster relief agencies.

National security is a constructed concept. That assertion is supported by the Copenhagen School of analysis, which details the typical process by which issues become established (or fade) from the national security agenda. The Copenhagen School’s social construction process has the following elements: *securitising actors*, typically political elites, who pursue a multi-step speech process to *securitise* an issue by establishing that there is an *existential*

² See Appendix I for the definition of Well-being and National values

threat to a state's values; an assertion that dealing with the threat requires *emergency action*; and an *audience* that is persuaded to accept that exceptional procedures beyond the current *rules* of political process are necessary to counter the threat (Buzan et al. 1998, pp. 26-41). Once an issue is securitised the state's actions in relation to the 'threat' are typically removed from the constraints of normal political procedure and become part of a 'panic politics' agenda (Buzan et al. 1998, p. 34).

The Copenhagen School analysis identifies the process by which issues become securitised, but it does not provide a basis for assessing the consequences of different threats or the basis on which they might be countered. A brief review of the variations in national responses to three NTS issues, people smuggling, drug trafficking and cyber security, illustrate the point. The response to people smuggling 'threats,' for instance, range from building a border fence to creating a punitive asylum seeker detention policy or a large scale refugee resettlement program; the response to drug trafficking 'threats' range from a so-called 'war on drugs' to policies that prioritise assistance and rehabilitation of drug users over stigmatisation.³ Likewise, cyber security reactions extend from France's Cyber Security Framework that categorises industries and companies, and implements scaled security practices based on user criticality,⁴ to Australia's relatively weak and uncoordinated cyber security initiatives by the Commonwealth and individual states.⁵

³ <https://mic.com/articles/105584/the-netherlands-just-showed-the-u-s-what-a-sane-drug-policy-looks-like#.deTZrc1Ug>

⁴ <https://www.smartindustry.com/blog/smart-industry-connect/which-nations-have-the-best-cyber-security-efforts/>

⁵ <http://www.abc.net.au/news/2018-01-19/australias-cyber-defences-relatively-weak-irvine-warns/9341342>

What then are national security threats and how might they be countered? The New Zealand *Intelligence and Security Act 2017* provides an example of how difficult it is to both define national security issues and formalise a national response. When introduced to Parliament the Intelligence and Security Bill set out an extensive list of actual or potential offences that would constitute a threat to the nation's security. New Zealand's Parliamentary Counsel identified shortcomings in that approach. As a result, in its final form the Act does not attempt to prescribe security threats or appropriate penalties but instead provides for the responsible Minister in conjunction with a Commissioner of Intelligence Warrants to determine whether something is a matter of national security (New Zealand Department of the Prime Minister 2017). The outcome confirms the socially constructed quality of national security and its definitional ambiguity.

5.3.2 Non-traditional threats to Australia's national security

What are the supposed threats to Australia's national security? This sub-section examines Australian security literature with a view to identifying what threats there are to the nation's security, and ideally to ascertain the level of counter measure preparedness. There is a rich history of Australian political elites using the securitisation process described by the Copenhagen School to construct a range of non-traditional security (NTS) 'threats' to the national interests. Arguably such influential Australian political mantras as the *White Australia Policy*, *reds under the bed*, *the domino theory* and *turn back the boats* are examples from among many NTS threats that have been securitised.

Other purported risks to national security could arise from acts of terrorism, 'illegal' immigration, human and narcotics trafficking, piracy and human or animal disease epidemics. Unlike sovereign security threats, there are no published assessments of the targets or impacts of those risks except in relation to terrorism. A detailed National Counter-Terrorism Plan outlines prospective threat targets and terrorist methods along with inter-agency response provisions (Commonwealth of Australia 2017c). The Plan provides information needed for operational planning and response requirements, but it does not reach back to examine likely threat sources, motivations or mitigation initiatives.

While there are no formal NTS threat analysis reports available except in relation to terrorism, there is a body of academic research on aspects of Indonesian-sourced asylum seeker boat arrivals because of the political opprobrium that surrounds the issue (McAdam & Chong 2014). A common feature of studies on the supposed security threat created by asylum seekers/illegal boat arrivals is the extent to which they resonate with the values that motivated the long-standing White Australia Policy. Securitisation of the asylum seeker 'threat' is redolent with vestiges of Australia's enduring fear of invasion by 'ethnic others' (McDonald 2011, p. 284). It is apparent in the political opportunism of the One Nation political party's portrayal of Australia as being 'swamped by Asians' (Hanson 1996). Another noteworthy aspect of asylum seeker threat securitisation is its broad base of community acceptance, notwithstanding its inconsistency with the narrative of Australia as a welcoming multicultural society (McKenzie 2017, p. 8).

The asylum seeker securitisation process began in 1999 when an increase in unauthorised boat arrivals created circumstances in which the Immigration Minister was able to represent

the issue as a national emergency. As a result, legislation imposing increased penalties for people smuggling was rushed through the Parliament (McKenzie 2017, p. 8). The deepening politicisation and attendant securitisation of 'border control' issues escalated during the 2001 national election when Special Forces troops were deployed to board a cargo vessel carrying over 400 asylum seekers rescued at sea and prevent them from landing in Australia (McKenzie 2017, p. 8). The 'intellectual incoherence' (Maley 2003, p. 193) of government rhetoric on asylum seekers reached a new level in an article penned for *The New York Times* by then Foreign Minister Alexander Downer in 2002. In the article the Minister claimed that people smuggling represented 'a direct threat to national sovereignty.' In addition, the Minister linked people smuggling with crimes including drug and arms trafficking, money laundering and document fraud (Downer 2002). These unsubstantiated claims were accompanied by the Immigration Minister's assertions that Australia's immigration system would be 'overrun' by the numbers seeking asylum. Yet, in fact there were just 5,516 asylum seeker arrivals in 2001, while in the same year 10,000 tourist arrivals were processed on average *every day* by the same immigration system (Maley 2003, p. 193). Confirmation of Minister Downer's incoherence in asserting that asylum seekers imperilled Australia's security is provided by the absence of any government or academic research to support the assertion. There is evidence of engagement by irregular migrants in transnational crime within the Asian region, including parts of Indonesia, but there is no established association of that activity with individuals seeking asylum in Australia (Williams & Vlassis 1998).

Other studies analyse different aspects of the boat-borne asylum seeker securitisation process (McMaster 2002; Maley 2003; McDonald 2005, 2011; McKenzie 2017; Curley & Vandyk

2017), but my review identifies only one example where asylum seeker boat arrivals might have a national security consequence. That exception is a reference to the potential for Indonesian authorities to actively encourage extensive people smuggling activity as a mechanism to secure political or other concessions from Australia (Schreer 2013, p. 29). However, while state-backed people trafficking for political or security advantage is possible, it is unlikely so long as current Indo-Pacific regional institutional mechanisms designed to constrain people trafficking, such as the Bali Process, are sustained. The Bali Process is a forum that was formed after a 2002 meeting of fourteen Asian Ministerial representatives together with Australia and the USA endorsed a non-binding Regional Cooperation Plan to combat people smuggling. The forum is head-quartered in Bangkok and is co-managed by Australia and Indonesia. Its objective is early detection, victim protection, prevention and prosecution based on regional information sharing, technical resource development and capacity-building (Curley & Vandyk 2017, pp. 45-46).

Despite the securitisation of issues such as people smuggling, drug trafficking, health pandemics and cyber-crime, there is no formal assessment of the purported threat these activities pose to Australia's national security. That is not so for terrorism.

5.4 Transnational terrorism

My review of Australia's national security documents established that there is a National Counter-Terrorism Plan (Commonwealth of Australia 2017c) that provides information on potential terrorist targets and response coordination plans, but it does not add significantly to understanding why Indonesia is so important to Australia's national security. Indonesia's

locus as a potential source of terrorism is one explanation for its importance but understanding the origin, motivation and possible mitigation of terrorism requires a wider reading of national security literature.

Unlike earlier twentieth century 'freedom fighter' violence that characterised nationalist struggles for independence from colonial rule, post-Cold War terrorism is differentiated as being a means by which usually non-state actors pursue an array of objectives. The term terrorism is ill-defined though broadly accepted to be a method or tactic designed to engender fear through acts of violence to influence the behaviour of a target audience (Smith 2012, p. 330). Studies categorise terrorist group orientations differently although the typology 'leftist,' 'rightist,' 'nationalist-separatist,' 'religious,' and 'other' (which includes criminally motivated groups) are most frequent. Another differentiator is focus – whether domestic or transnational (Piazza 2009, p. 63).

Indonesian-sourced transnational terrorist threats to Australian interests whether in Australia or elsewhere are the focus of my analysis. Past acts of terrorism against Australians in Bali and Jakarta appear to have had religious fundamentalist motives, though this analysis will illustrate the potential for other motives to develop. My examination of trans-national terrorism begins with a review of Krieger and Meierriecks' 2011 cross-disciplinary study which identifies seven determinants of terrorism. Of those, four are directly relevant to my analysis of Indonesia's special significance to Australia's national security.

5.4.1 Transnational terrorism – the cross disciplinary theory

There is an extensive literature by scholars in different disciplines that provide a range of theoretical understandings of terrorism and its determinants. The extent of those alternatives is reflected in the following table from the Krieger and Meierrieks' study on the causes of terrorism.

Global hypothesis	Potential determinant	Possible indicators
Economic deprivation	<i>Economic Conditions</i>	GDP p.c., poverty, inequality
Modernisation strain	<i>Economic Performance</i> Population Dynamics Education	GDP growth, unemployment, inflation Population growth, size, age structure, urbanization Literacy, school attainment
Institutional order	Political Institutions <i>Economic Institutions</i> Government	Political rights, civil liberties Economic freedom, property rights protection Welfare policies, government spending
Political Transformation	Political Stability	Regime stability, Civil war proxy
Identity conflict	Minorities Religion	Ethnic and linguistic fractionalisation Proportions of religions, religious fractionalization
Global order	<i>Economic Integration</i> International politics	FDI, terms of trade, trade openness Alliances, incidence of conflict or crisis, foreign aid.
Contagion	Contagion Geography	Spatial, temporal proximity to terrorism Climate, elevation, latitude

Table 5.1 Determinants of terrorism (Krieger & Meierrieks 2011, p. 5)

One aspect of Table 5.1's list of global hypotheses is most relevant to my analysis: in four of the seven hypotheses, *economic issues* are identified as potentially the sole or a contributory determinant of the terrorist threat. The determinants are identified as a state's economic conditions, economic performance, economic institutions or level of global economic integration, each of which is assessed against a range of indicator metrics.

The body of literature from which Table 5.1 is drawn is extensive, and a detailed review of the supporting studies for all hypothesis types is beyond the scope of my analysis. I also do not review those hypotheses in which non-economic factors are identified as likely terrorism determinants. While those studies demonstrate the need for multi-disciplinary analyses of terrorism and its origins, their findings do not engage directly with my research. As a result, I review only the hypotheses where adverse economic circumstances are implicated as a contributory source of terrorism because my FDI conflict moderating research only engages directly with those issues.

That is not to suggest that economic issues will be the primary or critical mitigator of transnational terrorism. In fact, it appears that economic development alone does not discourage terrorism. Krieger and Meierrieks conclude that transnational terrorism is 'too complex to be reduced only to one root cause and one panacea' (2011, p. 24). For clarity, I emphasise that my focus on the role of foreign direct investments does not imply that FDI itself directly mitigates terrorism. Rather, as is illustrated in subsequent chapters, my focus is on the impact effective FDI in developing countries can have not just on economic growth, but also on economic openness, global economic integration, bilateral cultural awareness and (ideally) host country governance standards, which collectively can help to obviate extremist violence.

Consequently, my review of the economic aspects of terrorism begins with the impact of economic conditions. Contrary to common perceptions, the proposition that terrorism is rooted in absolute or relative economic deprivation is controversial and evidence on the issue is conflicting. While there are studies by Blomberg and Hess (2008), Azam and Delacroix

(2006), Lai (2007) and Azam and Thelen (2008) that find economic development, as indicated by real per capita GDP growth, can significantly reduce the initiation of terrorism, other research by Krueger and Maleckova (2003), Kurrild-Klitgaard et al. (2006), Basuchoudhary and Shughart (2010), Plumper and Neumayer (2010) and Freytag et al. (2008), is much less conclusive and shows only weak links between poverty and terrorism (Krieger & Meierrieks 2011, pp. 9-10).

Further complexity in understanding the relationship between economic conditions and terrorist activity comes in Seung-Whan Choi's 2015 analysis of different outcomes depending on whether a state's development is oriented to industrial or agricultural production. What Choi's study demonstrates is that inconclusive findings in several earlier studies about the relationship between economic growth and terrorism (Piazza 2006; Drakos and Gofas 2006; Kurrild-Klitgaard et al. 2006) may be attributed to variations in the *source* of economic growth within the states being examined (Choi 2015, p. 159).

The distinction in commercial rewards from agricultural and industrial production provides an example. Notwithstanding the increases in agricultural productivity achieved through the Green Revolution (Pingali 2012), the crux of this distinction is that the financial rewards of agricultural production to smallholders are limited when compared to those derived from an increase in a state's stock of industrial capital. As a consequence, the population in an agricultural based society typically remain poor, rural, and unlikely to derive the full benefits of agricultural growth (Kuznets, 1973). The importance of these studies in relation to Indonesia lie in the fact that agriculture accounted for 33% of national employment in 2016.

That level is similar to The Philippines but very unlike Australia where agriculture employs only 2.6% of the workforce.⁶

Choi's conclusion is that 'industrialised economies allow people to consume more food, obtain better clothing and shelter, and gain access to more job opportunities, a social safety net, and better healthcare' (Choi 2015, p. 161). Furthermore, countries that achieve and maintain higher levels of industrial rather than agricultural growth are less likely to witness either domestic or transnational terrorism (Choi 2015, p. 172). On balance, the findings are that poverty alone is not a terrorism indicator. Rather it appears that in circumstances where poverty in combination with repressive institutional settings impedes political participation, individuals are inclined towards transnational violence (Krieger & Meierrieks 2011, p. 10).

The second potential economic motivator of terrorism in Table 5.1 is *economic performance in the context of modernisation strain*. 'Modernisation' is used here to indicate the process by which developing economies transition from typically traditional agricultural to globally engaged industrial or service economies. The transition process is often a source of social dislocation and is therefore a potential terrorism determinant. The theoretical premise is that the impact of global competition, labour market restructuring, new technologies and communication mediums, combined with Western lifestyle influences, build grievances among 'modernisation losers.' Those grievances generate social conflict and potential terrorist activity (Robison et al. 2006).

⁶ See <<https://data.worldbank.org/indicator/SL.AGR.EMPL.ZS?locations=AU-ID-PH>>

These claims are difficult to test in empirical studies because the best available proxies used to indicate modernisation-related strain, such as economic growth, population size and education standards, are acknowledged to be 'rough indicators' (Krieger & Meierrieks 2011, p. 10). Even so, economic growth studies by Drakos and Gofas (2006), Kurrild-Klitgaard et al. (2006), Piazza (2006) and Campos and Gassebner (2009) find little evidence that links modernisation strain with terrorist violence. Likewise, available evidence on the impact of education levels on terrorism is unclear (Choi 2015, p. 161). Findings by Azam and Thelen (2008) and Freytag et al. (2008) indicate that higher education dissuades terrorism, but there is also evidence that illiteracy has the equivalent influence (Krueger & Maleckova, 2003).

What is significant from those studies for my assessment of potential motivators of Indonesian terrorism is their inconclusiveness. While the studies find no consistent link between institutional strain and terrorist activity, neither do they refute the idea that grievances among 'modernisation losers' can generate social conflict and potential terrorist activity (Krieger & Meierrieks 2011, p. 15). That is significant because the political and economic developments outlined in this chapter indicate that there are modernisation strains in Indonesia that could potentially give rise to extremist violence.

The impact of economic institutions represented by economic choice and protection of individual property rights is the most indirectly related source of economically linked terrorism shown in Table 5.1. Research into institutional effects on terrorist activity serve to reinforce findings noted above that poverty alone does not foster violence but that poverty in combination with repressive institutional settings creates that possibility (Kurrild-Klitgaard et al. 2006; Piazza 2008). As with the issue of poverty, studies that seek to establish whether

democratic or autocratic political systems in isolation are best able to moderate terrorism are inconclusive.

What is more conclusive is that states which are *both* liberal *and* democratic are markedly less likely to be the source of transnational terrorism (Krueger and Maleckova 2003; Burgoon 2006; Kurrild-Klitgaard et al. 2006; Krueger and Laitin 2008; Piazza 2008; Plumper and Neumayer 2010). As discussed below, these findings have particular relevance to Indonesia because post-Soeharto, liberal, open market economic developments and democratising reforms have stalled and by some measures are being reversed.

Global *economic integration* or more particularly the impact of changes in the global order on developing states is the fourth economic determinant of terrorism noted in Table 5.1. This issue highlights the inherent economic and political implications of the process by which a state becomes integrated into the global economic system. Two common markers of that integration process are a state's trade openness,⁷ and its degree of Western foreign policy alignment as indicated by its alliance membership (Krieger & Meierrieks 2011, p. 8).

Scholars have examined economic and political integration issues separately. In terms of global *economic* integration, the findings in studies by Kurrild-Klitgaard et al. (2006) and Blomberg and Hess (2008) support the proposition that higher levels of global economic integration reduce the prospect of terrorist activity. So also does trade openness in less-developed economies such as Indonesia (Freytag et al. 2008). Findings in associated studies

⁷ Exports plus imports as a proportion of GDP. See Guttman and Richards (2005).

are that higher levels of global *political* integration are also associated with the lower potential for a state to be the source of transnational violence. In short, the research in both domains indicates that states with effective democratic institutions, higher levels of income per capita and global economic integration have less terrorist activity (Bloomberg and Hess 2008).

When these indicators are applied to the circumstances in Indonesia, however, the results are mixed. The positives are Indonesia's post-Soeharto transition to electoral democracy, its longstanding WTO membership and accession in 2007 to OECD key partner membership status. Yet as detailed below, Indonesia's democratic stagnation, modest economic growth and disavowal of alliance agreements in consequence of its long-standing commitment to principles of the Non-Aligned Movement, indicate a potential susceptibility to terrorist activity.

Krieger and Meierrieks conclude their review of the seven terrorism hypotheses with the judgement that it is states that are both socio-economically and politically underdeveloped where transnational terrorism is most likely to be generated (2011, p. 24). The following section examines the potential for those and other adverse circumstances to develop in Indonesia and foster radicalism and other threats to Australia's security.

5.4.2 Democratic regression in Indonesia

One potential development in Indonesia that would have adverse spill-over implications for Australia is democratic regression and the rise of authoritarian nationalism. Some recent studies highlight a diminution in the standard of democratic practice in Indonesia which, in

combination with the emergence of an assertive nationalism, is antithetical to Australia's security interests. (Lindsey 2017c; Hadiz 2017). My argument is based on the likelihood that an authoritarian nationalist government would subvert the economic and political participation of vulnerable segments of the Indonesian population. As demonstrated above, the combination of poverty and repressive institutional settings increases the prospect of terrorist violence (Krieger & Meierrieks 2011, p. 10).

Indonesia's post-Soeharto transition to democracy was rapid and substantial in the period from 1998 to 2006. There is empirical support for the perception that democratic development peaked at that time and signs of regression are reflected in published global democracy indices. For example, the most positive assessment of Indonesia's democracy rating is the Polity IV Index which increased Indonesia's rating from two to eight between 2000 and 2005 where it has remained for the past decade.⁸ Whereas, The Economist Intelligence Unit's (EIU) Democracy Index has since 2006 consistently positioned Indonesia as a 'flawed democracy' alongside seemingly much less democratic states as Sri Lanka, Bangladesh, the Philippines and Bulgaria. All of those states are rated well below the EIU status of a 'full democracy.'⁹

Indonesian anti-reformist elements persist with efforts to roll back electoral reforms, reduce the powers of the Corruption Commission and diminish the rights of minorities that were introduced during *reformasi* transformation in the late 1990s and early 2000s. Not all of these

⁸ <http://www.systemicpeace.org/polity/ins2.htm>

⁹ <https://infographics.economist.com/2018/DemocracyIndex/>

regression attempts have been successful, but Indonesia's democratic consolidation, according to Mietzner, appears to have frozen at 2005–2006 levels (Mietzner 2012, pp. 210–214). However, insistent sectarian activism by conservative Islamic organisations that challenge Indonesia's democratic status appear to have guided the aggressive actions to unseat the Jakarta Christian Governor Basuki Tjahaja Purnama (Ahok) during the 2017 election. These anti-Christian protests, purportedly backed by Prabowo Subianto, the unsuccessful authoritarian-populist candidate in the 2014 presidential election, contributed to Ahok losing the election (Warburton & Aspinall 2017, p. 1). Moreover, Ahok was subsequently charged and found guilty of blasphemy and sentenced to two years in prison. These events give rise to the question of whether the state of democracy in Indonesia has actually moved from stagnation to regression (Warburton & Aspinall 2017, pp. 2–3).

Aspects of that question are examined in articles by other, mostly Australian, academics (Mietzner 2012; Winters 2013; Aspinall 2015; Lindsey 2017; Robison & Hadiz 2017; Hadiz & Robison 2017;). With varying degrees of emphasis, the typical cause of Indonesia's democratic stagnation/regression cited by scholars is the power and influence of various elites. Foremost of these are the often very wealthy rentier oligarchs who transitioned their Soeharto era commercial privilege and influence into the post-*reformasi* present. The scale of their wealth is remarkable. For example, the four wealthiest individuals in Indonesia hold more wealth than the poorest 100 million inhabitants. The wealthiest 1% of the population own 49% of the nation's private wealth and the top 10% hold 77% of the wealth (Credit

Suisse 2016).¹⁰ Increasing inequality in Indonesia's national income distribution is apparent in the Gini co-efficient which increased from 0.35 in 2007 to 0.41 in 2015.¹¹

Collectively the anti-reform elites, who are represented in the bureaucracy and political parties as well as in business, are regarded as 'predatory' actors seeking to 'hijack' institutional reforms (Robison & Hadiz 2004). The timing of three major democracy roll-back 'victories' reflects the stagnation and reversal of Indonesia's democracy rating noted above. The first 'success' preceded the 2009 national election. Elite concern that excessive electoral power had been given to ordinary citizens led conservative politicians, under the guise of budget cost savings, to reverse earlier electoral reforms. The changes undermined the powers of the Election Commission and enabled elites to recapture significant political advantages by reversing requirements for contested elections of provincial governors (Mietzner 2012, pp. 212-213).

The second rollback target was the Corruption Eradication Commission which had achieved increasing success in prosecuting corrupt political and business elites since its founding in 2002. In 2009 the Commission's status was compromised when then President Yudhoyono failed to support two of its Commissioners against duplicitous corruption accusations. Despite a later finding that the accusations were false, the standing of the Commission has diminished and concerted efforts to reduce its powers continue. Nevertheless, corruption

¹⁰ By comparison Australia's top 1% own 22% of the wealth and the top 10% own 45%.

¹¹ A zero co-efficient represents perfect equality. *Source:* Indonesia Investments <<https://www.indonesia-investments.com/news/todays-headlines/gini-ratio-indonesia-declines-economic-inequality-narrows/item7113?>>

remains endemic primarily because the legal system itself is compromised by corruption (Mietzner 2012, pp. 213-214).

Finally, erosion of minority group rights since 2008 is the third aspect of Indonesia's reform regression. Non-Muslim religious groups in particular are the victims of escalating property and personal violence, for which the perpetrators are seldom prosecuted. Extra-judicial killings of drug suspects have begun, bogus criminal charges are used to silence government and anti-corruption activists, and most recently a controversial emergency law has allowed civil society groups to be banned by decree (Lindsey 2017, p. 3; Mietzner 2012, pp. 214-215.).

Caution is necessary in efforts to deduce the likely medium-term outcomes of these anti-democratic trends in Indonesia, but some readings suggest potentially major security consequences for Australia. While Marcus Mietzner counsels that bad democratic governance in Indonesia does not lead inevitably to an autocratic take-over, he adds the rider 'at least not yet' (Mietzner 2012, p. 223). Others are less sanguine. The Jakarta Legal Aid Foundation describes current trends towards authoritarianism as a 'democratic emergency' (Lindsay 2017, p. 3). Others note with concern the populist and nationalist claims of both candidates at the last presidential election who projected themselves as heirs to the isolationist and (failed) economic autarchy of the Soekarno nationalist era (Robinson & Hadiz 2017, p. 905).

The security significance of these assessments flows from the potential that Indonesia may surrender its post Soeharto democratic reform progress to an authoritarian 'Neo-New Order'

regime with aspirations that are incompatible with Australia's interests. Emphasis on that possibility currently centres on the role of Prabowo Subianto, a Suharto regime army general 'prepared to ride roughshod over formal democratic institutions' (Aspinall 2015, p. 26). Prabowo, who was the losing candidate in the 2014 Presidential election, presented policies that represented a roll back of key democratic reforms and is expected to contest the 2019 Presidential election (Aspinall 2015, p. 1). Prabowo's substantial electoral support in 2014 illustrated the fragility of democracy in Indonesia and demonstrated the potential for a 'formidable force for more sudden and dramatic authoritarian reversal' to emerge (Aspinall 2015, p. 28).

In the context of Dibb's (2012) security assessment that a fragmenting or authoritarian nationalist or extremist government would pose a major security concern for Australia, the above signs of Indonesia's democratic recession seem to be underappreciated in bilateral relationship assessments. A potential 'worst case' expression of the prospective outcome is that an illiberal, Islamic-fundamentalist, authoritarian President backed by oligarchic elites is elected to power. The security consequence for Australia of that outcome has so far been contemplated by few political or academic observers. The previously cited paper by Eve Warburton and Edward Aspinall (2017) which questions if democracy in Indonesia is already deteriorating is a notable exception.

5.5 Indonesia's national security

The purpose of this section is to establish if there are domestic Indonesian security issues that could have flow-on security consequences for Australia. Earlier analysis established that terrorism and possibly unauthorised boat arrivals represent a threat to Australia's national security. This review of Indonesia's own domestic security threat assessment identifies the potential for both of those threats to arise as spill-overs from internal Indonesian developments. The internal Indonesian threats are jihadi terrorism and the prospect of provincial or ethnic separatist violence.

My analysis begins with the *Indonesian Defence White Paper 2015* because it provides an extensive overview of the country's security situation. Like Australia, Indonesia does not consider itself vulnerable to serious external military threats. But, unlike Australia, Indonesia identifies a range of non-traditional security threats that are primarily domestic in origin. The major NTS threats set out in the White Paper include terrorism and radicalism, separatism, revolt, border violations, piracy, theft of natural resources, pandemics, cyber warfare, espionage, narcotics and natural disasters (Ministry of Defence of the Republic of Indonesia 2015, p. 25). My focus is on the issues of terrorism and radicalism as well as on separatism because their manifestation in Indonesia could have adverse spill-over impacts on Australia.

5.5.1 Terrorism and radicalism in Indonesia

Analysis of terrorism, which typically entwines the religious convictions of fundamentalist elements of Sunni Islam with extreme and sometimes violent opposition to other forms of Islamic and global society, is highly contested among scholars in several disciplines.

Unsurprisingly, my attempt to summarise the emergence and possible consequences of conservative Islam in Indonesia is also equivocal in its attempt to present an objective assessment of an emotive issue.

Proselytising Indian and Middle Eastern traders introduced Islam to Indonesia more than 700 years ago. It became known from the outset as 'Archipelago Islam' (*Islam Nusantara*) because of its syncretic incorporation of local Hindu and Javanese customs (Riviere 2016, p. 1). In Australia it is widely supposed that Islam in modern Indonesia is traditional, moderate and democratic. However, this judgment fails to reflect the complexity of the religion's history and current practice in Indonesia (Fealy 2017, p. 1). In fact, violent opposition to 'Archipelago Islam' has occurred from the earliest days of Indonesia's independence.

Sections of the Indonesian armed forces opposed the 1947 Sukarno-Hatta founding Constitution's secular principles and sought to impose Islam as the state religion. Dissident military commands developed in nine provinces. Their actions were integrated into a movement known as Darul Islam,¹² which incited several provincial rebellions before its military activity was suppressed in 1962. Elements of Darul Islam persisted under close scrutiny during the Soeharto Presidency. It resurfaced as a fundamentalist force after Soeharto's resignation in 1998 with the foundation for Jemaah Islamiyah (JI), the first of Indonesia's post-*reformasi* extremist groups (Singh 2004, pp. 50-53).

¹² Meaning 'House of Islam'

Following a series of JI bombings directed against foreign tourists in Bali (2002 and 2005) and the Marriot Hotel (2003), and against the Australian Embassy (2004) and several Christian churches across Indonesia in the early 2000s, efforts to contain terrorism appeared to have been successful. However, a further attack occurred in 2016 in which factions associated with jihadist fighters returning from Syria and Iraq were implicated. Moreover, there is concern that the return of further extremists from those conflicts will 'pose a high level of threat to law and order in Indonesia' (Riviere 2016, p. 3).

The presence of Islamic State (IS) extremists has divided the conservative Muslim community in Indonesia. Many local groups reject IS's ambitions as incompatible with the Islamic faith and wider interests of their community. Meanwhile supporters of IS are reportedly drawn to its ambition to capture territory and establish a caliphate under Islamic law (Fealy 2015, pp. 10-12). In addition, the IS presence has 're-legitimised the concept of attacking foreign non-combatants, especially non-Muslims' (Fealy 2015, p. 12). Intelligence agencies estimate that 1,200 to 1,800 mostly Indonesian recruits from Southeast Asia have travelled to Syria and Iraq to join IS. While the number who participated in the conflict is unclear there were sufficient to establish an Indonesian-Malay speaking fighting unit in Syria known as Katibah Nusantara. Katibah used social media to recruit in the Southeast Asian region and conduct logistical and tactical training (Jawaid 2017, p. 1).

Indonesia's response to terrorism has been criticised as slow and inconsistent. Police have not been given adequate powers to disrupt terrorist activities and have not developed effective operational relationships with counterparts in Malaysia and the Philippines (Riviere 2016, pp. 14-15). In addition, Indonesian correctional facilities serve as recruiting grounds

for extremists. De-radicalisation programs are limited and unsuccessful so that incarceration can serve to further radicalise offenders before they are returned to their community (Riviere 2016, pp. 14-15). Furthermore, authorities are unable to monitor the 'dozens of convicted terrorists who are released every year' many of whom return to their jihadist communities because they have limited skills and few economic opportunities (Jawaid 2017, p. 4).

This assessment indicates that terrorism in Indonesia is likely to endure, but when taken in conjunction with the impact of increasing religious conservatism, the potential for radicalised IS supporters to initiate terrorist acts may increase. A co-founder of the Liberal Islam Network laments that democratisation in 1998 opened the 'floodgates' for conservative Islamists to organise and evangelise. As a result, the centre could not hold, and Indonesian Muslims are becoming more intensely and visibly conservative (Varagur 2017a, p. 2). New political parties such as the 'sharia-promoting hard-line Indonesian Mujahedeen Council and the reactionary Prosperous and Justice Party' have become established though neither has secured strong voter support (Varagur 2017a, p. 2).

The influence of conservative Wahhabi teachings in schools and mosques financed by Saudi Arabia adds to Indonesia's growing ideological conservatism. Politicians are reluctant to resist the Saudi influence because it could result in Indonesia's annual hajj pilgrimage quota being reduced. The political backlash would be strong as there are decade-long waiting lists in many provinces, despite Indonesia having the world's largest hajj allocation of 221,000 pilgrims per year (Varagur 2017b, p. 5).

An illiberal trend and growing Saudi influence in Indonesia may be apparent in the 2017 visit to Indonesia by King Salman, the first visit by a Saudi monarch since 1970. The visit promised Indonesia \$US7billion in capital investments along with funding for construction and instructional funding for three additional Islamic and Arabic tertiary institutions (*Jakarta Post*, 2017, pp. 4-5). The *Jakarta Post* report noted that the one existing Saudi funded tertiary institution established in 1980 produced students ingrained ‘with the conservative strain of Islam’ and clerics promoting Wahhabist ideals that promote actions against minority Muslim Shiite and Ahmadiyah communities (*Jakarta Post*, 2017, pp. 4-5).

While stability of the Indonesian state is not currently threatened by jihadist activities there are claims that more needs to be done to combat its ideological appeal. Imprisoning individuals and disbanding organisations does not deal with the root cause of the threat. An assessment of the extremist threat by the Vice Chief of the Australian Defence Force concludes that ‘events in the Middle East, North Africa and South Asia provide a dire warning of the consequences of under-estimating the [*jihadist*] threat’ (Riviere 2016, p. 17).

5.5.2 Separatism in Indonesia

The phrase *Bhinneka Tunggal Ika* (unity in diversity) is one of the *Pancasila* (five principles) on which the Indonesia Constitution is based. Taken from the title of a 14th century Javanese poem it conveys a commitment to one country, one nation and one language (Indonesia Handbook 1996). Unity is an essential goal in a country extending across some 17,000

islands, with over 490 ethnic groups and multiple religions in addition to the 90% Muslim majority which includes about 1% in the Shia and Ahmadi sects.¹³

Post-Soeharto communal violence in eight provinces motivated by either secessionist ambitions or ethnic conflicts resulted in up to 20,000 deaths in the period 1998 to 2002 (Wilson 2015, pp. 1317-1318). East Timor's secession referendum in 1999 and escalating secessionist violent in Aceh and West Papua, plus anti-Christian sectarian conflict in the Moluccas and parts of Sulawesi, caused scholars to contemplate the disintegration or *balkanisation* of the Indonesia state (Wanandi 2002; Weatherbee 2002; Malley 2003).¹⁴ In 2004 the Indonesian military Chief of Staff claimed that 'if I withdraw the troops from Papua on Saturday, there is no doubt that on Sunday they [the separatists] would declare independence.' He went on to add: '... separatists in Aceh and Papua, if left alone, could become seeds of disintegration' (cited in Heiduk 2014, 306). While the statements may be part of an attempt to ward off government initiatives to reduce military power (Heiduk 2014, 306), separatism was clearly an issue of national concern.

By 2006 Aceh's secessionist ambitions had been placated as the result of aggressive military action, a weakening of secessionist ambitions following the 2004 tsunami together with the government's concession of some local autonomy, access to greater resource revenue and

¹³ <http://worldpopulationreview.com/countries/indonesia-population/>

¹⁴ The term 'balkanisation' has traditionally been used in reference to the political situation in the Balkans during the late 19th and early 20th centuries, when the Balkan region of the Ottoman Empire split up into smaller warring states. With regard to post-Suharto Indonesia, the term *balkanisasi* has been used to refer to the break-up of Yugoslavia in the early 1990s, which was accompanied by the so-called Yugoslav wars, as well as internal strife in Bosnia and Kosovo. The use of the term is generally pejorative (Heiduk 2014, p. 312).

implementation of *Syariah* law (Sujatmiko 2012, pp. 104-108).¹⁵ Nevertheless, there is still an active West Papuan independence movement and significant ethnic and sectarian conflicts persist. Even in the early 2000s, expectations were that an unstable or fragmenting Indonesia would become a haven for extremists of all stripes (Rabassa & Chalk 2001). In 2002 an assessment by the Indonesian government's advisory Centre for Strategic and International Studies concluded that 'Indonesia has become a weaker state, ... conflicts in many regions ... present an enormous challenge to the Indonesian government' (cited in Wanandi 2002, p. 144). The same report also suggests that Indonesian chaos and deterioration could destabilise Southeast Asia and prompt flows of refugees from many parts of the archipelago (cited in Wanandi 2002, p. 145). Those prospects motivate my analysis of the possible security consequences for Indonesia and Australia if separatist forces fracture Indonesia's national unity.

A common aspect of the *balkanisation* assessments is that social instability is largely attributable to a failure of the rule of law. In Indonesia the breakdown of law and order and rising criminality is attributed to a corrupt, undermanned, poorly trained, badly paid and poorly led police force (Weatherbee 2002, p. 25). The concerning aspect of those causal observations is that current assessments of Indonesia's corruption still place it in the bottom half of all countries in the 2016 Global Corruption Perception Index. Indonesia's corruption ranking of thirty-seven is similar to that of separatist-troubled states such as the Philippines, Thailand, Sri Lanka and Colombia and below that of Malaysia (forty-nine) and well below

¹⁵ *Syariah* is the Malay spelling for *Sharia*

Australia's rating of seventy-nine and Singapore's eighty-four (Transparency International 2016).

While the scale of separatist conflict has moderated since the early 2000s, ethnic clashes and mob violence against religious minorities have continued. The number of reported incidents of mass violence that have caused fatalities has increased consistently, reaching a high of almost 300 in 2016 (Harsono 2017). The scale of this violence prompted the UN Human Rights Commission to counsel the Indonesian Government 'to address increasing levels of violence and hatred towards religious minorities' (Wilson 2015, p. 1320).

The causal factors underlying this violence are variously attributed to patronage and corruption in local government, military protection of illicit exploitation of forestry and other resources and manipulation of identity issues by local politicians (Wilson 2015, p. 1318). However, because the conflicts are normally settled by coercive police or military actions, the underlying grievances are not resolved. Furthermore, human rights violations often occur during the coercive actions and these serve to exacerbate the conflicts (Heiduk 2014, p. 311).

In summary, separatism remains an important issue in Indonesia's national security. West Papuan independence activity and widespread ethnic and religious violence has continued since the fall of President Soeharto. Of most significance to Australia is the potential for an unstable or fragmenting Indonesia to become a haven for extremists (Rabassa & Chalk 2001), or to destabilise Southeast Asia and cause refugee emergencies in the region (Wanandi 2002, p. 145). There are manifold explanations for these separatist movements, but

as argued later, the potential economic and governance benefits associated with foreign direct investments has the potential to mitigate some of these threats to Indonesia's unity.

5.6. Conclusion

The objective of this chapter was to provide the analysis necessary to answer my second research question: *to what extent is a strong and productive relationship with Indonesia critical to Australia's national security?* The analysis established that there are current and potential Indonesian sourced NTS threats to Australia's national security that may well explain the desire to have a robust bilateral relationship even though Australia's sovereign security is not endangered by those threats. The chapter also establishes that the combination of liberal and democratic institutional settings together with economic development provides the counter measures most likely to subdue these security threats. That finding impacts my wider thesis puzzle on the need for an improved Australia-Indonesia relationship because it provides an indicator to how that outcome might be achieved.

Security professionals and scholars agree that neither Indonesia nor any other state will present a credible threat to Australia's *sovereign security* within the next two decades. Indonesia's strategic significance as a sea and air barrier between Australia and Asia was first acknowledged in the 1973 Defence Policy and the need for a positive relationship with Indonesia was considered even then to be 'of profound and permanent importance to Australia's national interest' (Fruehling 2009, p. 385).

Based on prevailing *strategic* security considerations there seems little pressing need for Australia to pursue a close relationship with Indonesia. If this is the case, what other

explanation is there for Australia's formal policy assessment that a strong and productive relationship with Indonesia is considered to be critical and vital to Australia's national security (Commonwealth of Australia 2016a)? The answer is not explicit in the *2016 Defence White Paper*, but the preceding analysis illustrates that Indonesia is a source of significant actual and contingent non-traditional security threats to Australia's *national security*.

That assessment is reinforced by findings in Indonesia's 2015 *Defence White Paper* of domestic security threats that can impact Australia's national security – terrorism and separatism. The persistence of terrorism as a threat to both Indonesia and Australia is being sustained by the return to Indonesia of radicalised Islamic State fighters together with inadequate monitoring and unsuccessful de-radicalisation of convicted terrorists

The 2015 Indonesian White Paper also highlights separatism occasioned by religious intolerance and inter-ethnic violence as a concern to its national security. There are major adverse implications for Australia of a potentially unstable or fragmenting Indonesia becoming a haven for extremists (Rabassa & Chalk 2001), or of instability or repression leading to flows of refugees across the region (Wanandi 2002, p. 145).

In summary, my analysis of Australia's security literature has established that there are reasons why a robust relationship with Indonesia is vital to the nation's security. Importantly though, it failed to identify any policy or operational initiatives beyond various terrorism related policing and intelligence sharing initiatives that can serve to build such a relationship. There appear to be no counter-terrorism narrative or threat-mitigating initiatives that identify the source or motivation for the perceived threats, or acknowledgement of the potential

benefits that would flow from a more a complex bilateral economic interdependence (Keohane & Nye 1977, pp. 24-25).

In terms of the neighbourhood security maxim where the choices are characterised as being either 'a high fence, a fierce dog and a big gun' or to 'befriend the neighbour' (Baldwin 1997, pp. 16-17), Australia's security policy ambitions preference the latter, but functional rapport building initiatives are needed. The following chapters examine the potential for economic interdependence and direct investments in particular to be part of Australia's long-term process of 'befriending' Indonesia.

Chapter 6: Trade-security theory: seeking conflict mitigating causal mechanisms

6.1 Introduction

To this point my analysis has established that there is a gap, even a contradiction, between Australia's rhetoric and its actions toward Indonesia. On the one hand, Australian security officials aspire to develop a robust, productive relationship with Indonesia because of its importance to Australia's national security. On the other hand, the conduct of Australian government and corporate officials often exhibits a seeming disregard for cultural and commercial engagement with Indonesia. My third research question examines if an Australian FDI diplomacy initiative might contribute to overcoming this contradiction and help overcome the source of Indonesian threats to Australia's national security.

As a preliminary to answering this question I need to establish whether FDI does have an impact on bilateral security relations. Despite the significant literature exploring the relationship between trade and security, little attention has been given to FDI. Consequently, I must take several steps to answer this question.

The first step is taken in this chapter. I analyse liberal trade-security theory and identify causal mechanisms that evidence suggests will determine the probability of transnational conflict. These trade-security mechanisms provide the basis on which I frame a comparable FDI-security hypothesis in the next chapter. That FDI-security hypothesis then enables me to evaluate FDI's possible contribution to economic and institutional development in emerging

economies such as Indonesia. My method of addressing this FDI-security void is to apply theoretical deduction rather than empirical observations: my analysis is based on the premise that the conflict moderating causal mechanisms established in trade-security theory and security studies may be indicative of a comparable FDI-security formulation.

Trade-security theory looks for its origin to Immanuel Kant's 18th century *democratic peace thesis* outlined in his 1795 paper *Perpetual Peace: A Philosophical Sketch*, which remained virtually unchallenged as liberal IR orthodoxy until late in the 20th century. The following summary of major developments in trade-security theory confirms the enduring merit of Kant's thesis and tracks the development of its most recent iterations as the *capitalist* and, latterly, *regional peace theory* formulations.¹ However, this foundational democratic peace orthodoxy has been challenged on both conceptual and empirical grounds by scholars who advocate alternative causes for the conflict moderation observed in circumstances of economic interdependence. A major challenge to the orthodoxy comes from capitalist peace proponents who argue that it is trade rather than democracy that explains the 'democratic peace.' Nevertheless, this review of the capitalist and other challenges to the democratic peace formulation begins with an examination of Kant's perpetual peace thesis that has provided the founding principles for the enduring trade-security debate.

¹ A more extensive chronology of other papers that influence the development of capitalist and regional peace theory is at Appendix II.

6.2 Kant's political philosophy

The writings of Immanuel Kant (1724-1804) provide the foundation for most democratic peace theory scholarship. Kant's ideal of a *perpetual peace*, as he described it in the 1790s, is based on states adopting a 'republican constitution,' 'cosmopolitan law' and a 'pacific union.' These basic principles are supposedly represented in the contemporary world by states with liberal democratic rights for individuals, international free trade ideals and multilateral security treaties (Russett 1993, p. 4). Writing in the early post-Cold War years, Bruce Russett wondered if the advance of global democracy heralded a period of Kantian world peace. He optimistically observed that the 'end of ideological hostility represents a surrender to the forces of Western values of economic and especially political freedom' (Russett 1993, p. 4).

Immanuel Kant did not produce a consolidated treatise on political philosophy itself. He is best known to scholars for his three distinguished philosophical texts, the *Critique of Judgement* (1790), *Critique of Practical Reason* (1788), and *Critique of Pure Reason* (1787). Nonetheless, interest in his writings on political philosophy was stimulated in the 1970s by noted Kant scholar Hans Reiss whose work explicated the normative principles on which Kant's writings were founded (Reiss 1970). My ambition here is to illustrate how Kant's ideals were interpreted during the 1980s and then how they coalesced into the democratic peace theory.

Kant's aim, according to Reiss, was to discover the philosophical foundations on which political actions could, and ought to be based. In addition to the *republican constitution* on which a state's democratic principles should be founded, Kant's foremost premise was that

justice must be universal and organised according to universally valid laws that allow for no exceptions. This was the basis of Kant's principle of universal rights for individuals within a society (Reiss 1970, p. 21). Kant reasoned that control of possessions gives rise to a right in relation to that property. Protecting the right in what Kant called 'mine and thine' requires coercion which, when exercised as a universal principle, constitutes a law. If all individuals in a society have the right to possessions, protection of the right of all requires all to enter into a civil society and forego certain freedoms by submission to a *universal law*. Such laws must operate to ensure that the free actions of one person are able to be reconciled with the freedoms of the other (Reiss 1970, pp. 21-22).

In like manner to the principle of universal law within states, Kant envisaged mutual acceptance by states themselves of the principle of rights as the way to sustain peaceful relations between states. In his 1786 essay *Conjectural Beginning of the Human Race*, Kant pointed to war as the source of the 'greatest evils which afflict civilised nations.' Neither states nor their citizens were safe unless conflicts were avoided (Reiss 1970, p. 34). Kant proposed a formulation of these principles of rights for application to relations between states, especially in relation to war.

Kant accepted that states would not forego sovereignty in the same way that individuals within states had forgone freedoms, so he espoused a principle of right by which nations agree to arbitral laws capable of settling their disputes. Awareness of the principles of rights and acceptance of the rule of justice are thus basic to Kant's ideal of perpetual peace (Reiss 1970, pp. 34-35). Another Kant scholar, Patrick Riley was more explicit about Kant's objectives. His reading was that Kant envisaged public legal order at every level being

jeopardised if there was no such order in relations between independent states (Riley 1983, pp. 114-115).

In his essay *Ideas for a Universal History* (1784), Kant argued that if states were able to exist in ‘lawless freedom’ they would impinge on the rights of citizens in order to pursue expansionist goals, and burden future generations with war debts and a ‘corrupt morality.’ His ideal for sustaining a ‘lawful state’ at the national level was dependent on *foedus pacificum*, a league of peace (Riley 1983, p. 115). As shown in the commentary below, *foedus pacificum* is an uncertain construct in political philosophy, though Riley describes it as ‘a *union of nations* which maintains itself, prevents wars and steadily expands’ (Riley 1983, p. 117, original emphasis). This *union of nations* along with the *universal law* and *republican constitution* form Kant’s tripod of principles for perpetual peace. The following sections illustrate how those principles continue to directly and indirectly impact how the capitalist peace thesis has come to be formulated.

6.2.1 The ‘Kantian tripod’

Kant’s texts predate by 100 years or more the emergence of systematised ‘international thought’ by Hobson, Angell, Lenin, Woodrow Wilson, and others in the late 19th -early 20th centuries (Buzan & Lawson 2014, p. 441), and the inauguration of International Relations studies at Aberystwyth University in 1919. Moreover, as seen below, it was not until the 1970s that Kant’s writings began to be reflected in liberal IR scholarship, although they remained extraneous to realist and Marxist orthodoxy. A stimulus for interest in the link between democracy and peace, and eventually for awareness of Kant’s scholarship was the

formation in 1961 of a US agency, the Arms Control and Disarmament Agency, charged in part with developing a ‘better understanding of how the basic structure of a lasting peace may be established’ (Babst 1964, p. 9).²

Dean Babst led an inquiry that examined whether the form of government had any influence on which states made war on each other. Babst’s 1964 article is possibly the earliest study in the literature to identify that, of 116 major wars between 1789 and 1941, not one had been fought between nations with elective governments (Babst 1964, p. 10), although Babst was probably not aware that an explanation for his finding existed in Kant’s political philosophy because so few English translations of Kant’s political works were available at the time (Reiss 1970). It was almost another twenty years before scholars recognised the connection.

In 1983 Michael Doyle introduced Kant’s liberal, or democratic, peace prescription into public affairs studies. Most relevant to my FDI analysis is Doyle’s criticism of earlier liberal theorists for their failure to adequately understand the ‘exceptional nature of liberal pacification.’ Doyle criticised the prevailing explanations for peace between democracies in which scholars had attributed peace to some mix of democracy’s role in exercising restraint on foreign military adventures, or to capitalist rationality that judged war to be irrational, or to the pacifying influence of international trade (Doyle 1983, p. 225). He conceded that such explanations could provide insight into peace between fellow liberal states, but they provided no explanation for recurrent wars between liberal and non-liberal states. Doyle turned to Kant for his theoretical reasoning. While not using the phrase ‘Kantian tripod,’ Doyle introduced

² US Arms Control and Disarmament Agency, Public Law 87-297, September 27, 1961

the hallmarks of Kant's philosophy into the literature by detailing what Kant had called the three 'definitive articles for perpetual peace among states' in his 1795 treatise *Perpetual Peace: A Philosophical Sketch* (Doyle 1983, p. 225).

In Doyle's view, Kant's three articles helped to explain both the source of peace between liberal states and why liberal states were disposed to hostility with non-liberal states. Kant's *first article* required states to have a *republican civil constitution*. In his reformulation of the articles, Doyle endowed his version of such a constitution with characteristics such as an elected representative government, separation of powers, juridical freedom, equality under the law, and the right to hold and freely trade possessions in a market-based economy (Doyle 1983, pp. 225-226). In his examination of Kant's *second article*, the *foedus pacificum* or league of peace between nations, Doyle positioned this in contemporary language as equivalent to a mutual nonaggression pact or collective security agreement between republics (Doyle 1983, pp. 226-227). *Cosmopolitan Law* was the *third article* to be reformulated by Doyle. Kant expressed its purpose as establishing 'conditions of universal hospitality' that obliged a state to facilitate access by foreigners for the purpose of exchanging goods and ideas. In Doyle's reformulation, cosmopolitan law takes on characteristics akin to a modern multi-lateral free trade agreement (Doyle 1983, p. 227).

Having reformulated the three articles into contemporary language, Doyle was able to develop a theoretical explanation for the enduring propensity for hostilities between liberal and non-liberal states. He hypothesised that only democratic states will be parties to both the second article, the *foedus pacificum* or nonaggression pact provisions, and the third article, the free trade agreement style of Cosmopolitan Law. It is these two Kantian constructs

operating in concert that constrain acts of aggression by liberal states against each other but not against other non-liberal states (Doyle 1983, pp. 229-231).

By the late 1980s there was sufficient consensus among liberal IR scholars that democracies do not fight one another for Jack Levy to conclude that ‘the absence of war between democracies comes as close as anything we have to an empirical law in international relations’ (Levy 1988, p. 662). Predictably perhaps, this proved to be the zenith of belief in Kant’s perpetual peace and its offspring, the democratic peace theory. Observing the same era, Raymond Cohen noted that ‘the ‘democratic peace’ school [had] become something of a self-perpetuating, self-satisfied group of researchers who display greater tolerance and pay more attention to the work of those who support their thesis than to their critics’ (quoted in Haas 1997, p. 136). Aspects of the democratic peace theory had begun to be questioned after a 1989 study by Zeev Maoz and Nasrin Abdolali had re-examined previous analyses of militarised interstate disputes (MID) between 1816 and 1976.³ This study produced two novel findings: first, that a democratic state was as equally likely as any other regime type to enter into conflicts if the opposing party was not a democracy (Maoz and Abdolali 1989, pp. 30-32); and second, that the status of democracies was levelled by the finding that pacific relations between democratic counterparties were equally matched by nonaggressive relations between dyads of autocratic and anocratic states (Maoz and Abdolali 1989, pp. 30-32).

³ See <<http://cow.dss.ucdavis.edu/data-set/MIDs>>

Maoz and Abdolali's research marked the beginning of a period of intense empirical analysis designed to establish if there were causal rather than correlative explanations for democratic peace. The ensuing detailed multi-variant regression and other statistical studies are relevant to my Australia-Indonesia hypothesis for two reasons: they indicate the limitations of the Kantian tripod thesis as a robust peace indicator; and theorising about those limitations gave rise in the early 2000s to a new offshoot – *capitalist peace theory*. It is capitalist peace theory that provides the grounding for the hypothesis concerning the conflict mitigating role of FDI I develop in the next chapter. The following sections trace these two developments.

6.2.2 Rethinking the Liberal Peace Theory⁴

Growing academic uncertainty about the liberal peace theory coincided with the fall of the Berlin wall and the notional end of the Cold War in November 1989.⁵ Yet the continuing endorsement of liberal peace theory by U.S. policy makers had a major impact on the ensuing transition towards democracy of the fifteen former Soviet states. President Clinton in his 1994 State of the Union Address stated that the best strategy to ensure a durable peace with former Soviet bloc countries was to support the advance of democracy: '[d]emocracies don't attack each other' he declared.⁶ Some months later he repeated the democratic peace

⁴ Christopher Layne states that *democratic peace theory* is not properly a theory. A "theory" proposes a causal relationship between the independent variable (democracy) at the unit level and (peace) as the dependent variable. Democratic peace is not a theory as no causal relationship between them is proven or adequately explained (Layne 1994, p.5).

⁵ See: <<http://www.theguardian.com/news/datablog/2011/aug/17/ussr-soviet-countries-data>> viewed 16 September 2015.

⁶ See: <<http://millercenter.org/president/clinton/speeches/speech-3437>> viewed 16 September 2015.

refrain when he committed US troops to an invasion of Haiti. On that occasion he claimed that ‘democracies are more likely to keep the peace.’⁷

At the same time, however, there were academic dissenters. Christopher Layne, for instance, presciently observed in 1994 that the democratic peace initiative had the potential to embroil America in ‘disastrous military interventions abroad, strategic overextensions, and [cause] the relative decline of American power’ (Layne 1994, p. 47). This was the context in which the peace theory became a contested academic issue.

The abruptness with which the theoretical focus changed is illustrated by the focus of a 1991 critique of peace theory by Clifton Morgan and Sally Campbell that sought to identify ‘additional processes’ (1991, p. 190) beyond democracy that might provide the causal mechanism understanding for peacefulness between democracies. The paper’s findings were inconclusive beyond a finding that ‘democracy does not appear to be a force for peace in any straight forward, uniform, or consistent fashion’ (Morgan & Campbell 1991, p. 210). Nevertheless, the authors encouraged further research to resolve what they viewed as confounding influences of economic and other variables (Morgan & Campbell 1991, p. 210).

The following year Stuart Bremer introduced six new prospective variables to test the cause of previously documented dyadic conflicts. Using the 1816-1965 *Correlates of War Project* database,⁸ Bremer assessed the relevance of each of the following variables to the onset of hostilities between each separate pair of combatant states: geographic proximity, relative

⁷ See: <<http://www.presidency.ucsb.edu/ws/?pid=49093>> viewed 16 September 2015.

⁸ See <<http://cow.dss.ucdavis.edu/data-set/MIDs>>

power, security alliances, type of government, level of economic development and degree of military preparedness (Bremer 1992, p. 309). Bremer's goal was to establish the relative significance of each of these factors in the outbreak of hostilities. He found that the dyads most vulnerable to hostility were those in close geographic proximity, with no security alliances, with weak economic development, non-democratic government and low levels of military preparedness. The apparent causal contributions to conflicts of this range of variables challenged existing conceptions of democratic peace. With notable understatement, Bremer observed that current peace research priorities 'may be seriously distorted' (Bremer 1992, p. 338). What is notable here is the relevance of these criteria to the Australia-Indonesia relationship: Australia and Indonesia are close geographically, have no security alliance, very different economic development, Indonesia's fledgling democratic government is showing signs of being under threat, and it has a low level of military preparedness when compared to Australia.

Rethinking of the peace theorem continued throughout the 1990s. A 1999 paper by John Oneal and Bruce Russett sought to identify potential co-variants to the Kantian tripod and to demonstrate that the peacefulness of democracies was 'spuriously related to the character of the regimes' (Oneal & Russett 1999, p. 2). This empirical study directly addressed the divide between IR theorists on the role of trade and membership of intergovernmental organisations (IGOs) on interstate relations. While liberal theorists represented trade as having pacific effects based on the cost impacts of trade disputes due to conflicts, some realist theorists reasoned that trade could foster conflicts when driven by potential trade benefits available from conflictual gains (Oneal & Russett 1999, p. 5). These theorists also questioned the

dyadic impacts of co-membership of intergovernmental organisations. While liberals represented such memberships as assisting the management and resolution of disputes, many realists had little regard for the impact of IGOs on security issues (Oneal & Russett 1999, p. 5).

Oneal and Russett analysed conflict data extending from 1885 to 1992. Their analytical breakthrough was an ability to isolate the systemic or high-level effect of selected variables from the specific dyadic relational effect of each variable. The inability to make that distinction had been the source of an intrinsic weakness in earlier studies because there had been major systemic changes in the subject variables during the study period. Systemic global trade intensity had changed markedly, as had the number and role of intergovernmental organisations. In addition, the total number and global proportion of democratic states had swelled, especially following World War II (Oneal & Russett 1999, p. 7).

The introduction of improved relational analysis enabled Oneal & Russett to isolate both the pacific effects of trade and of IGO membership at the state to state dyad level. This research produced two major conclusions. First, dyads with a high trade to GDP ratio (trade intensity) had experienced substantial pacific benefit across the full study period, especially in dyads where both states also had high democracy ratings. Second, high levels of common dyadic membership of IGOs correlated with significant, though less substantial, pacific impacts on bilateral state relationships (Oneal & Russett 1999, p. 34). These trade intensity and IGO findings were supported in a later study by Oneal and others (Oneal et al., 2003). This second study indicated that increasing dyadic economic interdependence from the 10th to the

(unlikely real world) 90th percentile correlated with a 32% reduction in the risk of a fatal dispute.⁹ Likewise, boosting the number of intergovernmental organisations in which states have a shared membership by the same factor was shown to reduce conflict risk by more than 40% (Oneal et al., 2003, p. 388). Both these extensions to the original peace theory have important implications for Australia-Indonesia relations because the dyadic trade intensity is minimal (as is the level of direct investments) and Australia is not a member of ASEAN, Indonesia's foremost IGO presence.

Testing of democratic peace theory foundations continued and faced its most forthright criticism in papers published by Michael Ward and co-authors (2007) and Erik Gartzke (2007). Ward and his collaborators refined the analytical modelling to enable past conflictual data to be examined at the dyadic level and to also incorporate the influence of interdependent relationships such as treaty and agreement obligations (Ward et al. 2007, p. 586). This refined model and identification of 'overfitting' in the conclusions from earlier studies led Ward and his co-authors to conclude that certitude about the Kantian or democratic peace needed to be tempered.¹⁰ It also noted wide variations in the impact of IGO membership and found almost no evidence that trade constrained levels of conflict (Ward et al. 2007, pp. 597-598).

Gartzke was even more critical of the empirics on which the democratic peace theory had been based. His memorable though perhaps unkind metaphor equated democratic peace

⁹ For definitions of militarised disputes, threats and use of force see Jones, Bremer & Singer (1996).

¹⁰ See: <<http://www.investopedia.com/terms/o/overfitting.asp>> viewed 1 October 2015

scholars' findings with a fable from the writing of A. A. Milne. The fable tells of Piglet and Winnie-the-Pooh out hunting and mistaking their own tracks in the snow for those of an elusive prey. As the hunters circle back across their own trail, 'evidence' of the elusive prey keeps mounting (Gartzke 2007, p. 167). Gartzke suggested that this was what was happening when peace theory scholars went back over the same metrics again and again: they reinforced their earlier conclusions.

Gartzke surmised that it was *capitalism* rather than democracy that was the primary source of peace. Based on three novel proxy measures for the level of 'capitalism' in different states – democracy, market openness, and the level of economic development – he formulated a 'revised theory of capitalist peace' (Gartzke 2007, p. 170).¹¹ Subsequent democratic peace theorists have contested Gartzke's findings (Dafoe 2011; Choi 2011). However, notwithstanding the apparent refutation of the initial capitalist peace theorising, a body of literature seeking to establish capitalism's pacific causal effects has developed and is surveyed in the following section. These studies concurrently widen the scope of potential conflict inaugurating variables but most significantly begin to narrow the analytical focus towards the dyadic level relationships where conflicts may occur.

The outcome of these research efforts is summarised in a forthright book titled *Deconstructing the "Democratic Peace": How a research agenda boomeranged* by Michael Haas (2014). From the outset Haas asserts that a persistent failure of peace researchers to agree on a single definition of democracy is one of many deficiencies 'jeopardizing the

¹¹ For definitions of these measures see Gartzke (2007, p. 183).

conceptual validity’ of their research (2014, p. 11). Haas also points to research where democracy is inadequately defined, or the definition is ‘flexed’ to advantage certain outcomes. Haas’ conclusion is that ‘[d]emocratic peace’ researchers should stop ‘trying to guild the lily ... of a worn-out research finding’ and ‘work on issues of practical significance’ instead (Haas 2014, pp. 111-113). Amongst those practical issues Haas includes research on terrorism and inequality, both of which are aspects of my third research question and which are intrinsically linked to what is known as *capitalist peace theory*.

6.2.3 Emergence of a Capitalist Peace Theory¹²

Economic interdependence extends the analysis of state behaviour beyond the realist dictums of military and economic capability to include the role of non-state international agents. Liberal IR scholars were challenged to examine complex interdependency in the context of ‘situations characterised by reciprocal effects among countries or among actors in different countries’ (Keohane & Nye 1977, p. 8) and numerous scholars responded to the challenge. Liberal peace literature is now replete with studies on the pacifying effects of economic interdependence (Mansfield & Pollins (2001); Russett & Oneal (2001); Polachek & Seiglie (2006); Goldsmith (2007); Schneider & Gleditsch (2010); Gartzke & Westwinter (2016). In fact, Erik Gartzke and Yonatan Lupu consider that the relationship between commercial interdependence and military conflict is one of the most examined subjects in International Relations’ literature (2012, p. 115).

¹² Schneider and Gleditsch (2010) date the use of the term Capitalist Peace in social science studies to a 2003 paper by Erich Weede (2003).

This section demonstrates that notwithstanding the high level of scrutiny, the question of economic interdependence and international conflict mitigation is not resolved. One perspective identifies economic interdependence as a key causal factor that can reduce the chance of military conflict, but an alternative assessment is that economic interdependence can be a source of crises and conflict (Copeland 2015, p. 1). Separately there are international system alternatives represented by theories of Marxist and Capitalist Imperialism in which class and modes of production provide the basis for understanding international political and economic relationship outcomes (Brewer 1991). The security consequences of Marxist and Imperialist theories are not examined in the following chapter however I acknowledge one aspect of an associated construct – dependency theory – to be a source of potential bilateral conflict.

Since 2000, the focus of capitalist peace scholarship has been directed towards establishing if there are specific economic factors in international relations that either cause conflict or sustain pacific relations. Further, the studies seek to identify the causal mechanisms that account for such outcomes. In this context a causal mechanism is defined as ‘a portable concept that explains how and why a hypothesised cause, in a given context, contributes to a particular outcome’ (Falleti & Lynch 2009, p. 1143). Most importantly the cause alone does not produce the outcome. Rather, it is its interaction within a particular context that produces a certain conclusion.

Because of different contextual constraints, analysis of causal mechanisms points to the likelihood that international conflict is accounted for by ‘a small number of dyads where one variable has a large effect [and] a large number of dyads where that variable has essentially

no effect' (Beck et al. 2004, p. 388). Expressed more broadly, causal mechanism outcomes are not predetermined but are influenced by the circumstances in which they occur (Falleti & Lynch 2009, p. 1163). Causal mechanism analysis shows how far peace theory scholarship has progressed from Doyle's clear-cut view, just twenty years earlier, that democratic peace theory provides an almost 'empirical law in international relations' (Doyle 1988, p. 662). Doyle's view contrasts with the contextually bounded causation analysis favoured by capitalist peace theorists.

One source of trade-security causal mechanism analysis is Gerald Schneider and Nils Petter Gleditsch's edited book *Assessing the Capitalist Peace* which provides a range of capitalist peace theory perspectives. Chapters by Gartzke and Hewitt (2010), Michael Mousseau (2010) and Erich Weede (2010) examine the dyadic relationship impacts of trade in conjunction with levels of capital market openness, foreign investment and relative economic development. Pre-empting criticism, the editors' introduction questions whether or not contributors have adequately explained the different causal mechanisms purported to influence home and host country foreign policymakers (Schneider & Gleditsch 2013, pp. 3-5). For example, Gartzke and Hewitt's chapter provides empirical support for the conclusion that it is 'economic development and market freedoms rather than political liberty that precipitate interstate peace' (2010, p. 138) but, while highlighting the market-based correlations, the paper provides no understanding of the mechanisms by which the economic forces operate to produce the pacific outcome. Separately, an iconoclastic study by Mousseau asserts that capitalist and democratic peace theories are not mutually exclusive though in his

assessment the capitalist peace ‘effectively accounts for the democratic peace’ (Mousseau 2010, p. 187).

The progressive element of Mousseau’s study was to reverse the dependant variable from conflict to peace. Previous IR security research has examined militarised conflicts by regime type and established the rarity of conflicts between democratic regimes. The dependent variable in that formulation is conflict. Mousseau reversed that and sought to account for enduring peace, not conflict, in the context of broader foreign policy dealings between nations (Mousseau 2010, p. 189). Mousseau argued that a ‘free market’ peace arises because capitalist countries cooperate peaceably in order to access each other’s markets and promote international law (Mousseau 2010, p. 187). Into that free market setting Mousseau introduced a ‘contract intensive economy’ metric as a likely causal indicator of enduring pacific relations (Mousseau 2009).¹³ The paper highlights how countries with high contract intensity also have high levels of mutual cooperation, common foreign policy preferences and ‘as far as the data inform us have never had a single fatality in a militarized confrontation’ (Mousseau 2010, p. 187).

Mousseau conjectured that voter preference may be the causal mechanism sustaining the peace. His assessment was that voters in states with contract intensive economies oblige their leaders to pursue economic growth and facilitate export market opportunities. That mutual obligation fosters a common interest in developing and maintaining global markets and

¹³ See <<http://politicalscience.cos.ucf.edu/wp-content/uploads/2015/03/CINE-2.1-Codebook.pdf>> viewed 4 October 2015.

international regulatory institutions (Mousseau 2010, p. 189). Mousseau's conclusion is clear: domestic economic conditions as reflected in the level of contract intensity provide the conduit to peace. His conclusion is reinforced by the fact that in the study's cohort of democratic states, almost 50% had experienced conflict but no state that engaged in conflict was also a contract intensive economy (Mousseau 2009, p. 82).

The conclusion that economic growth and export market access act as antidotes to conflict is supported by Erich Weede's research into outcomes from settlement terms imposed following the two World Wars (Weede 2010). The punitive reparation terms imposed on Germany in 1919 inhibited its economic recovery and, combined with the Great Depression, produced the poverty and desperation that contributed to the outbreak of World War II (Weede 2010, p. 208). That contrasts with the post-World War II reconstruction of Europe and Japan which facilitated economic development, employment growth and international free trade. Consequently, the vanquished Germans and Japanese became prosperous democratic allies (Weede 2010, p. 209). Weede's empirical evidence supports the conclusion that commercial and economic freedom inherent in transnational capital market integration is a causal peace mechanism. He presents the view that even democracy itself is vulnerable without capitalism, free trade, economic development and prosperity (Weede 2010, pp. 210-211).

Jameson Ungerer's application of Lakatos's *Methodology of Scientific Research Programmes* (MSRP) to democratic peace research (Ungerer 2012) is a notable exception to what are depicted as 'contrived debates' in efforts to identify conflict mitigating causal mechanisms (Crescenzi & Kadera 2015, p. 7). Any attempt to briefly summarise MSRP is

perilous but it is characterised as knowledge-building based on the incorporation of ‘auxiliary hypotheses’ that may be modified in the course of a research project. The objective of an ‘auxiliary hypothesis’ is to progress the research enquiry and secure deeper understanding rather than relying solely on its falsification. Such hypotheses promote research results that may have greater theoretical and empirical understanding of the subject (Ungerer 2012, p. 4).

Ungerer engaged MSRP principles in a paper that traced scholarship on the observed peace between democracies through five successive theories (structural, normative, reverse causality, institutional and economic norms) as alternative explanations (Ungerer 2012, p. 2). Ungerer’s analysis identified the two most promising areas for research within the democratic peace research effort as: 1) the economic norms or contract-intensive markets explanation; and 2) reverse causality studies which centre on the resolution of territorial disputes. He also identified Mousseau’s contract-intensive studies because they explained both the independent (democracy) and dependent (conflict) variables. In Lakatosian terms, the studies were seen to establish ‘excess corroboration’ over previous explanations and provided a ‘progressive problem-shift’ to the research program (Ungerer 2012, p. 23).

Contract intensity scholarship is relevant to my research because FDI projects are contract dependent and contracts must be enforceable. As contract enforceability is often low in developing states, this aspect of FDI has led to the development of alternative dispute settlement mechanisms. Contractual provisions beyond established black letter law have

emerged that include arbitration and mediation obligations (Ungerer 2012, pp. 24-25).¹⁴ These contract mechanisms facilitate large-scale FDI infrastructure projects. Another aspect of MSRP that likely impacts the relationship between FDI and security is its emphasis on the need to reflect both ‘negative peace’ or lack of conflict as well as ‘positive peace’ as factors that sustain peaceful relations. This issue is important in the identification of conflict mitigating causal mechanisms in the network studies cited in the following chapter.

This review of capitalist peace theory development has illustrated analytical efforts to progress relationship understanding beyond broad and abstract claims in the democratic peace theory towards the identification of causal mechanisms. My conclusion is that capitalist peace theorists have fractured the scholarly certainty of Kant’s democratic peace ‘tripod’ as the primary basis for explicating non-conflictual relationship outcomes. That conclusion prompts my pursuit of a deeper understanding of commercially-based causal mechanisms that may impact peace and conflict outcomes. For example, the following section establishes that there are regional variations in conflict outcomes attributable to differences in the intensity of trading relationships. These findings have particular relevance given Australia’s low level of trade and FDI engagement in Southeast Asian.

6.3 Regional peace theory – an Asian perspective

Writing in 2006, Benjamin Goldsmith pointed to irregularities in the efficacy of global peace theory when the broad theory was applied to specific regional economic settings. He noted

¹⁴ Basic standard rules that are generally known and free from doubt. <https://www.law.cornell.edu/wex/black_letter_law>

that Europe and North America have a higher proportion of countries with liberal democracies than do Asia, South America or West Africa. As a result, he reasoned that if regime type is central to the maintenance of peace then regions with a smaller proportion of democracies should experience higher levels of conflict (Goldsmith 2006, p. 534). Using conflict data sets common to other studies that extended back over a century, Goldsmith identified significant exceptions, by region, to the expected levels of conflict. He concluded that ‘regional dynamics clearly make a difference’ (2006, p. 556). His further analysis identified two other significant differences between regional conflict data and global peace theory’s expectations. Those differences related to regime type and levels of economic interdependence (Goldsmith 2006, p. 533).

Goldsmith represented the findings of his analysis through a quotation from an earlier study by Nathaniel Beck et al.:

[T]heories of international conflict that have a one-size-fits-all approach to regions and time periods should be replaced with theories that reflect the highly contingent and context dependent nature of the phenomenon (Beck et al., 2004, p. 380).

Goldsmith’s subsequent paper titled *A Liberal Peace in Asia?* presented an empirical application of peace theory principles to the Asian region. Its findings further confounded the global democratic peace orthodoxy. Goldsmith employed a wide territorial definition of Asia

by including Central Asia and Australia (as part of Oceania).¹⁵ Moreover, his 1950-2000 timeframe included both the Cold War and post-Cold War eras. A significant citation count indicates the paper's relevance to regional peace theory studies.

Goldsmith found that democracy was not a significant factor in modifying *intra-regional* relationships (Goldsmith 2007, pp. 14-17). He also established that shared IGO membership was not significant and even tended to correlate with an increased incidence of interstate conflict, although he moderated this finding concerning IGOs in relation to ASEAN membership because ASEAN had a role in reducing military conflict within its membership cohort (Goldsmith 2007, pp. 11-14). Goldsmith's study also established that bilateral treaties or mutual defence pacts had no relevance in regional relationships during the study period. In fact, defence pacts were so rare in Asia that Goldsmith dropped them from his regional dyadic equations (2007, p. 21).

One of Goldsmith's findings is especially relevant to my FDI-security hypothesis. His analysis illustrated that total trade and trade dependence *between* Asian dyads was significantly higher than that with non-Asian trade partners.¹⁶ Furthermore, he established that in the Asian region 'trade dependence is robustly associated with lower conflict' (Goldsmith 2007, p. 18). Goldsmith's findings that trade and trade dependence were a source of dyadic relationship conciliation in Asia are robust, but a level of conjecture remained as to the actual causal mechanism/s responsible for that outcome.

¹⁵ Central Asia consisted of post-1991 former Soviet republics Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan

¹⁶ Trade interdependence measures based on Gleditsch (2002)

Goldsmith's finding of lower conflict between trade dependent states in the Asian region was extended in a study by Yonatan Lupu and Vincent Traag that examined the negative externalities of conflict between states that were members of a trading community.¹⁷ This study extended trade-security analysis beyond the dyadic relationship level to an analysis of the extra-dyadic costs of conflict to other members of the trading community, even if there was no direct trade dependency between each individual member of the trading community (Lupu & Traag 2012, p. 1012). This study introduced network analysis tools to examine the complexity of network interdependence. It also illustrated how a dyadic conflict event would impact other member states and that interdependence served to decrease the probability of conflict within the community (Lupu & Traag 2012, pp. 1033-1034). These and other mechanisms provide the basis for development of my hypothesis concerning the relationship between FDI and security in the next chapter.

6.4 Summary

This chapter's review of the temporal and theoretical evolution of peace theory provides the foundation on which my analysis of FDI's likely security impacts in the following chapter is based.¹⁸ From its 1795 origin in Kant's *Perpetual Peace: A Philosophical Sketch* to its recognition in security studies during the 1980s, the democratic peace theory has given rise to capitalist and regional peace variants that seek to better explain the source and maintenance of non-conflictual international relations.

¹⁷ A trading community is defined as those states that trade significantly more with each other than with states outside the community (Lupu & Traag 2012, p. 1014).

¹⁸ Not every study in the evolutionary progress of trade-security/capitalist peace literature has been acknowledged in this chapter. A chronological summary of further relevant studies is set out in Appendix II.

In Asia, trade interdependence with fellow Asian states relative to other trading partners, is identified as the primary determinant of pacific relationships (Goldsmith 2007, p. 18). Lupu and Traag (2012) corroborate the robust finding of trade being instrumental in trading community conflict avoidance. That finding seemingly has application in a community such as ASEAN. These trade-security findings contribute a significant element to the development of my FDI-security hypothesis which examines what role FDI could have in transnational conflict mitigation. That question is addressed in the next chapter.

Chapter 7: Trade-security theory – the basis of an FDI-security hypothesis

7.1 Introduction

My objective in this chapter is to develop and qualitatively assess a hypothesis concerning the relationship between FDI and security. Using a deductive reasoning process, I consider whether FDI can be substituted for international trade as the independent variable in established trade and related security theories. My analysis proceeds by identifying the conflict mitigating causal mechanisms that have been identified in trade-security research and then assessing whether FDI might activate the same conflict mitigating mechanisms. If so, FDI would likely create similar conflict avoidance outcomes.

I examine six potential conflict mediating mechanisms and find that in five of those cases the inferential finding is that FDI may have at least equivalent conflict moderating effects. This analysis involves deductive reasoning rather than empirical assessment because there is no source of FDI statistics from developing states that is reliably constructed or based on comparable source data available to conduct an empirical substitution of FDI for trade. The extent of FDI data limitations is recognised by UNCTAD in its assessment that available FDI data ‘often does not meet the required standard for the purpose of rigorous policy analysis,’ particularly in developing countries (Fujita 2008, p. 107). Since there have only been significant FDI flows to developing countries since the 1990s, this relatively brief post-globalisation period is another constraint on the availability of data, and therefore on my ability to conduct an empirical analysis of FDI security effects.

My analytical focus is on the security effects attributable to economic interdependence and on the actor-agency impacts of FDI because those impacts help to answer my third research question, which asks whether Australian FDI can help mitigate Indonesian sourced threats to Australia's security. The chapter begins with a review of the limited literature that examines the security impacts of FDI even though, as highlighted in the section following that review, FDI is now the largest source of global development capital. Section 7.4 presents my assessment of the likely security impacts when FDI is substituted for trade in six trade related security theories.

7.2 FDI and security – literature review

To illustrate the limited focus on FDI's contribution to international security outcomes I searched *Google Scholar* for all papers with 'FDI' or 'foreign direct investment' and 'security' in the title between 1990 and 2016. The search yielded seventy results. For 'trade and security' the search yielded more than 1600 results. Similarly, a search of *Econlit* with the same criteria came up with only fourteen hits for FDI but 179 hits for trade and security. Finally, a *Library Search* of the World Bank and IMF catalogue identified only seventeen papers that incorporated FDI/foreign direct investment and security in the title but 437 publications for trade and security. This disparity is remarkable given the post-1990 surge in global FDI stock values.

As noted above, the dearth of conflict data available to test the FDI-security proposition may be one explanation for the lack of published studies. In security analysis, conflict is usually defined in terms of either war or militarised interstate disputes (MID) based on the Correlates

of War Project data.¹ But across the post-1980s period there are too few militarised interstate disputes to allow meaningful empirical analysis (Polachek et al. 2011, p. 24). To overcome the lack of MID data, Polachek and co-authors adopted a ‘second-generation protocol called Integrated Data of Events’ in which a ‘conflict’ metric was derived from Virtual Research Associates’ analysis of media reports on bilateral interactions. This process identified bilateral conflict and cooperation events and scaled them by significance to establish a database of dyadic *net conflict* metrics (positive or negative). The authors acknowledged the measure had shortcomings in terms of event weightings as well as duplicated and misreported events, yet they adopted this metric in the absence of any meaningful alternative (Polachek et al. 2011, pp. 23-27). Nevertheless, the study is one of few to examine the issue and its findings are significant to my thesis question because it concluded:

Our empirical results indicate that trade and FDI each independently have a very similar role in promoting peace and reducing conflict, though the effect of FDI appears to be marginally larger than trade ... The results indicate that a 10% increase in trade will on average lead to a 7.68% decrease in conflict (Polachek et al. 2011, pp. 33-34).

In another significant study Margit Bussmann identified what she called a ‘shortcoming’ by peace research scholars in that they focus on trade to the exclusion of FDI (Bussmann 2010, p. 143). Bussmann’s research illustrated both the rapid change in scale of FDI stocks in the

¹ See < <http://cow.dss.ucdavis.edu/data-sets/MIDs> >

1980-2002 study period and the ‘drastic rise’ (Bussmann 2010, p. 143) during the 1990s of FDI stocks in developing countries. Her paper tested whether the economic integration premise of liberal peace theory was sustained if each form of foreign direct investment – inflow, outflow and stock – was used as a proxy for trade intensity. The outcome was strongly affirmative and became even more persuasive with higher levels of FDI. She concluded that ‘pairs of states that have high FDI inflows and levels of FDI stocks are less likely to experience the onset of a militarised dispute’ (Bussmann 2010, p. 152).

Hoon Lee and Sara Mitchell examined the security effects of FDI in the context of globalisation era changes in investment patterns in a study that I will not review in detail here because its potential conflict mitigating causal mechanisms findings are included in my hypothesis testing later in this chapter. However, Lee and Mitchell identified increased opportunity costs of violence and improved information signalling between states with dyadic FDI investments as inferential conflict mitigating FDI mechanisms (Lee & Mitchell 2012, p. 697).

The final study in this review of the post-globalisation security impacts of FDI is a 2009 Working Paper by Ceren Altincekic. Altincekic took the data set used in Gartzke’s 2007 study discussed in Chapter 6 which concluded that capitalism rather than democracy was the source of peace, and extended Gartzke’s research by asking what aspects of ‘capitalism’ were at work (Altincekic 2009, p. 9 footnote). In the original paper, Gartzke concluded that trade was inadequate as a proxy for economic interdependency because, notwithstanding trade as a proportion of global GDP being at almost unprecedented levels in the decades preceding the two world wars, it did not thwart the outbreak of those conflicts (Gartzke 2007, p. 3). In his

analysis, Gartzke had sought an alternative measure to trade intensity to indicate economic interdependency. He settled for ‘financial openness,’ which he argued was central to ‘modern’ economic globalisation, as the appropriate alternative (Gartzke 2007, p. 4). By contrast, Altincekic judged that ‘financial openness’ was too broad. Instead she narrowed the ‘openness’ proxy down to flows of foreign portfolio investment (FPI) and FDI because they constitute the largest values in international capital transactions. Gartzke’s data was then reanalysed across the full range of democratic and capitalist peace theory variables – level of democracy, level of development (GDP per head), trade dependency, financial openness and contiguity, as well as the new FPI and FDI proxies (Altincekic 2009, pp. 9-12).

Altincekic’s research had two notable findings: the first was that trade, as a dyadic relationship indicator was ‘insignificant throughout the models’ (Altincekic 2009, p. 10); the second was that capital openness especially FDI ‘engenders the peaceful atmosphere that many states have enjoyed in the post-WW2 era’ (Altincekic 2009, p. 4). In her concluding observations Altincekic posited the existence of an ‘FDI peace’ in which the greater the level of direct bilateral investment the lower was the prospect of militarised disputes, and surmised that FDI offered a clearer path to stability in distraught countries than democracy (Altincekic 2009, p. 16). Albeit, this study’s findings are of a correlative rather than causal relationship.

These studies are relevant to my FDI-security analysis as each indicates that FDI has some dyadic conflict mitigating effect. However, apart from Lee and Mitchell’s (2012) research, the papers provide little understanding of the causal mechanisms that promote the pacific outcomes. My hypothesis seeks to add to the understanding of those mechanisms, but first it is important to distinguish the scale of FDI’s significance in the global capital market.

7.3 Why FDI matters

While foreign direct investment and international trade are entwined in certain circumstances, the central premise of this chapter is that FDI and trade are for the most part not coterminous commercially or in terms of their security impacts. To the extent that they are coterminous, as in global value chain (GVC) based trade flows, I argue that FDI serves to compound the trade-security benefits identified in the previous chapter.² These two commercial functions are distinctly different. International trade is characterised by time bound, arms-length contracts for exchange of ownership in goods or services between one economy and another.³ Trade contracts may extend from occasional, short-run, cross-border manufacturing contracts to decades long take-or-pay commodity contracts and just-in-time, multi-jurisdictional supply chain contracts for the manufacture and assembly of complex consumer products.

Those characteristics contrast with the hallmarks of an FDI venture, which requires an enduring commitment to ownership of at least 10% (but typically more than 50%) of the capital and operational management control of a foreign domiciled venture.⁴ Such a definition is not especially helpful as it does not provide any real understanding of the inception and ongoing demands of an FDI project. For instance, FDI has different forms that range from joint ventures with local partners, to ‘brown field’ ventures that involve the

² Global value chain or GVC refers to international production, trade and investment where different stages of the production process are located across different countries. <http://www.oecd.org/sti/ind/global-value-chains.htm>

³ <https://data.oecd.org/trade/trade-in-goods-and-services.htm>

⁴ <http://www.oecd.org/daf/inv/investmentfordevelopment/2487495.pdf>

acquisition of an established offshore enterprise, to FDI start-up ventures known as ‘green field’ investments.⁵

Likely differences in economic development and relationship impacts of different project types are examined in Chapter 9, but what is immediately relevant is that all forms of FDI make equivalent commercial demands on a multinational corporate (MNC) investor. The common threshold requirement for an FDI project is an exhaustive and costly feasibility and due diligence study. Before a project can proceed a company must invest (all or some of) the establishment or acquisition capital, plus equipment, technology, management and process know-how to launch and operate an offshore venture. This is known as the *sunk cost* because little if any of it is recoverable if a project fails or is sequestered.⁶

When operational, the company’s directors and executives become responsible for everyday financial and management demands, regulatory compliance, staff recruitment and training, sourcing inputs and securing contractual commitments for the enterprise outputs – often known as the *barriers to exit* (Buckley & Casson, 1998; Meyer & Estrin, 2001).⁷ Unlike international trade, FDI requires an enduring commitment of corporate resources to an ongoing foreign domicile venture. The guardianship of these offshore financial and operational assets typically compels executives of FDI ventures to engage with host country

⁵ *Business Dictionary*, <<http://www.businessdictionary.com/definition/greenfield-investment.html#ixzz45Td2fi mA>>; <<http://www.businessdictionary.com/definition/brownfield-investment.html#ixzz45ToB0sbx>> viewed 4 April 2016.

⁶ *Sunk costs* are past capital and associated outlays amortised/depreciated according to accounting standards. Termination or impairment of a venture requires *sunk costs* to be charged against profit in that year. <https://www.accountingtools.com/articles/what-is-a-sunk-cost.html>

⁷ <https://www.investopedia.com/terms/b/barriers-to-exit.asp>

governance regimes more intensively than applies in an arms-length trade relationship (Kellogg 2015).

There are other major aspects of post-1980s FDI flows that reinforce its potential international relationship impacts. These aspects are:

- i. FDI is now the largest source of external finance for developing economies (UNCTAD 2017, p. x).
- ii. Annual FDI investment flows to developing economies (DEs) have increased from less than 10% in the 1990s to about 50% in recent years. (UNCTAD 2016, Annex Table 04).
- iii. The operational effect of (i) and (ii) above is that for many MNCs the proportion of total company assets invested in DEs is such that corporate executives become agents in home and host country economic and foreign policy deliberations.

Table 7.1 below illustrates the changed status of FDI as a global source of development capital since 1990. During that time global foreign direct investments has increased from being equivalent to 10% of global gross domestic production (GDP) to a value equivalent to 32% of global GDP in 2013 (UNCTAD 2016). As the table indicates, the value of global FDI stocks in 2013 exceeded the value of global trade. That difference has widened and by 2016 global FDI stocks were valued at \$US26.7 trillion ($10^{12\text{th}}$), well in excess of the \$US17.3 trillion export trade flows that year. While those metrics are not directly comparable because FDI stock is a cumulative value whereas trade is an annual flow value, the comparison nevertheless highlights the rapid growth of FDI as a source of global development capital.

	1990	2000	2010	2013
FDI stock/global GDP % *	10	22	31	32
Trade pa/global GDP % **	19	24	29	31

Table 7.1 Global trade flows pa & FDI stock as a proportion of global GDP (Source: *UNCTAD 2016 <<http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx>>; ** World Bank 2016 <<http://data.worldbank.org/indicator/NE.IMP.GNFS?locations=1W>>)

A further illustration of FDI's unheralded transformation in global and corporate importance is evident when the value of global FDI stock is compared with the total value of worldwide company and pooled fund assets. The quality of source data for some of this analysis is uncertain, but my best estimate based on the commercial data sources and estimates set out in Appendix III, is that foreign domicile assets are in the order of 50% of the aggregate book value of total worldwide corporate and pooled fund assets.⁸ The data uncertainty arises from an inability to validate adequately the commensurability of data from different sources of global assets owned by foreign investors, especially as the range of foreign direct investors extends well beyond corporations to include pooled investment entities such as venture capital, private equity, real estate, infrastructure and commodity funds that hold more than 10% equity and are actively engaged in managing a foreign investment.

The second aspect of post-1980s FDI that is not yet reflected in IR security literature is the potential impact major changes in the location of FDI holdings could have on dyadic relationships. As will be discussed in Chapter 9, a noticeable reorientation of global FDI flows occurred following the UN Monterrey Consensus Summit in 2000. Many influences

⁸ Corporate domicile being the state where a company's headquarters are located.

beyond the UN Summit will have shaped FDI location selections but following the Summit's endorsement of private direct investment as an initiative to improve development financing and aid effectiveness in emerging economies, the proportion of annual global FDI flows directed to developing countries has more than doubled (Gestrin 2016, p. 51). In the period since 2012 about half of annual global FDI flows have been directed to developing countries (UNCTAD 2016, Annex table 01).

The significance of this change is evident in global FDI metrics. Prior to 2000, the longstanding practice was for more than 90% of global FDI investments to occur in economically developed countries. With limited exceptions, wealthy country MNCs invested in other wealthy countries. But since 2000, the major redirection of annual FDI flows to developing economies has rebalanced FDI stocks so that by 2016 almost 24% of total global FDI stock was located in developing and transition economies (UNCTAD 2016, Annex Table 04).

Operationally the changes in scale and location of recent FDI flows have major implications for investing companies. The simple metrics are that on average about 50% of total global corporate assets are located in a foreign jurisdiction, and of those foreign domicile assets, 24% are, on average, located in developing countries.⁹ Therefore, on average, every company has about 12% (i.e. 50% of 24%) of its corporate assets located in a developing or emerging economy. In practice of course, many companies have no FDI assets, which means that some

⁹ Importantly, FDI in DEs is not concentrated in any one developing country. For example, FDI in China as a proportion of global FDI increased only from 8.4% in 2000 to 11.1% in 2016. (<http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf > pp. 226-227)

companies have a far more substantial part of their total corporate worth invested in developing economies.

Table 7.2 highlights the scale of extra-jurisdictional holdings by major MNCs. This UNCTAD data reveals that collectively the top one hundred global MNCs have on average over two-thirds of their total corporate assets located outside their home economy. Regrettably the specific geographic disposition of these investments is not published (UNCTAD 2016, Annex Table 24).

Corporation	Foreign	Total	Foreign %
	US\$m	US\$m	
Royal Dutch Shell plc	349,720	411,275	85
Toyota Motor Corporation	303,678	435,958	70
BP plc	235,124	263,316	89
Total SA	233,217	243,468	96
Anheuser-Busch InBev NV	208,012	258,381	81
Volkswagen Group	197,254	431,888	46
Chevron Corporation	189,116	260,078	73
General Electric Co	178,525	365,183	49
Exxon Mobil Corporation	165,969	330,314	50
Softbank Corp	145,611	220,296	66
Vodafone Group Plc	143,574	165,367	87
Daimler AG	138,967	256,127	54
Honda Motor Co Ltd	130,067	169,537	77
Apple Computer Inc	126,793	321,686	39
BHP Billiton Group Ltd	118,953	118,953	100
Nissan Motor Co Ltd	116,612	164,734	71
Siemens AG	115,251	140,309	82
Enel SpA	111,240	164,010	68
CK Hutchison Holdings Limited	110,515	130,677	85
Mitsubishi Corporation	107,860	140,879	77

Table 7.2: The world's top 20 non-financial MNEs, ranked by foreign assets, 2016
(Source: UNCTAD 2016: Annex table 24).

One implication of MNCs having substantial corporate assets located in developing countries is that it can motivate corporate agent engagement in home and host country security and foreign policy development. Process tracing analysis discussed below supports the expectation that executive custodians of foreign domicile MNC assets have in some circumstances influenced international relationship outcomes (Kellogg 2015).

Taken together, the scale of these three FDI stock metrics – a value in excess of annual global trade, on average about 50% of global corporate assets domiciled outside the home jurisdiction, and the growing concentration of new FDI investments in developing economies – indicates that the potential for FDI to influence security warrants analysis by scholars and foreign policy makers. For clarity, my hypothesis is not that the scale of FDI alone creates new security externalities. Rather it is the scale and location of FDI to developing economies that may have new security impacts.

7.4 Constructing and testing an FDI-security hypothesis

7.4.1 Introduction

The previous chapter's review of trade-security theory illustrated the deepening theoretical appreciation of the factors that impact security outcomes in situations of economic interdependence. The objective of this section is in a small way to redress the inattention to FDI's possible security impacts by examining six conflict mitigating mechanisms from trade-security theory and, using a qualitative assessment, identifying the likely security outcome when FDI is substituted for trade as the independent variable. The six trade-based causal mechanisms are: opportunity costs; network interdependence; costly signalling; corporate

engagement in government policy; community awareness of economic dependence; dyadic trade expectations.

My approach to this analysis is, where practicable, to mirror the trade-security process that established the causal mechanisms, but there are some inconsistencies. Liberal trade theorists typically treat all trade equally in terms of economic impacts and conflict effects (see, for example, Mansfield & Pollins 2001 and Oneal & Russett 1999). In practice that is unlikely to be the case for either trade or direct investments. For example, a state's reaction to the prospect of losing a vital trade supply contract for energy, food or water will be markedly different to the prospect of losing a standard merchandise trade relationship.

That assumption of uniformity in trade's impact contrasts with recognised variations in FDI's anticipated host country contribution. In developmental economics literature FDI's economic contribution is typically analysed in four broad sectoral categories: infrastructure, extractive industries, manufacturing, and services. Studies recognise variability in each sector's likely contribution to host country economic development outcomes (Moran 2011). FDI backed infrastructure projects are most consistently observed to yield positive host country development outcomes, while extractive industry ventures (resources or agriculture) are most likely to have negative economic, social or environmental impacts (Moran 2011, pp. 26-27). Notwithstanding awareness of the different potential economic benefits and likely differences in security relationship outcomes, the absence of conflict data currently limits the possibility of conducting sector-specific analysis to test for differences in security outcomes. My analysis points to the opportunity for future research to establish if sectoral FDI has particular dyadic relationship outcomes.

In the absence of established differences in security impacts by FDI sector, my analysis proceeds on the premise that the economic effects of each sector are assumed to be equivalent. There are three further FDI specific assumptions that are implicit in my analysis. First, that host countries have adequate absorptive capacity, including workforce training, education and physical infrastructure, to retain the economic benefits of the FDI ventures. Second, that FDI projects are positively integrated with host country development priorities. Third, that host countries have appropriate fiscal and monetary policy settings to capture FDI productivity and technology spill-over benefits and avoid adverse currency and balance of payments impacts that give rise to the ‘Dutch disease’ or resource curse.¹⁰

The analysis proceeds by examining individually each of the six conflict assuaging factors. My expectation that FDI’s security impacts may be equivalent to those of trade is founded on the proposition that the markedly greater commercial risk exposure for home country investors and the cost to host country counterparts, their employees and a host country national economy is significantly greater for an FDI venture compared to that of a trade contract. Conceptually, an FDI project that constitutes X% of a host nation’s annual capital

¹⁰ Dutch disease is the negative impact on an economy of anything that gives rise to a sharp inflow of foreign currency. The currency inflows lead to currency appreciation, making the country’s other products less price competitive on the export market. It also leads to higher levels of cheap imports and can lead to deindustrialisation as industries apart from resource exploitation are moved to cheaper locations. The origin of the phrase is the Dutch economic crisis of the 1960s following the discovery of North Sea natural gas: *FT.com/lexicon*, viewed 25 March 2016 <<http://lexicon.ft.com/Term?term=dutch-disease>>

formation has at least equal if not greater economic significance than a trade contract that constitutes X% of the nation's annual international trade.¹¹

Moreover, the sunk cost impact on reported corporate profits if an FDI project becomes impaired together with continuing barriers to exit will likely motivate MNC executives to sustain pacific relations. Likewise, adverse impacts on host country private and state beneficiaries of an FDI venture combine to elevate maintenance of a non-conflictual FDI relationship above that established in trade relationships.

7.4.2 The hypothesis

If FDI is substituted for trade as the independent variable in six trade-security theories the conflict mitigation outcomes will be theoretically equivalent to those of trade.

7.4.3 Opportunity costs

Ricardian principles of national economic comparative advantage provide the theoretical ground on which liberal arguments for international trade, foreign investment and economic interdependence are based. David Ricardo's 1817 thesis that a nation's economy is advantaged by making and exporting goods and services in which it has a comparative advantage, and importing goods and services where it is comparatively disadvantaged retains its relevance.¹² Ricardo's thesis provides an appreciation of the opportunity cost issue in

¹¹ Capital formation is the net annual addition to a state's capital stock <<http://www.investopedia.com/terms/c/capitalformation.asp>>

¹² <http://lexicon.ft.com/Term?term=comparative-advantage>

trade-security studies because it highlights the adverse consequences that follow if conflicts constrain international commerce. In short, both parties lose their trade benefits.

Of itself though, the commercial loss will only serve to mitigate conflict if that loss together with the cost of a military conflict – the full opportunity cost – is greater than the potential benefits available from the military contest. Stated another way, opportunity costs should act to moderate conflict in circumstances where the costs of lost trade and the military adventure are likely to exceed the rewards of a military conquest. As such the cost of waging war is linked to the level of trade: a high trade level relative to GDP produces a high cost of war. Conflict is unlikely if states judge prospective conflict losses to be greater than the value at stake in a dispute.

The application of opportunity cost theory has the same foundational premise for both trade and FDI. Commercially both trade and FDI provide access to resources. While trade theory recognises trade as a mechanism that forestalls the resort to territorial conquest as the basis for securing access to resources, FDI provides a more unambiguous alternative. FDI in each of its four types (infrastructure, extractive industries, manufacturing, services) secures access to resources in the form of commodities, reduced factor input costs or access to market opportunities. The opportunity cost distinction between trade and FDI derives from the latter's direct operational ownership, which entails tangible and intangible commitments that are not inherent to an arms-length transnational trade relationship.

The FDI opportunity cost overlay is attributable to both the sunk costs and barriers to exit and consequentially has both home and host country effects. For example, conflict imperils

home country owned FDI assets that may be forfeited or damaged. Equally, a host country forgoes access to FDI's technology spill-over benefits and incurs 'blow-back' costs in the form of lost tax revenue, higher unemployment, loan defaults and the loss of FDI associated trade revenue. These aligned incentives strengthen the mutual conflict avoidance resolve of home and host country elites and political leaders. In summary, the aggregate tangible and intangible value of lost resource access and FDI benefits represents substantial additional conflict constraining opportunity costs relative to trade. Conflict will not ensue if forgone trade (and FDI) benefits of a militarised conflict are likely to exceed the rewards of conquest (Kim 2013, 895).

7.4.4 Network interdependence

Introduction of network studies to trade-security analysis has established that trading partner decisions in states that are subject to potential conflict vary and are contingent upon possible alternative trade relationships with multiple other states. These studies extend international trade relationship analysis beyond the level of the conflict dyad and examine relationships in the context of a more real-world network of multiple trading partnerships (Gartzke & Westwinter 2016). Network studies allow both the trade and security response of one state to be contingent upon the actions of multiple other states. As a result, the reciprocal effect among a network of many trade relationships creates the potential for multiple security outcomes. Each state's individual set of trading relationships within the overall network will impact its conflict tolerance and thereby result in different dyadic security responses across the network (Gartzke & Westwinter 2016).

Network studies indicate that states in a mutually reliant interdependent dyadic trade relationship have less martial conflict but experience more non-military disputes because trade disruptions can act as a substitute for military action (Gartzke & Westwinter 2016, pp. 327-328). However, in the specific case of an asymmetric trade dependency, a dependent state could be exposed to coercion and military conflict. Gartzke and Westwinter reason that it is possible in such circumstances for a vulnerable state to initiate other dyadic trade opportunities that enable it to substitute its trade dependence away from the coercive relationship and diminish the original dependency risk (2016, p. 326). In this construct each state's individual trade relationships shape its overall conflict tolerance. More broadly, economic network analysis opens a new basis for examining the 'multiple causal pathways though which commerce operates on war and peace' (Gartzke & Westwinter 2016, pp. 339-340).

I argue that when FDI is substituted for trade in a network context the security outcomes for developing economies specifically can be adverse. For example, even in a trading relationship where a state has a dependent trade relationship and is subjected to coercion by the trade adversary, conflict can be avoided by establishing alternative trading associations. With FDI, a host country that is dependent on one or a small number of FDI ventures is probably unable to deflect an aggressor by attracting new FDI investors. In those circumstances FDI can create and sustain a host country dependency that has potentially adverse economic and security consequences.

Such circumstances characterise dependency theory literature which generally argues that low income states are exploited by developed states that exercise control over factors on

which low income states depend (Evans & Newnham 1998, p. 122). That control may be exercised by restricting access by producers in developing economies to global commodity markets, imposition of tariffs, creating aid dependencies or through exploitative FDI ventures. In this context, unlike with a trading relationship, the dependant host state may be unable to diversify away from the exploitative relationship because the developed state control is overwhelming (Ferraro 2008, pp. 59-60). In summary, FDI by a developed home state in a low income economically dependent DE host state may serve to increase the security and economic vulnerability of the host state. This negative dependency aspect of FDI is examined in more detail later in the thesis.

7.4.5 Costly signalling

A less intuitive conflict mitigating causal mechanism in trade-security theory is costly signalling. Signalling theory is drawn from the bargaining model of war in which conflict is primarily attributed to asymmetrical assessments by potential belligerents of information on their respective depth of commitment to the use of force. Signalling theory is an established element in the scholarship on war, deterrence and security alliances, but scholars have extended its application to the effects of global capital markets on issues of inter-state contestation (Gartzke & Li 2003, p. 567). The 2003 study by Gartzke and Li incorporated signalling theory as a mechanism by which global economic integration could impact international relations. In principle, the role of signalling is to provide states in a potential conflict with the capacity to communicate relevant facts in a credible manner. ‘Costly signalling’ occurs when states know there is an expensive consequence, and that reduces the incentive for negotiators to bluff (Gartzke & Li 2003, pp. 565-566). Gartzke and Li posited

that signalling provided a less costly yet effective alternative mechanism to military force by which states could pursue their national interests and that this explained how ‘globalisation or economic integration promotes peace’ (Gartzke & Li 2003, p. 562). The authors were cognisant of the extent to which their conclusion stood in contradistinction to realist orthodoxy in IR scholarship and acknowledged the dismissive view of globalisation’s impacts on international relations presented by realist scholars such as Kenneth Waltz (1999; 2000). The extent of the contrast was at its most extreme when Gartzke and Li proposed that even individual MNCs can have impacts on international affairs (Gartzke & Li 2003, p 562).

In this context, high economic interdependence increases the mediums through which states can demonstrate their resolve by initiatives such as imposing bilateral trade sanctions that harm consumers but assist conflict preparedness. Such signals reduce uncertainty about the resolve to use force and thereby temper the ambitions of aggressive opportunists (Copeland 2015, p. 21). Signalling theory mechanisms extend beyond opportunity cost considerations and incorporate such variables as democracy, levels of trade dependence and the degree of capital market openness (Copeland 2015, 64).

Theories of costly signalling and the value of limiting information asymmetries between potential belligerents suggest that FDI’s embedded increase in economic and cultural interdependence will also provide a medium through which states can convey such signals. For example, capital market openness is recognised in trade security literature as an important medium for signalling conflict resolve (Kim 2014, p. 898), but in practice, capital market openness is not a critical aspect of a transnational trading relationship because third party transaction settlement is not uncommon. By contrast, capital payments for an FDI

venture are dependent on a host government commitment to an open and liquid capital market in order for a major FDI project to proceed, especially in a developing economy (Regan 2017, p. 1). Consequently, maintenance of a functioning capital market is an important additional signalling tool in an FDI-security setting.

7.4.6 Corporate political engagement

The prospect of corporate officer engagement in the development and implementation of home and host country public policies is a little studied aspect of trade-security theory. A notable exception is research by Anita Kellogg that examined events in Central American over a twenty-five-year period to 2010. Kellogg identified how corporate officials were able to influence public policy and reduce militarised interstate disputes (MIDs) between Colombia and Venezuela during those twenty-five years (Kellogg 2015). Using a process tracing methodology Kellogg illustrated how directors and executives of MNCs in both countries participated in public policy implementation to achieve peaceable outcomes.

Noting the rarity of qualitative techniques in trade-security research, Kellogg argued that the threat of militarised conflict between interdependent economic states may be moderated if economic elites engage with state policy makers in their respective countries. What Kellogg's study of Colombia-Venezuela relations illustrates is that achievement of the non-conflictual outcome over two decades was largely a function of corporate executives gaining access to sources of domestic power in both countries. That access was via political party connections, formal institutional consultation, and recruitment of business representatives into government administrations or election of executives to government office (Kellogg

2015, pp. 5-6). Kellogg identified the links between corporate and government officials in both countries and illustrated the institutionalised pathways by which corporate executives and their professional business associations influenced the making of public policy. This analysis extended political economy research into the structural issues and social coalitions that influence domestic economic policy outcomes. Kellogg's study also canvassed the role of domestic business in interstate bargaining when conflict arises (Kellogg 2015, pp. 29-30).

The outcome of these elite level corporate-political agency relationships was a transformation of Colombia-Venezuela history from one of recurrent cross border military confrontations to a period of cooperation and bilateral institution building. The amity persisted until, in 2009, Venezuelan President Chavez 'eliminated all pathways for economic elites to meaningfully participate in the political process' (Kellogg 2015, p. 30). The outcome of Chavez's decision was, in a reasonably short time, a return to the past pattern of interstate cross border hostilities. This raises the question of whether greater direct investment, in addition to the trade interdependence, could have sustained the non-conflictual relationship. This outcome seems plausible given that investors with higher sunk costs and barriers to exit would find stronger commercial and political incentives to mitigate bilateral conflict.

Less formal evidence of engagement by MNC representatives in the process of territorial dispute mitigation appears in a study by Lee and Mitchell (2012). The study provided examples of companies with commercial interests that were potentially jeopardised by territorial conflicts 'lobbying their respective governments for a peaceful resolution of the disputed issues' (Lee & Mitchell 2012, p. 698). One example was the Croatian EU Business Council exerting pressure on Croatia and Slovenia to settle their 2009 territorial dispute by

mediation or reference to the International Court of Justice (BBC News, March 3, 2009). The other was the role of the Thai Chamber of Commerce ‘repeatedly’ admonishing the Thai government about the cost of its failure to settle a border dispute with Cambodia (The Nation Thailand, November 13, 2009).

These examples of home and host country political engagement by corporate executives as a conflict mitigating causal mechanisms are cited in trade-security literature. I assert that corporate executives responsible for foreign domicile investment projects have a greater *prima facie* incentive to engage in home and host government relational activities designed to avoid conflicts than trading company executives. In this instance the trade sourced causal mechanism of executive agency activity is clearly identified. Substitution of FDI for trade in these circumstances illustrates the probability that FDI will generate an equivalent conflict mitigating causal inference.

7.4.7 Community awareness of economic interdependence

Community awareness of likely economic impacts of conflict is another causal factor in conflict mitigation due to agency influence on government decision making. This issue is tested in a Japanese survey of community responsiveness to conflict tolerance in a situation of significant economic interdependence (Tanaka 2017). The survey provides a further example of a trade-security issue with potential FDI-security cross-over implications. The findings are based on a large *n* survey of public responses to the issue of Sino-Japanese relations and establish that both actual trade interdependence and community awareness of that interdependence are required in order to modify a dyadic conflict disposition. The survey

by Seiki Tanaka, Atsushi Tago and Skrede Gleditsch (2017) presented 1751 Japanese consumers with five hypotheses relating to Japan-China economic interdependence.

Tanaka et al.'s hypothesis was that economic interdependence by itself may not constrain political leaders unless there is also public awareness of the high economic cost that would result from a conflict. This survey had two notable outcomes. The first was that even in circumstances of established acrimonious relationships, hostility can be diminished if informants are educated on the level of economic interdependence. Once respondents were aware of the interdependent relationship, support for military action diminished markedly. While the survey outcome illustrated the potential for economic engagement to influence public preferences, the authors pointed to a second issue which precluded the ability to generalise this finding. What was untested in the study was the degree to which political leaders are responsive to community support for conflict avoidance. While greater community awareness of economic interdependence moderated community support for conflict, it was far from clear whether or not interdependence, and community awareness of that interdependence, moderated the actions of government and foreign policy officials (Tanaka, Tago & Gleditsch 2016, pp. 51-4).

Other studies, however, have indicated that community awareness can modify conflict potentiality. First, democratic peace theory studies have established that, at least within democracies, community regard for foreign policy issues and foreign policy decisions have influenced electoral outcomes, and that community regard for bilateral economic interdependence is unlikely to be dismissed (Aldridge, et al., 1989; Gelpi et al. 2007; Gronke et al., 2003). Second, Kellogg (2015) showed that conflict-oriented activities can be

moderated by the engagement of home and host country agents. While Kellogg's findings were specific to the agency role of corporate executives, it is likely that citizen groups impacted by potential conflict would have an equivalent impact.

In summary, community awareness of employment, training and other spill-over benefits that flow from effective FDI ventures is arguably a further example of the potential for FDI to incline conflict avoidance in at least an equivalent manner to trade. That view is supported by the prospect of heightened community responsiveness if the additional cost of an imperilled FDI venture such as lost employment, foregone technology access and diminished government tax revenues are published.

7.4.8 Dyadic trade expectations.

The sixth pacific causal mechanism identified in trade-security theory that may give rise to a similar FDI causal inference is the impact of changes in dyadic trade expectations. Dale Copeland's finding was that unilateral adverse changes in a trading relationship had a 'prominent or decisive causal role' in explaining conflictual outcomes in twenty-six or 65% of forty documented case study conflicts in the two hundred years to 1991 (Copeland 2014, p. 431).

In a voluminous book titled *Economic Interdependence and War* (2014) Copeland examined the relevance of trade expectations in forty separate case studies of military conflicts in the years 1790 to 1991. This analysis departed from conventional liberal and realist theorists' explanations for the role of trade in the study of conflicts. Central to the 'trade expectations theory' is a state's commitment to protecting both its sovereign and economic security. In

that context a state's expectations about the future of its dyadic trading relationships are vital to its economic security and Copeland introduced a subjective 'expectations' variable as a proxy for a state's economic security outlook (Copeland 2014, pp. 2-6). Expectations provide a bridge between liberal theorists' focus on trade's conflict mitigating role and realists' concentration on the conflict potential if dependent states are denied access to trade or resources.

Copeland reasoned that if trade expectations were positive a state would act to sustain commerce and avoid conflict disruptions. Conversely, negative expectations induced fear of economic decline and disposed leaders to counter that prospect with assertive economic or military initiatives (Copeland 2014, pp. 428-9). These trade-security dynamics are illustrated in conceptual circumstances where state A has an interdependent economic relationship with state B but develops an expectation that B will obtain a market power advantage that threatens A's security. That leads A to overcome the vulnerability with actions ranging from suspension of trade with B to acts of aggression by A to acquire resources that obviate its susceptibility (Copeland 2014, p. 43). Copeland established that falling trade expectations had a 'prominent or decisive causal role' in explaining conflictual outcomes in twenty-six (or 65%) of his forty documented case study conflicts (Copeland 2014, p. 431).

It would not be useful to reanalyse any of Copeland's forty historic case studies with FDI as a substitute variable for trade expectations because none of his case studies overlap with my focus on FDI's post-Cold War period of commercial significance. Nevertheless, there is merit in examining if the relationship signalling causal mechanism on which the trade expectation findings were based is also evident if FDI is substituted for trade.

Unlike the time bound nature of a typical contractual trading relationship that may be renewed, cancelled or varied periodically, FDI projects require an operational presence that typically has an indeterminate commitment horizon. As such, FDI project longevity provides greater commercial certainty to home and host country participants. Moreover, the signalling impact when a major host country FDI project is proposed, rejected or cancelled is arguably a far more explicit expectation signalling mechanism than occurs with trade contracts.

In the epilogue to *Economic Interdependence and War*, Copeland states that ‘understanding of trade-security dilemmas and how they differ from traditional military-security dilemmas is still at an early stage’ (Copeland 2015, p. 445). If that is so notwithstanding the body of trade-security theory, it is reasonable to conclude that the understanding of FDI’s role as a factor in international security relations is at an even earlier stage, perhaps even just embryonic.

7.4.9 Findings

My starting intuition that substitution of FDI for trade as the causal variable in trade-security studies would point to equally strong dyadic causal inferences for FDI is sustained in all but one of the six trade-security mechanisms examined. Network interdependence is acknowledged as a conflict mitigating factor in trade-security theory, but when FDI is substituted for trade with developing economies, the economic and security outcome may be negative. That potential would eventuate if FDI ventures led to exploitative commercial and security dependency relationships.

The five positive causal inferences from this deductive analysis of FDI's contribution to security relationships represent a novel addition to the limited body of FDI security literature. The important contribution of the findings for my thesis is that they suggest a positive answer to my third research question of whether FDI could help mitigate Indonesian sourced threats to Australia's security will likely be positive. Furthermore, the positive findings that attach to FDI raise the question of whether there are effective public policy measures that could promote greater direct investment in Indonesia by Australian MNCs or of Indonesian FDI in Australia.

7.5 Conclusion

This chapter has examined the substitution of FDI for trade as the causal variable in six threat mitigating causal mechanisms in trade-security theory. The need to pursue this research method reflects the perplexing lack of focus in IR scholarship on the security related effects of FDI especially in the post-1980s globalisation period. Understanding FDI's impact matters because direct investment is now the foremost source of global development capital. Global stock values exceed the annual value of trade in goods and services, over 50% of annual new FDI flows to developing countries, and collectively developing economies now account for more than 20% of global FDI stocks.

Indications from my analysis are that in all but one of the six applications of this FDI for trade factor substitution process, FDI has potentially equivalent or greater threat mediating effects to that of trade. The six conflict mitigating mechanisms examined were *opportunity costs*, *costly signalling*, *network interdependence*, *corporate political engagement*,

interdependence awareness and *relationship expectations*. It was only in circumstances where FDI was the source of an economic dependency that it did not serve to moderate a bilateral security threat. With that exception, there were no examples in this analysis where FDI is likely to be the cause of a militarised conflict.

Consistent with findings in trade-security theory that higher levels of trade to GDP lower bilateral conflict propensity so also would disposition to conflict be negatively correlated with increasing levels of FDI. With FDI the conflict avoidance motives are most attributable to home country corporate influence to protect the sunk costs and ongoing operational demands of an FDI project, while for host countries avoidance of financial ‘blow back’ consequences – unemployment, loss of trade and economic development – are likely conflict avoidance motivators. These are inferential conclusions that warrant further analysis. That is especially so in light of the post-1980s scale of global FDI flows and the fact that these flows are being directed in unprecedented levels to developing economies.

Chapter 8: FDI and developing economies: does Indonesia need Australian FDI?

8.1 Introduction

Thus far, this thesis has taken three steps toward establishing whether direct investments could contribute to a stronger Australia-Indonesia relationship. Chapters 3 and 4 pointed to the current relationship divide having its roots in cultural differences and historic legacies such as the Bandung Conference and the White Australia policy. Chapter 5 established that Indonesia does not pose a threat to Australia's sovereign security, but that Defence Department calls for a strong and productive relationship are underscored by a need to mitigate Indonesian sourced non-traditional threats to Australia's security. Chapters 6 and 7 outlined evidence supporting a hypothesis that FDI is a mechanism that could potentially contribute to bridging this bilateral relationship divide.

This chapter examines the circumstances in which FDI can contribute to the economic development of emerging economies such as Indonesia. Section 2 outlines the deepening theoretical awareness of FDI's development impacts. Section 3 refines the theoretical analysis by examining the sectoral differences in FDI's development impacts, while section 4 details the threshold settings that foster beneficial FDI project outcomes. Details of Indonesia's national development plans in Section 5 illustrate the breadth of FDI opportunities. Sections 6 and 7 detail the prevailing institutional settings and trends in Indonesian FDI inflows.

If Australian FDI is to have a part in building the desired strong relationship with Indonesia, I reason that in addition to meeting commercial ambitions, the investments will also need to contribute to Indonesian national development objectives. This chapter's findings highlight the gulf between opportunity and actuality in the Australia-Indonesia investment relationship.

8.2 FDI – developing country impacts

Analysis of FDI impacts by sector and the impact of variations in institutional settings in developing economies is an emerging research area and most study findings are not conclusive. Sectoral analysis is constrained by the relatively recent emergence of strong FDI flows to developing countries and the consequential lack of robust comparative data. The use of aggregate FDI inflow data as the default metric in economic impact studies rather than sectorally differentiated FDI is a recurring weakness (Cipollina et al. 2012, pp. 1601-1606).

Aggregate data carries the implicit expectation that each dollar of FDI has the same national development impact regardless of the industry sector, style of investment (joint venture, green field or brown field), degree of technological intensity or potential technology spill-over benefit.¹ The shortcoming of this approach can be illustrated by considering the comparability of such different FDI ventures as an oil project in Nigeria, a power generation venture in Indonesia, an electronics plant in Malaysia and Wal-Mart's entry to the Mexican

¹ As defined in Chapter 7, 'Green field' investment is defined as a type of venture where finances are employed to create a new physical facility for a business in a location where no existing facilities are currently present. 'Brown field' investment, by contrast, is defined as the purchase or lease of an existing production facility for the purpose of a new product release. *Business Dictionary*, <<http://www.businessdictionary.com/definition/greenfield-investment.html#ixzz45Td2fimA>>; <<http://www.businessdictionary.com/definition/brownfield-investment.html#ixzz45ToB0sbx>>, viewed 4 April 2016.

retail service sector. Obviously assuming a generalised positive or negative impact from such diverse ventures would be a gross simplification (Moran 2011, pp. 2-3).

Other constraints on the ability of researchers to present generalisable study findings from FDI in developing economies arise from the need to:

- identify differences in the ability of local investors to access a host nation capital market for finance to develop FDI spill-over opportunities
- identify capacity constraints of local physical or social infrastructure to support FDI initiatives
- accommodate differences in host country legal and regulatory regimes
- align FDI ventures with the development priorities and economic management policies of a host country (Alfaro and Charlton 2007, pp. 1-4).

Notwithstanding those constraints, my interest is in studies that look to identify which economic sectors and what institutional settings facilitate FDI that generates beneficial economic and wider development outcomes for a host country such as Indonesia. Quality FDI is identified as projects that significantly increase employment, enhance skills or boost the competitiveness of local enterprises (Alfaro and Charlton 2007, p. 1). The objective then is to identify if there are sectors of a developing economy in which FDI can deliver enduring development benefits, and to establish if there are sectors in which FDI is likely to have adverse social, environmental or other impacts. Fulfilling those objectives would provide the basis on which a potential Australian economic diplomacy initiative could deliver economic

benefits, avoid potentially adverse outcomes, and help enhance the Indonesian bilateral security relationship.

This aspect of FDI scholarship appears to have begun with a ground-breaking empirical study by Eduardo Borensztein et al. (1998) of FDI impacts on sixty-nine developing countries over two decades to 1990. Borensztein's paper, which has been cited almost six thousand times, set the agenda for subsequent intensive research on sectoral FDI issues. Borensztein's focus was on variations in the impact of technology diffusion or 'spill-over' from FDI to the threshold levels of human capital endowment and GDP per capita (Borensztein et al. 1998, p.125).²

In summary, Borensztein and co-authors reported generally positive outcomes from technology spill-overs to domestic companies, which in turn induced higher levels of domestic capital investment.³ When that combination occurred, FDI produced a positive economic development impact in the host country, as might be expected. The surprise findings in the study, however, were instances where countries with low levels of human capital development evinced negative economic growth as a result of the FDI inflows (Borensztein et al. 1998, pp.123-128). These findings stimulated deeper aggregate and sectoral research on FDI impacts.

² 'Human capital' is defined as the average years of secondary school attainment of the male population above twenty-five years of age (Borensztein et al. 1998, p. 125).

³ Known in later studies as 'crowding-in.' The opposite, 'crowding-out,' occurs when FDI adversely impacts domestic corporate investment.

One example of this research is a study by Abdur Chowdhury and George Mavrotas that utilised an innovative econometric methodology to address the question of endogeneity i.e. whether FDI caused economic growth, or whether economic growth caused FDI (2006, p. 11). The findings in that study are at odds with the conventional view that FDI causes economic growth. In one case Chowdhury and Mavrotas established that it was GDP growth that promoted FDI, while in two other cases they found strong confirmation of bi-directional causality. The authors concluded that deeper analyses of issues such as infrastructure quality, communications technology, governance, legal certainty and taxation impacts were needed to better understand the complexity of FDI's economic impacts (Chowdhury & Mavrotas 2006, pp. 17-18).

The results of fourteen further studies of FDI impacts on economic development were summarised in a 2002 OECD survey and, consistent with Borensztein et al's 1998 findings, the consensus was that the developmental impact benefits of FDI were significantly dependent on the extant level of host country economic development, the standard of education and the quality of infrastructure facilities in the host country (OECD 2002). For example, the ability of local firms to benefit from FDI impacts was dependent on their ability to employ staff with the education and training necessary to absorb FDI knowledge spill-overs. Local firms also needed access to capital market services to finance investments in new technology opportunities (Hansen & Rand 2006, p. 23).

These studies illustrate the need for greater granularity in academic research on FDI's impacts at the level of industry sectors and with regard for host nation fiscal settings and absorption capacity before estimates of its effects can be made with reasonable confidence.

Research progress is reviewed in the following sections of this chapter, but that effort has been mirrored by the establishment of pragmatic inward FDI promotion programs in almost all developed and developing nations. These programs typically identify and often incentivise particular types of inward FDI and regulate or prohibit other FDI inflows (Zanatta et al., 2008).

National policymakers seek to anticipate which types of inward FDI ventures deliver the most significant national development benefits. One study of national FDI programs identified 124 different countries with agencies dedicated to attracting foreign direct investment. Of those, fifty-six nominated and received additional FDI into specific target industries they deemed beneficial to their national development ambitions (Harding & Javorcik 2011, pp. 1455-1460). While FDI agencies succeeded in attracting additional investment inflows, analysis of economic development outcomes across industry sectors is more demanding and the outcomes less definitive. However, one conclusive finding has been that FDI has different sectoral impacts: initial findings were that primary sector FDI impacts tended to be negative, manufacturing industry were positive, and service sector outcomes ambiguous (Alfaro 2003, pp. 13-14).

8.3 FDI benefits by sector

This section provides an understanding of the industry sectors in which FDI is most likely to deliver economic and broader spill-over benefits for developing economies. In view of the post-1980s emphasis on global value chain production in Asia, it is unsurprising that manufacturing FDI is identified in several studies as the sector most likely to provide

economic and technology spill-over benefits to a host economy (Chuang & Lin 1999; Chuang & Hsu 2004). The form of spill-over benefits to local firms includes new technology and management capabilities as well as the ‘crowding in’ of firms to meet the upstream and downstream supply and distribution needs of FDI projects. On the other hand, FDI can have adverse outcomes due to the ‘crowding out’ of local producers from existing markets and the draining away of material inputs, capital, skilled managers and workers (Moran 2011, pp. 36-42).

A broader premise for identifying host country industry sectors that produce positive economic benefits from FDI projects comes in a study by Maria Cipollina et al. (2012) of FDI’s impacts in a range of countries that include emerging Asian and former communist states. This study found that ‘more capital intensive and technologically advanced sectors ... reveal a strong, robust ... economically and statistically significant effect of FDI on growth’ (Cipollina et al. 2012, p. 1617). This paper did not identify particular industries in either the capital intensive or technologically advanced sectors, however, the former typically includes industries such as telecommunications and transportation infrastructure such as railways, roads and airlines as well as the refining of oil and minerals.⁴ The technology sector usually includes ventures in semiconductor, software, IT systems and hardware production.⁵

More details of sectoral variations in FDI’s impacts is contained in studies by Theodore Moran, a former US State Department representative at the North American Free Trade and

⁴ <https://www.investopedia.com/terms/c/capitalintensive.asp>

⁵ https://www.investopedia.com/terms/t/technology_sector.asp

WTO Uruguay Round negotiations and a Georgetown University academic. In a book titled *Foreign Direct Investment and Development. Launching a Second Generation of Policy Research* Moran examined the development impact of FDI in the extractive industries, infrastructure, manufacturing and services sectors (Moran 2011, p. 1).

Moran's starting premise was that FDI ventures in all industry sectors had the potential to deliver either positive or negative outcomes across the range of economic, social, political and environmental considerations (Moran 2011, pp. 4-5). What emerges from his assessment is that extractive industry ventures are the most likely to have wide negative host country impacts. Moran attributed that likelihood to the potential for foreign investors 'to exercise considerable influence, for good or ill' over host country institutional settings (Moran 2011, p. 9). Moran pointed to examples of rebellions, civil wars, violence against reformers and local firms ruined when corrupt regimes were sustained by duplicitous multinational companies (Moran 2011, pp. 9-10).

Although there is no agreement that the inevitable outcome of FDI projects in natural resource endowed states will be negative (Haber and Menaldo 2011), one well documented adverse outcome from extractive resource projects in developing countries resulted from inadequate government monetary and fiscal policy responses to strong revenue flows generated by major projects. Known as 'Dutch disease' or the resource curse,⁶ these negative impacts arise when projects reduce input availability in other sectors, increase wages, cause strong balance of payment surpluses and currency appreciation. Such responses distort trade

⁶ See Chapter 7 for a definition, or go to <<http://lexicon.ft.com/Term?term=dutch-disease>>

flows as existing exports are less price competitive in overseas markets and cheap imports threaten competing local producers. The result can be deindustrialisation, loss of traditional employment opportunities and significant social and economic dislocation (Moran 2011, pp. 10-11). Norway and Botswana are rare examples of countries that appear to have successfully managed these risks by creating sovereign wealth funds to garner resource boom windfalls that are appropriated for long-term countercyclical infrastructure and human development programs (Moran 2011, p. 11).

Analysis indicates that FDI backed infrastructure projects are the most likely to have positive host country development outcomes (Moran 2011, p. 26). That is especially so in low and middle-income countries where projects have a strong record of positive economic impacts. Reliable electricity, water and telecommunications together with efficient road, port and airport facilities are essential for domestically sourced economic growth and for attracting other skill enhancing manufacturing FDI ventures (Moran 2011, pp. 26-27). This conclusion is significant in terms of the Australia-Indonesia relationship because, as detailed later, Indonesia's core infrastructure shortcomings have contributed to its limited participation in high growth but logistics sensitive global supply chain manufacturing programs (World Bank 2016).

Not all infrastructure investment projects in developed and developing countries have been successful. Excessive investor enthusiasm during the 1990s for privatised public-sector infrastructure projects based on foreign funded Public Private Infrastructure Partnerships

(PPIP) led to failures in the early 2000s.⁷ Overoptimistic user demand forecasts, corruption and contested investor-state contract outcomes soured many projects (Moran 2011, pp. 26-27). These project failures led to three important developments in the formation and governance of international FDI infrastructure projects. The developments are advantageous for any potential engagement by Australian infrastructure providers in Indonesia because cross-border infrastructure projects now use essentially standardised contracts templates, and specialised currency risk management facilities have been developed to overcome the mismatch between long-dated project revenues denominated in often volatile local currencies and hard currency investment capital.⁸ Finally, the World Bank now hosts a Public-Private Infrastructure website that provides ‘best practice’ governance models for PPIP projects (Moran 2011, p. 27).⁹ These initiatives would enable Australian firms to limit their initiation risk in the event that they enter the Indonesian infrastructure market.

Service industry FDI is the final sector examined in this review of FDI’s potential contribution to national development in developing economies. Service sector FDI studies are just beginning to gain prominence but it is a priority area for further analysis because of the escalating size and importance of global services such as retail, banking, insurance, telecommunications, accommodation, construction, electricity, water, gas, education and

⁷ UN Economic and Social Commission for Asia: *A Guide-book on Public Private Partnership in Infrastructure*, viewed 31 March 2016 < http://www.unescap.org/sites/default/files/ppp_guidebook.pdf >

⁸ Hard currencies are stable, convertible currencies such as the Euro, US dollar, or Yen that enjoy the confidence of investors and traders alike. Hard currencies serve as a means of payment settlements because they do not suffer from sharp exchange rate fluctuations: *Businessdictionary.com*, viewed 31 March 2016 <<http://www.businessdictionary.com/definition/hard-currency.html#ixzz44X7aCpMV>>

⁹ World Bank, *Infrastructure and Public Private Partnerships* website, <http://www.worldbank.org/en/topic/publicprivatepartnerships>, viewed 25 March 2016

health care (Moran 2011, p. 73). For example, services FDI stocks as a proportion of global FDI stocks have increased from 49% in 1990 to almost 66% in 2015. Concurrently, FDI stocks in the manufacturing sector have fallen from 42% to 26% and in agriculture from 9% to 6% (UNCTAD 2017, p. 21).¹⁰

Despite its growing significance, there are few studies of the development impacts of services FDI in developing economies. In one study, FDI in nonfinancial services ventures was identified as having adverse economic growth impacts on a regional grouping of Southeast Asian states because the FDI reduced resources available to support growth in the manufacturing industry. Conversely, this same study indicated that growth in the manufacturing and services sectors was stimulated by FDI in the financial services sector (Doytch & Uctum 2011, p. 423). Meanwhile a World Bank study of potential benefits from service sector investments in Indonesia indicated substantial spill-over benefits from reforms to the sector. The service sector reforms in engineering, financial and other services reportedly accounted for about 8% of the increase in manufacturing productivity in the period 1997-2009 (Duggan et al. 2015, p. i).

8.4 FDI threshold setting

What are the institutional settings that position a host economy to benefit from FDI projects? One IMF Working Paper has conducted a detailed review of numerous papers that set down necessary threshold levels of development for a country to benefit from FDI. The Working

¹⁰ The metrics are consistent between periods but the services sector FDI is inflated by the allocation of services performed in the manufacturing and agricultural sectors to services (UNCTAD 2017, p. 22)

Paper aggregated the economic and institutional requirements into a framework for assessing the preparedness of a country such as Indonesia to benefit from greater direct foreign investment (Dabla-Norris et al. 2010, pp. 14-15).

Based on the studies cited within each requirement, the IMF Working Paper identified the following threshold requirements for positive economic development outcomes from FDI projects:

- i. **Sectoral FDI priorities** – as established above, spill-over benefits from FDI vary across industry, and prioritised host country FDI sectors have delivered significant economic growth benefits (Alfaro & Charlton 2007).
- ii. **Global engagement** – consistent with Moran’s findings (2011, p. 38-41), the IMF report cited research findings by Balasubramanayam et al. (1996) on host country policies that favoured export promotion over import substituting investments. Export oriented policies fostered managerial skill transfers and production know-how that ‘crowded-in’ associated local production. Economic openness or Impex – imports + exports as a percentage of national GDP – was an indicative measure of global engagement.¹¹
- iii. **Economic policies** – appropriate fiscal and monetary policy settings by host governments constrained Dutch disease impacts and contributed to the growth and spill-over benefits of FDI projects (Mody & Murshid, 2005).

¹¹ <https://www.britannica.com/topic/economic-openness>. Viewed 18 April 2018.

- iv. **Absorptive capacity** – the report reiterated the need for host countries to have both a sufficiently educated workforce and adequate physical infrastructure to secure economic growth benefits from FDI (Borensztein et al. 1998; Kinda, 2007).¹²
- v. **Capital market capacity** – financial markets that enabled local entrepreneurs to access debt or equity finance for technology spill-over and factor input investment opportunities arising from FDI ventures (Alfaro et al 2004).
- vi. **Institutional standards** – protection of ownership rights and enforcement of contract provisions for normally capital intensive, front-end loaded, long-gestation FDI projects. There were some home country sovereign risk mitigation guarantees or insurances that enabled some FDI investors to access global debt market funding for projects in states with adverse risk ratings (Rajan & Zingales 1998).¹³

This section has provided a theoretical guide to the basis for identifying the economic sectors and indicative institutional settings necessary for a developing economy to secure beneficial development outcomes from foreign investment inflows. It is unlikely that any developing country can fulfil all these institutional prerequisites, and Indonesia certainly does not.

¹² Borensztein et al. (1998) indicated a threshold average of 0.52 years of male secondary school attainment. Xu (2000) put the threshold at 1.9 years. Indonesia's level of attainment in 2015 was 2.5 years.

¹³ *Webster's Finance and Investment Dictionary* defines sovereign risk as a legal or political risk that an investment in another country will become worthless because of political turmoil that causes the business environment to collapse or prompts a government to take over and seize foreign assets. It occurs when there is a lack of a strong and fair judicial system to enforce contracts and the risk that a government might prevent or limit money from being transferred out of the country. Viewed 7 March 2016, <http://www.yourdictionary.com/sovereign-risk#mCJhGw7bCwH18zLQ.99>.

Nevertheless, analysis below identifies several parameters where Indonesia's settings are sufficiently aligned to indicate that FDI will likely have positive development benefits. Examination of these institutional parameters is important to my research because a negative assessment would prejudice the merit of any Australian FDI initiatives. As indicated previously, *ceteris paribus*, positive host country economic and social development benefits from FDI should contribute to building a strong and productive relationship and contribute to mitigating threats to Australia's national security. A further step in this analysis is, therefore, to establish if Indonesia in fact welcomes FDI and if so, are the institutional settings sufficiently conducive to effective investment outcomes for both investors and the Indonesian economy. These requirements are examined in the following section.

8.5 Indonesia's economic development plans

Following his inauguration in 2014, President Widodo made several references to Indonesia's limited national budget, stating on one occasion that 'we need investment, we need investors, to boost our growth, to build our deep seaports, to build our airports' (McDowell et al. 2014, para. 3). That call for global FDI reflects a major shortfall in the capital required to meet infrastructure construction and economic development objectives set out in the country's medium and long-term national development plans. Since 2006, Indonesia's economic growth rate has fallen from about 6.5% p.a. to little more than 5% in recent years. This level of growth is below what is required to create the almost two million jobs necessary to employ new workforce entrants each year (IMF 2018, p. 19).

Indonesia initiated a 20-year national development plan known by the acronym RPJPN in 2005. The plan's high-level vision is a just, prosperous and democratic Indonesia. The long-term plan is being implemented by way of four five-year plans that correspond with the Presidential election cycle and enable each new administration to set its priorities towards fulfilment of the 2025 development objectives (APEC 2011, p. 4). Two five-year cycles of the RPJPN have been completed and the third commenced in 2015. Expectations of the two completed cycles were frustrated by global developments that adversely impacted the Indonesian economy. The 2008 Global Financial Crisis (GFC) frustrated ambitions to reduce poverty and unemployment levels during the 2005-2009 plan. Likewise, strong economic growth targets and forecast reductions in inflation set out in the 2009-2014 plan were frustrated after 2011 by large falls in the price of key Indonesian commodity exports. The export price for oil, coal and palm oil, which collectively represented almost 30% of total exports, each fell by at least 40% – palm oil was down 62% (Wihardja 2016, pp. 43-44).

Impacts of the GFC caused then President Yudhoyono to overlay the original RPJPN planning process in 2011 with a Masterplan designed to accelerate and expand Indonesia's economic development. Known as MP3EI, the Masterplan is consistent with RPJPN but refines the requirements for all ministries and government agencies to formulate their strategic plans in order to achieve more detailed 2025 sectoral targets (APEC 2011, pp. 7-8). All the above plans were premised on expectations of foreign investment inflows to finance the development objectives, but none has been as explicit or ambitious for FDI inflows as President Widodo's current five-year development plan, which commenced in 2015.

The Widodo government's policy is to replace prevailing economic dependence on commodity exports with an emphasis on manufacturing industries, construction and the services sector (World Bank 2015, p. 5). Consistent with the President's FDI invitation, emphasis in the current five-year plan is on infrastructure development because investment in the sector has been consistently inadequate. Since the early 2000s, annual infrastructure expenditures have been about 2.5% of GDP. That level is only one-third of Indonesia's average expenditure during the 1990s and about one-third of current average infrastructure expenditure by regional peers (Commonwealth of Australia 2015, p. 5). This underinvestment is reflected in numerous metrics:

- arterial road travel speeds in Indonesia are amongst the worst in East Asia
- logistics costs in Indonesia at 17% of corporate outlays are double peer economies.
- load shedding causes uncertain electricity supply in many regions
- 80% of the population lacks access to piped water
- Internet access per 100 persons is 1.2 in Indonesia compared with 8.4 in Malaysia and 5.0 in Vietnam

In summary, the World Bank estimates that infrastructure deficiencies account for 1% of lost GDP growth per annum in Indonesia (cited in Commonwealth of Australia 2015, p. 5).

Since 2015 the present government has initiated sixteen reforms to deregulate and support foreign investor access to key sectors of the Indonesian economy. The FDI regime has been liberalised and barriers to ownership of many sensitive sectors have been lowered or removed. Liberalisation is being facilitated by the inauguration of a single submission

process for local and foreign investment projects designed to facilitate licensing and coordination approvals for both the central and the 34 regional governments. While elite interests in the Indonesian bureaucracy and business are known to frustrate implementation of such reforms, signs of change are apparent in Indonesia's improvement from 106th to 72nd in the World Bank's annual *Ease of Doing Business Survey* between 2016 and 2018 (IMF 2018, p. 19).

Substantiation of the government's commitment to proceed with major infrastructure projects is demonstrated by its injection of large budgetary allocations to state-owned infrastructure enterprises. This is a pragmatic response to the urgent need for new capacity in a country where infrastructure remains predominantly state-owned. The notable aspect of these initiatives for prospective Australian corporate investors is acknowledgement that even with this additional funding, the sheer scale of the planned infrastructure projects necessitates private sector planning and resources to complete the ventures. Of particular note to Australian infrastructure project investors and managers is a government indication of 'downstream capital-recycling opportunities' by way of privatisation or leasing of major infrastructure assets (Ray & Ing 2016, pp. 10-11).

New infrastructure construction results are being achieved notwithstanding criticism of project prioritisation, planning procedures and construction standards. From the total of 247 prioritised infrastructure projects planned for completion by 2022 at a cost of US\$323 billion, four have been completed, 131 are under construction and the balance are being progressed. Highlighting the potential for Australian investors, more than half of the substantial financing

required for these infrastructure projects will come from private sector domestic and foreign investors by way of commercial loans or direct equity commitments (IMF 2018, p. 20).

Indonesia's ambition to secure FDI extends well beyond infrastructure. The agency with oversight of domestic and foreign equity projects is the Indonesian Investment Coordinating Board (BKPM). BKPM's development priorities are projects in tourism and the digital economy. Tourism numbers have increased following the introduction of visa-free travel for visitors from 170 countries. Plans are being implemented to develop ten new travel destinations to match Bali's popularity with foreign tourists (BKPM 2018a). During 2017 the Indonesian Minister for National Development Planning conducted a five-city 'roadshow' in Australia during which he sought investment in tourism and infrastructure ventures by Australian institutions (Topsfield 2017).

Development of capabilities in the digital economy is the objective of Indonesia's 'fourth generation' or *Industry 4.0* industrialisation program based on collaboration by government, industry and academic institutions. Five technologies, including Artificial Intelligence, Human-Machine Interface and robotic and sensor technology, have been prioritised. Initial emphasis is on the integration of educational and industry capabilities. Pursuit of *Industry 4.0* objectives is supported by proposed annual government expenditures on R&D and technology development of 2% of GDP which represents a seven-fold increase on current expenditures. As with Indonesia's other development initiative, foreign investors are encouraged to contribute, and Australian corporations have the opportunity to participate in these projects. Further opportunities arise from an initiative to strengthen selected sectors of

Indonesia's industry base including the food and beverage, electronics and chemicals industries (BKPM 2018b).

Institutional recognition of Indonesia's significance in the global economy is apparent in its decade long membership of the OECD Development Centre, and Key Partner recognition in 2012. While technically not a full member of the OECD, Indonesia's status positions it in line with Brazil, India, China and South Africa, which all share the same level of relationship with the OECD.¹⁴ As a result, the Indonesian government secures OECD contributions for reform initiatives in tax, investment, budgeting, education, agriculture, trade and anti-corruption and the activation of Public Private Partnership infrastructure investments.¹⁵

8.6 Indonesia's FDI threshold settings

The previous section of this chapter illustrated Indonesia's ambition to source FDI as a significant component of its national development plan. This section provides a brief review of the country's institutional preparedness to benefit from FDI inflows using the threshold indicators for positive development outcomes identified in the IMF Working Paper by Dabla-Norris et al. (2010) discussed above. That review provides the basis for an outline in the following section of the growth in scale and sources of recent FDI inflows that are contributing to Indonesia's economic significance.

¹⁴ <http://www.oecd.org/about/membersandpartners/>. Viewed 6 May 2018

¹⁵ <http://www.oecd.org/southeast-asia/countries/indonesia/>. Viewed 6 May 2018

Of the six threshold considerations identified in the IMF Working Paper that dispose a recipient economy to fully benefit from inward FDI, Indonesia's preparedness ranges from being fully prepared to being ill-prepared. Each of the threshold issues is briefly examined below and broad indicators rather than detailed analyses are used as a guide to Indonesia's capacity to fully benefit from FDI projects. Assessments of the first three issues are brief because there are strong indications that Indonesia is well prepared for FDI benefits in relation to those requirements:

Sectoral FDI priorities: Indonesia's detailed **sectoral development priorities** were set out in the above analysis of BKPM's investment promotion activities. The advantage of FDI flowing to economic sectors identified by national planners was highlighted earlier.

Global engagement: managerial skill transfers, production know-how and 'crowding-in' of local producers are indicated benefits of a trade exposed economy. Indonesia is moderately trade exposed having comparable **global engagement** to Australia both in terms of its trade to GDP ratio at 37% (Australia's is 40%) and the predominance of resources in trade exports.¹⁶ Nevertheless, these engagement levels are below more deeply engaged regional neighbours that participate more effectively in global value chain manufacturing (Ray & Ing 2016, p. 2)

Economic policies: Indonesia's post-2000 macroeconomic management has been sound.

The adequacy of its **economic policies** is demonstrated by the decisions of four

¹⁶ <https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS>. Viewed 6 May 2018

global credit ratings agencies (Moody's, Fitch, R&I and Japan Credit Rating) to upgrade Indonesia's sovereign credit rating to investment grade level in the six months to March 2018 (BKPM 2018c).

Absorptive capacity: the ability of FDI projects to benefit host states is strongly impacted by the ability of host country managers and staff to apply, copy and adapt new technologies and assimilate skill formation training. Borensztein et al. used male (sic) secondary school education levels as a proxy for human capital development and found a strong complimentary effect between education and FDI development outcomes (Borensztein et al. 1998, p. 117). Indonesia's capacity to benefit from FDI flow-on effects relative to this metric would seem to be marginal as the male secondary school level of attainment in 2015 at 2.5 years was only marginally above the indicated threshold minimum level of 1.9 years (Xu 2000) necessary to provide a sufficiently educated FDI workforce (OECD 2017). The other element of **absorptive capacity** necessary to accommodate FDI spill-over benefits is an adequate physical infrastructure. This is a major constraint on Indonesia's development, and the initiatives examined above to overcome these inadequacies are a priority of the current government.

Capital market capacity: this measure illustrates one clear weakness in Indonesia's development potential – inadequate domestic savings and capital accumulation required to create jobs for almost two million new job seekers each year. The gross

savings rate of 33% is well below China's 46%.¹⁷ Inadequate geographic spread of banking facilities and unusually high lending margins constrain Indonesia's **capital market** so that only 36% of adults in Indonesia have a formal transaction account compared with an average of 53% in other East Asian developing economies (IMF 2017, p. 36). As a result, FDI is essential to Indonesia's economic growth even though spill-over benefits are restricted by the domestic capital market's inability to provide the debt and equity finance required by local entrepreneurs to take advantage of investment opportunities associated with FDI projects (IMF 2018, p. 3; EYGM 2017, pp. 9-10).

Institutional standards: widespread political, judicial, corporate, police and military corruption is the foremost institutional deficiency in Indonesia. As noted earlier, I have chosen not to reanalyse this issue in detail because the impact of corruption is indeterminate in both the academic literature and in its implications for individual FDI ventures (Brada et. al. 2012, p. 640). In practice, corruption in Indonesia is widely condemned and despite it being ranked 90th out of 176 countries in the 2016 Transparency International Corruption Perception Index, some progress towards reducing the practice is evident in the following Table 8.1 recording corruption perceptions from 2006 to 2015 according to Transparency International, where higher numbers indicate less perceived corruption.

¹⁷ <https://www.ceicdata.com/en/indicator/indonesia/gross-savings-rate>

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Indonesia	2.4	2.3	2.6	2.8	2.8	3.0	3.2	3.2	3.4	3.6

Table 8.1 Indonesian Corruption Perception Index 2006-2015 (Source: Transparency International, 2016).

Nevertheless, protection of ownership rights and enforcement of contract provisions are major concerns for foreign investors in Indonesia (Ray & Ing 2016, p. 9), but as indicated in my earlier cultural analysis, successful investors in Asia are those that are able to combine the relative certainty of ‘black letter law’ with a greater dependence on mutual trust-based relationships (Hinze 2013, pp. 3-4). As Table 8.2 below indicates, US, UK and EU investors, unlike their Australian counterparts, are significant investors who have overcome Indonesia’s corruption and are able to comply with stringent home country anti-bribery legislation. Other Indonesian institutional practices are more conducive to FDI ventures as indicated by its ranking as the 9th most attractive global foreign direct investment location in the UNCTAD 2016-2018 *Global Investment Prospects Assessment*.¹⁸

In summary, Indonesia has both a need for inward foreign direct investments and a moderate level of threshold institutional settings that should enable the country to secure long-term benefits from those investments, especially in sectors prioritised in the national development plans. The final section of this chapter identifies the scale and sectoral allocation of Indonesia’s recent FDI inflows.

¹⁸ See: <<http://www.bkpm.go.id/en/why-invest/indonesia-economic-update/2018-economic-outlook-its-time-to-invest-no-need-to-wait-any-longer>>, viewed 28 April 2018

8.7 Indonesian FDI inflows by sector and by source

Indonesia's MP3EI and *Industry 4.0* plans set out the sectoral priorities for domestic and foreign direct investors, and President Widodo's 2014 invitation to global investors reiterated that the country's need for expenditure on infrastructure alone would exceed US\$300 billion by 2022. This review of Indonesia's FDI inflows in the years since the GFC indicates only modest progress towards achieving those planning ambitions. Consequently, the following chapter identifies the opportunity for Australian FDI to contribute to Indonesia's ambitions and to building the complex interdependence on which a strong bilateral relationship can be built.

Table 8.2 illustrates Indonesia's strong rebound in FDI inflows in the three years following the GFC but then no real increase in total inflows in the four years to 2016. However, while total FDI inflows have not increased there are three notable aspects in the sectoral composition of the numbers. The first is that primary sector FDI has increased only marginally across the period. That outcome is consistent with the MP3EI Masterplan's ambition to diversify Indonesia's economy away from a reliance on natural resources. Palm oil, coal, gas, oil and rubber have constituted over 50% of Indonesia's exports and remain at about 35% (IMF 2018, p. 45).

Foreign Direct Investment Realization by Sector							
	US\$m						
Sector	2010	2011	2012	2013	2014	2015	2016
	I	I	I	I	I	I	I
Primary Sector	3,034	4,883	5,933	6,472	6,991	6,236	4,502
Secondary Sector	3,337	6,790	11,770	15,859	13,019	11,763	16,688
Tertiary Sector	9,844	7,802	6,862	6,287	8,519	11,276	7,775
Total	16,215	19,475	24,565	28,618	28,530	29,276	28,964

Table 8.2: Foreign Direct Investment Realisation by Sector (Source: BKPM. <http://www.bkpm.go.id/en/statistic/foreign-direct-investment-fdi>).

Strong growth in secondary industry FDI inflows is the second notable aspect of Table 8.2, with the result that manufacturing industry exports have increased the diversity of Indonesia's exports since 2011. Despite the increased export diversity, though, the growth in value of manufacturing exports has not been sufficient to offset a strong growth in the value of primary industry exports during the same period. As a result, the overall sectoral make-up of Indonesia's exports has not changed substantially. A major constraint on the value of Indonesia's secondary industry exports is their low value-added content and lack of sophistication and complexity when compared to exports from Malaysia, Thailand or other large non-Asian developing countries (IMF 2018, pp. 48-52). Overcoming the low level of export product complexity is one factor in Indonesia's *Industry 4.0* initiative to lift national R&D spending to 2% of GDP and develop capabilities in the nominated five advanced technologies.

Tertiary sector FDI inflow since 2010 is notable because it has scarcely changed. This is significant because Indonesia's ambition during this period was to secure investments in services and infrastructure at a time when there was a global surge in tertiary sector

investments. Consistent with the tertiary sector's share of global economic activity, almost 33% of global FDI stock is now concentrated in the services sector; by contrast secondary is 26% and primary 6% (UNCTAD 2017, p. 21). Yet investment in the Indonesian service sector is modest and, notwithstanding the MP3EI Masterplan, both the commercial services and public works infrastructure sectors remain underdeveloped. Given the scale of planned investment requirements, both sectors seem to provide obvious opportunities for Australian investors to contribute to building a stronger and more productive bilateral relationship.

There is one more issue in this assessment of potential opportunities for Australian direct investors to contribute meaningfully to Indonesia's development and that is to establish whether the potential for Australian MNCs to secure access to commercial opportunities has been overshadowed by investors from another country. Data in Table 8.3 below indicates that Singapore-based investors are Indonesia's most consistent and substantial FDI investors. In the five years to 2016 they accounted for more than 20% of the total inflow while investments by Japanese MNCs amounted to 13%. These inflows are substantial, but they do not suggest there will be any limit to access by Australian MNCs to investment opportunities in Indonesia.

Country \$bn	2012	2013	2014	2015	2016	Total	%
Singapore	4.9	4.7	5.8	5.9	9.2	30.5	21.8
Japan	2.5	4.7	2.7	2.9	5.4	18.2	13.0
South Korea	1.9	2.2		1.2		5.3	3.8
USA	1.2	2.4				3.6	2.6
UK		1.1	1.6			2.7	1.9
Malaysia			1.8	3.0		4.8	3.4

Netherlands			1.7	1.3	1.5	4.5	3.2
China + HK					4.9	4.9	3.5
Other	14.1	13.5	14.9	14.9	8.0	65.4	46.7
Total \$bn	24.6	28.6	28.5	29.2	29.0	139.9	100.0

Table 8.3 Indonesia FDI inflow by country (Source: BKPM 2017).

Australia's outward FDI flow is highly variable year-to-year. It ranged from \$30 billion in 2008 to a negative flow, representing the repatriation of capital, exceeding \$20 billion in 2015.¹⁹ In the decade to 2016 Australia's average annual FDI outflow (excluding the capital repatriation) exceeded \$20 billion. As such, an economic diplomacy initiative that increased Australian FDI flow to Indonesia significantly above the current average of 1% would make Australia a significant investor in total, and potentially a very significant investor in particular sectors of the Indonesian economy. That prospect is analysed further in chapter 9.

The recent appearance of China/Hong Kong as a substantial Indonesian FDI investor is significant in part because it did not occur earlier than 2016 but more so because of what it may portend for Indonesia and the region. Since the launch in 2001 of the 'Going Out' strategy, China/Hong Kong has become the second largest global source of annual FDI outflows and the world's second largest holder of FDI stocks (UNCTAD 2017, Table 02-03). Much of that investment has been directed to securing access to resources in developing countries where China is now the predominant investor. However, the focus of Chinese

¹⁹ <http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx>

foreign investments is likely to be reoriented by the initiation in 2013 of the ‘One Belt, One Road’ (OBOR) program.

Motivated in part by an intention to utilise excess Chinese construction capacity and to develop trading relationships in Central and Southeast Asia and the Baltic states, OBOR has facilitated major railway, airport, power and port infrastructure projects in these regions. What is significant for prospective Australian offshore investors is that a Chinese state-owned enterprise (SOE) is the principal in most OBOR projects. That is significant because capital is available to SOEs at less than globally competitive commercial interest rates. For highly front loaded, capital intensive infrastructure projects, low cost financing provides a substantial competitive advantage (Liu et al. 2017, pp. 1374-1375). On balance, OBOR arguably has both geo-economic and geo-strategic objectives in Indonesia and Southeast Asia that impact Australia’s security interests.

I argue that facilitating Australian FDI in Indonesia is an initiative that can meaningfully contribute to satisfying the Defence Department’s ambition for Australia to build a vital relationship with Asia’s emerging Third Giant (Reid 2012). Reorienting the focus of Australian Government supported trade and investment promotion missions to Indonesia away from the past and towards an alignment with Indonesia’s published investment development priorities could be a small but meaningful beginning.²⁰

²⁰ See <<https://www.austrade.gov.au/Events/Ministerial-Led-Business-Missions/Previous/iabw2017>> and <http://trademinister.gov.au/articles/Pages/2015/ar_ar_151201.aspx> for Australian government statements and activities that recognise this opportunity.

8.8 Conclusion

Does Indonesia need Australian FDI? Having established that there are Indonesian sourced NTS threats to Australian interests and that FDI, like trade, might act to mitigate such threats the prospect would be hollow if Indonesia had no call for Australian FDI. This chapter has established that Indonesia certainly has call for FDI, and that need is sufficient to make Australian FDI acceptable. This presents substantial opportunities for Australian direct investors. However, the chapter also established that not all FDI is equal in terms of its employment, skills transfer or impacts on local enterprises and that FDI benefits are contingent upon the existence of certain host country threshold institutional settings. My analysis shows that Indonesia does not have adequate institutional standards in place for all the threshold settings, but it does have clear national development priorities. Its foremost priority is infrastructure development that requires expenditure by 2022 of about US\$300 billion on almost 250 projects to build major road, airport and marine infrastructure needs. Priority is also being given to an *Industry 4.0* program that will build capabilities in the digital economy based on collaboration by government, industry and academic institutions. President Widodo has called for global investors to engage with Indonesia and help it achieve its national development objectives. For the past five years Singaporean and Japanese MNCs have provided the most substantial and consistent FDI inflows. Nevertheless, the scale of Indonesia's FDI needs is such that there are ample opportunities for Australian investors to become significant participants in major infrastructure and industrial projects. The following chapter examines if it may be possible to change the long-standing flow of Australian FDI

away from low-growth Anglo-centric countries to commercially rewarding high-growth investment opportunities in Indonesia.

Chapter 9: Australia-Indonesia – FDI's relationship opportunity

9.1 Introduction

If it is true that FDI has conflict constraining impacts similar to trade, this will only be policy relevant if governments are able to influence outward FDI flows. This raises two questions: are there foreign investment opportunities in security relevant states that firms could exploit; and are there politically feasible policy initiatives that would enable governments to achieve security or other foreign policy objectives by promoting FDI? This chapter seeks to answer these questions by examining policy options available to the Australian government that might deepen corporate engagement with Indonesia. The analysis is grounded in empirical observation of long-running international precedents where government backed OFDI support initiatives have pursued an amalgam of public sector foreign policy and development assistance goals and have opened otherwise inaccessible private sector investment opportunities.

This form of economic diplomacy could be characterised as *smart engagement*. *Smart engagement* is defined in a study by the Australian Council of Learned Academies (ACLA) as the 'slow and patient nurturing of long-term, sustainable, mutually beneficial relationships ... beyond the pursuit of purely transactional relationships for short-term self-interested gain (Ang 2017, p. 23). The ACLA report is directed at cultural diplomacy opportunities to address Australia's 'soft power deficit' in Asia where koalas, kangaroos and the White Australia policy dominate perceptions (Varghese 2013). Nevertheless, its objectives parallel

the potential bilateral security outcomes I argue could flow from significant Australian FDI in Indonesia.

The chapter begins by reviewing Australia’s economic diplomacy program in order to establish whether there is a context in which an OFDI support agency could be considered an appropriate foreign policy initiative. Section 9.3 provides a fact base by summarising Australia’s current trade and investment engagement with Indonesia and illustrates the gap between the present reality and the unfulfilled opportunity. Section 9.4 analyses the long-pending Indonesia-Australia Comprehensive Economic Partnership Agreement, which I argue could make a vital contribution to demonstrating the importance of commercial interdependence to the security relationship. The final section (9.5) sets out my argument for an Indonesian-centric, or broader ASEAN regional, outward FDI support agency as a coherent extension of Australia’s economic diplomacy program. Such an initiative is at odds with the policy prescriptions of orthodox neoclassical economic theory. As a pre-emptive engagement with critique from that quarter, the section details long-standing precedents and examples of OFDI and similar support initiatives by most OECD and several emerging countries.

9.2 Australia’s economic diplomacy – an assessment

In 2014 Australia’s newly elected Liberal-Coalition Government launched an innovative economic diplomacy program that focused on regional growth, trade liberalisation, support for Australian overseas businesses ventures and inward FDI (Sainsbury 2016, p. 613). This

section examines what progress has been made towards achieving those policy objectives apart from the pursuit of inward FDI.

Recent government and private sector reports highlight the paucity of direct investments by Australian companies in Asia. A Foreign Affairs Department report on investment relations with ASEAN countries notes that Australia is 'well behind' other developed countries and that companies 'need to move now to build relationships, establish connections and expand their footprints to optimise their chances of capitalising on ASEAN's future growth' (Commonwealth of Australia 2017d, p. 5). A separate report by international consulting firm PricewaterhouseCoopers describes Australia's level of investment in Asia as 'woeful' (PwC 2014, p. 4).

What is economic diplomacy? There is no agreed definition, but *diplomacy* is depicted by a former Secretary of the Foreign Affairs Department, as 'the compass by which Australia makes its way in the world in order to fulfill its core task of advancing the nation's security and prosperity' (Byrne et al., 2016, p. 581). *Economic diplomacy* might therefore be read as the instrument which guides Australia's economic engagement with the world in pursuit of security and prosperity. Tristram Sainsbury describes economic diplomacy as 'the set of informal and formal processes and links between states and non-state actors on international economic issues' (2016, p. 614). That perspective's focus on 'international economic issues' elevates the purpose of economic diplomacy to monitoring economic performance in other states and participating in regional and global economic fora.

Economic policy initiatives are considered to be both nebulous and inherently difficult for diplomats to pursue (Sainsbury 2016, p. 614). That assessment was confirmed by Australian trade officials during my face-to-face interviews. One official described the practice of conducting Roundtable discussions between Australian and local CEOs during overseas Ministerial visits as 'pure theatre.'¹ Another noted that notwithstanding Free Trade Agreements with China, Japan and Korea and the convening of ninety Australian regional promotional seminars in conjunction with local Members of Parliament, few companies attend, and results are negligible. The only initiative with active company engagement is a small-scale Export Market Development Grant scheme that reimburses some of an exporter's costs.²

Another interviewee criticised Australian overseas trade and investment promotion programs for being too remote from business and failing to align with business to pursue common long-term commercial and relationship objectives.³ He cited examples of two-way development opportunities in Indonesia for cattle breeding and large-scale infrastructure design and construction. Such projects could fulfill both commercial and relationship objectives but are not being progressed by government or business.

Why don't companies take the initiative? One interviewee's explanation is that twenty-six years of solid growth has enabled Australian companies to achieve acceptable profits and

¹ M1, 22 May 2017. Face-to-face interview

² M2, 16 May 2017. Face-to-face interview

³ A1, 29 May 2017. Face-to-face interview

given them little incentive to pursue higher risk FDI opportunities.⁴ Another perspective is that corporate executives focus on building short-term shareholder value (which is incentivised by personal short-term bonus structures), and longer term OFDI relationship building is not prioritised or rewarded.⁵ One positive assessment of the economic diplomacy program came from an overseas based trade official who noted that ‘economic diplomacy has cleverly repurposed Australian aid. Aid is now rebadged as an economic diplomacy initiative and infrastructure assistance is now presented as a cooperative project – not aid.’⁶

By other measures Australia’s economic diplomacy has been far more successful. The initial Australia Indonesia bilateral investment treaty came into force in 1993 and provided the basis for an initial round of Soeharto era Australian investment projects in Indonesia. Provisions of the initial treaty were subsumed into a 2010 Free Trade Agreement (FTA) with the ASEAN states and New Zealand which, in advance of a pending comprehensive agreement with Indonesia, provides the instruments that guide Australia’s current economic engagement in the region. The 2010 FTA agreement provides a greater level of operating certainty for Australian service suppliers and investors, and extensive tariff reductions for goods exporters. Negotiations continue towards finalisation of the Indonesia-Australia Comprehensive Economic Partnership Agreement (CEPA) which would be a much more important addition to the FTA agreement. CEPA is examined in more detail below.

⁴ M2, 16 May 2017. Face-to-face interview

⁵ A1, 29 May 2017. Face-to-face interview

⁶ M3, 23 May 2017. Face-to-face interview

Overlying the above examples of mostly bilateral trade agreements are the prospective impacts of two broad and notionally competing multilateral trade agreements. The first is the modified Trans-Pacific Partnership Agreement that was signed in 2018 by eleven states: Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, Peru, New Zealand, Singapore and Vietnam. Known as TPP-11, it does not include the US (albeit that opportunity is available) but it maintains the economic integration features of extensive free market access opportunities for goods and services and enhanced foreign investment provisions that were agreed in the original TPP Agreement (DFAT 2018). Indonesia is not a TPP-11 member although President Widodo has indicated that membership is being considered (*Jakarta Post* 2018). Whether or not Indonesia joins the TPP, the agreement appears to provide a higher and more consistent level of commercial certainty for regional trade and investment initiatives. This could build Australian MNC's confidence in Asian investment opportunities.

Separately, there is a 'lower-ambition model' (Wilson 2018, p. 1) of Asian multilateral economic integration. The Regional Comprehensive Economic Partnership (RCEP) was initiated in 2012 as an ASEAN-centred free trade proposal that incorporates the ten ASEAN member states and six countries with existing FTAs with ASEAN: Australia, China, India, Japan, South Korea and New Zealand. RCEP is both commercially and strategically significant to the Asian region and, notwithstanding completion of more than twenty negotiating rounds, no date for completion of the agreement has been indicated.

RCEP has substantial economic and geostrategic significance for Australia. Unlike TPP-11, RCEP includes China, India, Indonesia and Korea, and its economic appeal is that the

group's GDP is projected to be double that of the TPP-11 member-countries within fifteen years (Armstrong 2016, p. 2). Yet RCEP's geostrategic significance may eclipse its economic impacts because of its influence on great power alignment. In summary, the primary alignment of all TPP-11 members is with the US, whereas some RCEP members are more aligned with China, while others, including India, Indonesia, Malaysia and Vietnam, are uncommitted to either major power. As such, TPP-11 and RCEP can be viewed as part of the emerging Asian regional contestation between the US and China. The outcome is uncertain but US withdrawal from the original TPP as China was initiating the Asian Infrastructure Investment Bank and the Belt and Road Initiative, may have given China a preeminent role in the resolution of Asia's economic architecture at a decisive time (Wilson 2018, p. 3).

A key element of Australia's economic diplomacy challenge is to ensure that it has an effective presence in the process of settling what may become the trade and investment norms of the Asian region. An appreciation of the commercially and strategically significant alignments these agreements represent can be gained from the following figure (Figure 9.1) that appeared in the *2017 Foreign Policy White Paper* (Commonwealth of Australia 2017a, p. 69).

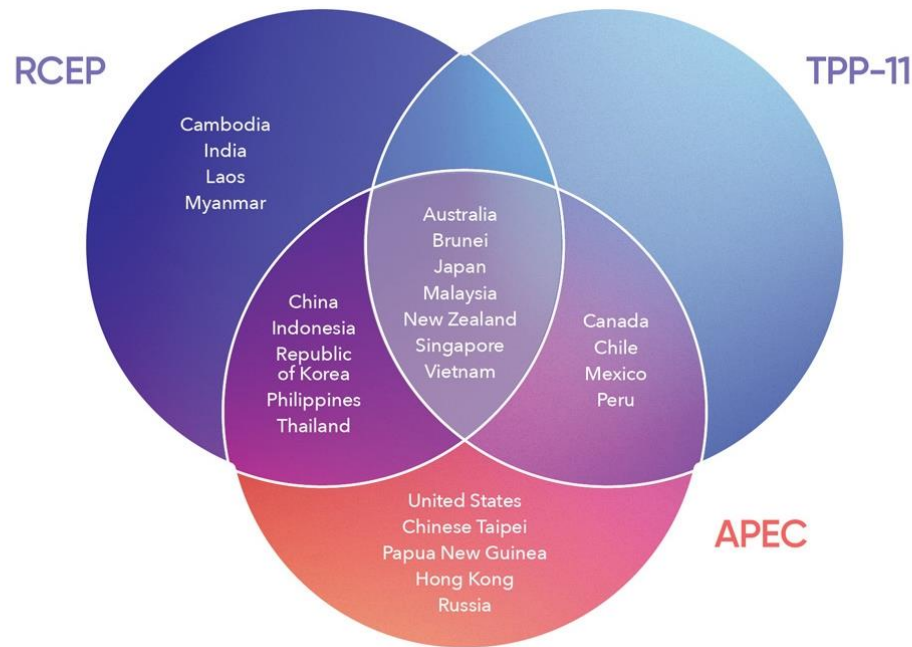


Figure 9.1 Current and prospective free trade agreement groupings (Source: Commonwealth of Australia 2017a, p. 69)

Australia's contribution to finalising the TPP-11 Agreement, its commitment of A\$1 billion of capital to the Asian Infrastructure Investment Bank and participation in the RCEP negotiations, reflect success in its pursuit of regional trade liberalisation and economic growth. However, there are few signs that the diplomacy policy has made any meaningful progress towards fulfilling its third objective which is to support Australian overseas business ventures.

Interviews with government and corporate executives indicate that policy initiatives in this sphere are not highly regarded. Those assessments and frustration with the level of regional corporate engagement indicate limited success in achieving the economic diplomacy objective of greater prosperity and national security. While Australia's prosperity by most

measures has improved since 2014 it is implausible to attribute that outcome to economic diplomacy. Furthermore, security outcomes, particularly in terms of Indonesian sourced NTS threats such as terrorism, have arguably not improved since 2014. In fact, the level of national security concern appears to be increasing, as can be seen in the 2016 Defense White Paper’s more emphatic assessment of the critical need for a strong relationship with Indonesia (Commonwealth of Australia 2016a, p. 125) and the 2017 Foreign Policy White Paper’s emphasis on ensuring that Australians are ‘... safe from the threat of terrorism and violent extremism’ (Commonwealth of Australia 2017a, p. 69).

That emphasis bolsters my resolve to examine if incorporation of an OFDI support program into the economic diplomacy initiative could help mitigate NTS threats to Australia’s national interests. My emphasis is on Indonesian FDI because the security analysis indicated that is where threats to Australia’s interests may arise. The previous chapter outlined Indonesia’s very large need for, and preparedness to accept, foreign direct investments. What follows is an illustration of how ‘woeful’ and ‘well behind’ Australia’s current FDI engagement is with Indonesia. As noted earlier, Australia ranks as the 17th largest global FDI investor but only 1% of that overseas investment is located in Indonesia.⁷ The gulf between Indonesia’s FDI investment needs and Australia’s limited presence suggests that notwithstanding high level economic diplomacy success forgone bilateral commercial and security opportunities in Indonesia beg the question of whether the addition of an OFDI support agency could help capture those opportunities.

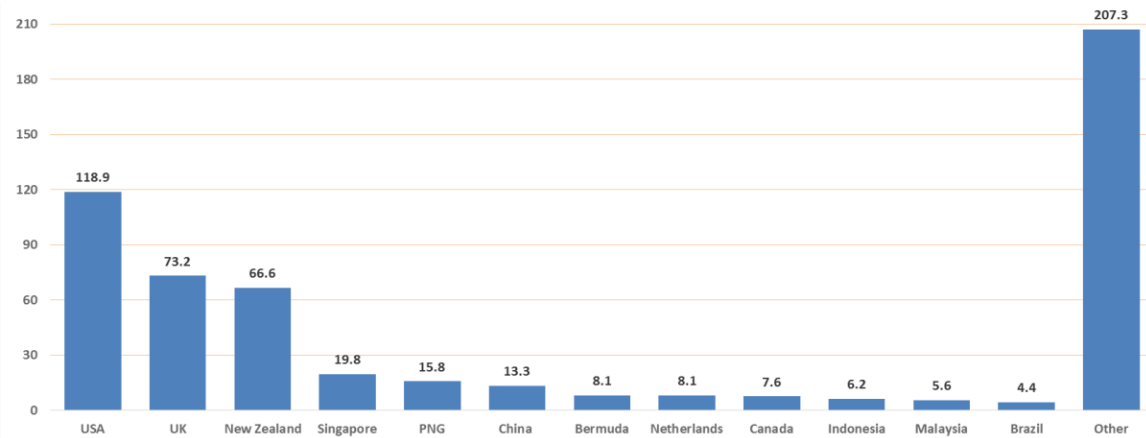
⁷ <http://dfat.gov.au/trade/resources/investment-statistics/Pages/statistics-on-where-australia-invests.aspx> DFAT 2017; 2018 ‘Statistics on where Australia invests’

9.3 What is Australia's FDI presence in Indonesia?

Both Figure 9.2 and Table 9.1 illustrate in different ways that Australian corporate investment in Indonesia and the ASEAN region is underwhelming. This is shown most clearly by the fact that FDI stocks in New Zealand are more than ten times greater than the value of holdings in Indonesia.

Australia's Direct Investment Stock Abroad, 2016

(A\$ billion)



Sources: ABS Cat 5352.0 - International Investment Position, Australia: Supplementary Statistics, Table 5, 2016; Austrade

Figure 9.2 Australia's Direct Investment Stock Abroad, 2016 (Source: Tang 2017, p. 2).

Likewise, the combined value of Australian direct investments stocks in all ten ASEAN member states was little more than half the value of investments in New Zealand until 2015.

Australia: Outward FDI stocks (\$ Million)										
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Indonesia	1,875	2,089	3,068	3,319	3,642	5,075	7,500	5,308	5,526	6,221
ASEAN	17,231	13,773	16,021	16,760	18,022	24,341	28,184	29,357	37,644	37,750
New Zealand	46,933	34,310	42,174	39,827	39,925	44,141	47,691	60,204	60,520	66,604
Total Australia	386,876	352,528	406,435	442,527	412,364	457,894	515,488	544,480	542,611	554,874
% Indonesia	0.5	0.6	0.8	0.8	0.9	1.1	1.5	1.0	1.0	1.1
% ASEAN	4.5	3.9	3.9	3.8	4.4	5.3	5.5	5.4	6.9	6.8
% New Zealand	12.1	9.7	10.4	9.0	9.7	9.6	9.3	11.1	11.2	12.0

Source: ABS 53520

Table 9.1 Australia: Outward FDI stocks (\$ Million) (Source: ABS 2017)

The incongruity of this seemingly unacknowledged, large and persistent eschewal of investment in Indonesia is most vivid when juxtaposed with the 2016 Defence Department’s declaration of a ‘vital’ need for Australia to develop a productive relationship with Indonesian (Commonwealth of Australia 2016a, p. 59). Wider government indifference to that issue is seemingly reflected in the 2017 Foreign Policy White Paper’s detached acknowledgement that ‘Australian direct investment into Asia is relatively low, potentially affecting the ability of some firms to tap into growth markets and value chains’ (Commonwealth of Australia 2017a, p. 50).

Apart from the potential security benefits of deeper interdependence with Indonesia and the ASEAN region, the scale of forgone commercial opportunities is apparent from Table 9.2 which compares basic economic metrics. For example, New Zealand with less than five million people and a GDP one-fifth that of Indonesia holds over ten times the value of Australian FDI. Similarly, the two Anglophone countries, New Zealand and the United Kingdom hold almost 25% of Australia’s FDI stocks yet their combined 2016 GDP is little greater than that of ASEAN and their combined population (a market growth indicator) is little more than 10% that of the ASEAN states.

FDI 2016 host country metrics				
	Population	GDP	GDP growth	FDI stock
	million	US\$billion	%p.a.	%
Indonesia	259	932	5	1.1
ASEAN	639	2,551	4.6	6.8
New Zealand	5	182	3.6	12.0
United Kingdom	66	2,629	1.9	12.8
			<i>Source: DFAT Fact sheets</i>	

Table 9.2: FDI 2016 host country metrics (Source: Compiled from DFAT 2017i; DFAT 2017j)

Why do the US (21.4%), UK (12.8%) and New Zealand (12%) account for almost half of Australia’s OFDI? There appears to be only one study, by Kishor Sharma and Yapa Bandara, that explores the patterns and determinants of outward Australian FDI decision making. This study uses Dunning’s (2000) Eclectic Paradigm of corporate internationalisation to assess the basic organisation, location and internal advantages that motivate OFDI decision making. Sharma and Bandara refine Dunning’s theory by examining the specific influences within his paradigm to establish the primary factors that motivate the strong Anglophone FDI preference (Sharma & Bandara 2010).

Sharma and Bandara’s research identified two entwined influences that strongly impacted the market access decisions by Australian corporations: host country market size was one; the other was access via the host country to a large regionally integrated market. These two factors appear to account for much of Australia’s predominant investment in the US and the UK. Both countries provide a substantial domestic market and, at least until 2018, the UK opened access to the European Economic Community and US FDI provided Australian

companies with access to the North American Free Trade Agreement (NAFTA) markets. This study also found that trade openness and macro-economic stability together with language and cultural similarity all had a positive influence on Australian FDI location selection, but not with the same level of statistical significance as the market size issue (Sharma & Bandara 2010, pp. 667-669).

Sharma and Bandara's paper provides no understanding of the outsize stock of Australian FDI in New Zealand. Path dependence, the influence accumulated knowledge has in shaping the internationalisation trajectory of a firm given the bounded rationality of any corporate actor, may offer an explanation because the 1983 Australia-New Zealand free trade agreement is Australia's first comprehensive bilateral agreement.⁸ Figure 9.3 below suggests that a self-sustaining pattern of typically small but successful Australian investors have followed an easy diversification path into the New Zealand market. That assessment is supported by the fact that there are more Australian manufacturing, retail, media, financial and technical services company investors in New Zealand than any other country (Goodman 2015, p. 11). The number of Australian companies operating in the major markets by industry sector is set out in Figure 9.3.

⁸ <https://www.austrade.gov.au/Australian/Export/Free-Trade-Agreements/ANZCERTA>

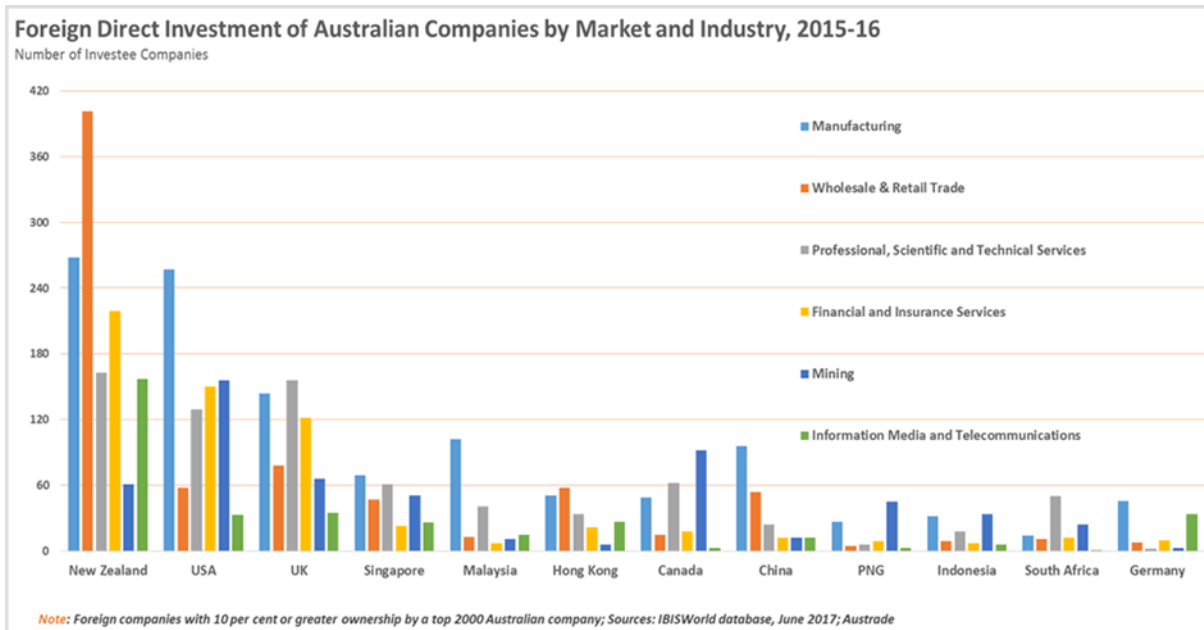


Figure 9.3 Foreign Investment of Australian Companies by Market and Industry, 2015-16 (Source: Tang 2017, pp. 1, 6).

It is instructive to consider what impact the loss of access by Australian companies to the EEC, and possibly the NAFTA market, may have on Australian FDI investors in the UK and the US. One outcome could be to encourage Australian MNCs to consider the ASEAN region. Like the UK and the US, several ASEAN host nations have large domestic markets and there is slow but real progress towards realisation of the ASEAN Economic Community's objective of a single free trade market (Tangkitvanich & Rattanakhamfu 2017). In summary, Australia is a significant global FDI investor. Australian companies have offshore investment operations in all industry sectors in developed and developing economies. However, Australian companies are notably underinvested in Asia generally and in Indonesia especially.

I have established that Australian companies have both the necessary FDI scale and industry diversity necessary to make a meaningful contribution to Indonesia's national development. In turn, Indonesia's successful economic and accompanying institutional development should reduce prospective threats to Australia's national security. What remains to be established is whether there is a potential economic diplomacy program that could foster Australian outward FDI to the ASEAN region and to Indonesia specifically. What follows is a two-step process to identify that possibility. The first step is an assessment of the Indonesia-Australia Comprehensive Economic Partnership Agreement's contribution, before the final section sets out the case for an Australia FDI support agency.

9.4 Indonesia-Australia Comprehensive Economic Partnership Agreement (CEPA)

The wisdom of the observation by Carl Hinze (2015, pp. 3-4) noted in Chapter 3 that the development of business relationships in Asia require a long lead time and a deliberate courting process with many meetings and business trips is currently being demonstrated by the extended Indonesia-Australia CEPA negotiation. Discussions began in 2010 but were suspended in 2013 due to diplomatic tensions over Australia's ban on live cattle exports and the tapping of President Yudhoyono's telephone. Following the reactivation of negotiations in 2016, Australia looks to have displayed a characteristic Anglo priority of pressing for agreement completion over the 'ASEAN Way' of relationship development.

Announcements by senior Australian Ministers that deal completion was expected by December 2017, then March 2018, have both proved inaccurate and by mid-2018 no completion date has been announced. Nevertheless, negotiations are continuing on a small

number of unresolved issues amongst which is access by Australian institutions to the Indonesian education sector.⁹ Indonesia has explained the delay by stating that CEPA will be the first trade agreement that it has signed with any country in almost a decade and they are a 'bit rusty' and 'out of practice' in negotiating (Busch 2017).

CEPA is relevant to my thesis because a comprehensive trade and investment relationship could provide the platform for development of the complex interdependence which Keohane and Nye assert is the precursor to opening multiple channels through which effective bilateral relationships can be established (Keohane & Nye 1977, pp. 24-25). Finalisation of CEPA may facilitate increased Australian FDI and in turn have some security threat mitigating outcomes.

There are, however, other aspects of CEPA that reinforce its potential significance to the Australia-Indonesia relationship. My assessment of institutional theory in Chapter 2 established that successful transnational agreements are distinguished by the treatment of four issues:

- The distribution of systemic gains from an agreement
- The depth of a state's commitment to an agreement
- The basis on which states have flexible participation in an agreement
- Accommodation of global multilateralism's impacts within the cooperation provisions (Gilligan & Johns 2012, p. 228).

⁹ <https://www.smh.com.au/business/australia-and-indonesia-fail-to-meet-fretrade-deal-deadline-20171221-h08qz0.html>

One of the few documents available from the CEPA deliberations is a 2016 submission to the Trade Ministers by the combined national Chambers of Commerce, Business Councils and Employer groups of both Australia and Indonesia. Subject to incorporation of the Business Partnership Group's (BPG) core proposals into the final Agreement, there are good reasons to anticipate that CEPA will provide mutually positive outcomes in relation to three of the four key cooperation criteria. That observation is based on the following review of BPG's submission as it applies to each of the four cooperation criteria.

First, the distribution of systemic gains from the agreement will be distributed equitably because of the following provisions:

- Obligations to establish two-way cross border Customs Pre-Inspections
- A commitment to jointly develop a 2030 Indonesian Food Security Plan
- Pursuit of opportunities to establish cross border generation and supply of electricity
- Establishment of a Public Private Partnership (PPP) Centre to facilitate bilateral infrastructure project developments

Second, BPG's provisions demonstrate a significant level of government commitment to the agreement because:

1. Revised visa categories will improve the two-way transfer of tourists as well as professional and skilled individuals.
2. Widely accessible language and cultural orientation programs are to be established.
3. A joint Indonesia Australia Agribusiness Leaders Network and grains industry Centre of Excellence will be established

4. Maritime and aviation transport links between Northern Australia and Indonesia will be improved
5. The countries will initiate a program to harmonise commercial governance and professional training standards.

BPG's submission addresses commercial issues so there are no recommendations that relate to penalties and the flexibility of state participation in the agreement. However, there are two recommendations that reflect the impact of global multilateralism on the participants. The first is an undertaking by both states to collaborate on opportunities to promote the region's tourism potential to the global market and the other is an undertaking to pursue cross-border cooperation to enhance access to global value chain production and distribution opportunities (Indonesia-Australia Business Partnership Group 2016, p. 14).

A notable aspect of BPG's submission to the CEPA negotiators is the alacrity with which it describes the process used to develop the joint recommendations. The parties describe the level of joint consultation on which the recommendations are based as 'gold standard' (Indonesia-Australia Business Partnership 2016, p. 4). The process is an operational example of hallmark ASEAN-style consultation, consensus-building, discreetness, informality and non-confrontational bargaining. The final Comprehensive Economic Partnership Agreement should serve as a model for similar Indonesia-Australia comprehensive agreements in other issue-areas.

9.5 Exemplars for an Australian OFDI support agency

The idea that governments might influence cross border flows of FDI capital is at odds with orthodox neoclassical economic theory. Yet, this section illustrates that such agencies are a long standing and seemingly uncontested reality for the majority of OECD and many other states. In fact, Australia is now a notable exception with its minimal support for OFDI initiatives. That was not always the case as a successful OFDI support agency was inaugurated by the Fraser Liberal-Coalition government in 1982 and was continued by succeeding Labor governments until it was peremptorily cancelled soon after the Howard Liberal-Coalition government was elected in 1996 (Tomar 1995-96).

The fact that OFDI support agencies have an accepted role in global capital markets is indicated by the publication in 1999 of a UN Conference on Trade and Development *Handbook on Outward Investment Agencies and Institutions*. Based on survey responses from almost 100 government-supported OFDI institutions, the Handbook categorises support functions provided by government agencies as being either investment promotion, the provision of development finance or a source of investment guarantee facilities (UNCTAD 1999). My analysis identified at least twenty-three current state-supported OFDI agencies: fifteen EU states, the US, UK, Japan, China, Singapore, India, Canada and Brazil.

State intervention in the globally competitive FDI marketplace has clear parallels in another seemingly highly competitive environment and that is the field of technological research and innovation. In each case, state participation in an essentially private sector market process is long-standing yet rarely acknowledged and poorly understood. Research and innovation is

typically represented as a private sector obligation, with governments having little engagement apart from maintaining market competition and perhaps correcting market failures by ‘incentivising’ research in projects or sectors with particular public merit. Recent research by Mariana Mazzucato (among others), though, has argued that there is in fact a long practice of governments being widely involved in the innovation process. Mazzucato’s examples are state engagement to maintain the long-term US research and development of computing and information technology, and alternative energy research programs in Germany, Denmark and China (Mazzucato 2015, p. 98). The relevant parallel with the role of government OFDI agencies is the commitment of the long-term or ‘patient’ capital necessary to sustain ventures through the high-risk phase of development. Indeed, indications are that the need in developed economies for the commitment of ‘patient’ government capital is unlikely to decrease because corporate short-termism continues to reduce private research expenditures (Lazonick 2015, p. 91). Although the R&D-FDI parallel is not exact, the basis for state intervention policies that sustain projects through the higher risk development phase is the potential to produce longer term, nationally significant innovation and relationship benefits.

A proposal to establish an Australian government backed OFDI agency might be opposed by some parties because of a perception that OFDI projects have adverse employment impacts. Despite such a claim having been made by the current US President the assessment is inconsistent with findings in most academic research.¹⁰ Several EU, US and Japanese studies

¹⁰ <https://qz.com/1144201/under-trump-us-jobs-are-moving-overseas-even-faster-than-before/>

conclude that home country employment effects of OFDI are limited or have a small beneficial impact (Sunesen et al. 2010; Lipsey et al. 2000; Masso et al. 2008; Becker & Muendler 2008; Castellani et al. 2008; Yamashita & Fukao 2010). Nevertheless, various studies have identified adverse OFDI employment impacts in specific cases such as the loss of seafood processing in New Zealand (Stringer et al. 2011) and the transfer of certain manufacturing activities from Malaysia to Vietnam (Lim 2017). Apart from employment effects, other studies identify significant home country productivity benefits and export gains from OFDI that extend beyond first-order advantages to individual companies (Tang & Altshuler 2014; Sunesen et al. 2010).

The likelihood that OFDI support programs have significant beneficial spill-over effects in the home economy is apparent in the scale and enduring government support for the programs by most OECD member countries. Government backed OFDI programs date from the 1970s. In 2014 the current portfolio value of FDI projects backed by the US and the fifteen member states of the European Development Finance Institution (EDFI) exceeded US\$70 billion (Savoy et al. 2016, p. 5). Individual agency mandates vary, but one of their common functions is assisting home companies to pursue investment opportunities in emerging economies. The facility is usually, though not always, provided when standard commercial funding, insurance or other services are not commonly available to investors in the host country.

Karl Sauvart and co-authors identify six general categories of government OFDI support sources. Within each category there are numerous individual forms of assistance. The categories are:

- i. Institutions
 - a. Export-import banks
 - b. Investment insurers
 - c. Development finance institutions
- ii. Information services
 - a. Foreign market economic, legal, political data
 - b. Investment missions
- iii. Financial measures
 - a. Feasibility and pre-investment grants
 - b. Reimbursement of overseas set-up costs
 - c. Concessional loans, currency hedging, direct or quasi-equity finance
- iv. Fiscal measures
 - a. Tax exemptions or deferral on foreign income
 - b. Leveraged tax deductions for foreign expenditures
 - c. Corporate tax rate relief for enterprises in particular sectors or destinations
- v. Investment insurance
 - a. Cover for expropriation, political violence, currency risk, suspension of capital or profit remittance
- vi. Treaties
 - a. Bilateral investment treaties
 - b. Double taxation treaties (Sauvant et al. 2014, pp. 13-15)

Some states enhance this suite of assistance with additional advantages for small and medium size enterprises (SME) that engage in OFDI projects. Countries such as the US, China and the Republic of Korea each provide specific financial or capacity building assistance to enable SMEs to expand offshore. These specialised facilities enable SMEs, which constitute the bulk of the private sector in most economies, to access support services and adjust to cultural differences on terms equivalent to large enterprises (Sauvant et al. 2014, p. 23).

All the above competencies would warrant consideration in structuring an Australian OFDI support agency, but there are examples of more narrowly focused incentive programs that are especially relevant to the Australia-Indonesia context. The most directly comparable models for a potential Australian agency focused on assisting OFDI in Indonesia, are Spain's COFIDES, France's OSEO, Italy's SIMEST, and Singapore's IE (Sauvant et al. 2014, p. 42).¹¹ These examples are most relevant because they constrain the OFDI support services to companies operating in particular countries or specific industry sectors.

The US Overseas Private Investment Corporation (OPIC) appears to be the only government OFDI support agency that formally recognises FDI's foreign policy impacts. OPIC's website describes the organisation as a self-funding US government agency that mobilises private capital to promote growth in developing economies and in so doing, 'advances U.S. foreign policy and national security priorities.'¹² The view that US OFDI can impact foreign policy outcomes was expressed by Jeffrey Garten almost two decades ago. Garten depicted

¹¹ See <https://www.cofides.es/en/about-us/> (COFIDES), <https://www.tresor.economie.gouv.fr/Ressources/File/372129> (OSEO), <http://www.eca-watch.org/ecas/simest-societ%C3%A0-italiana-le-imprese-allestero-spa> (SIMEST) and <https://www.enterprisesg.gov.sg/about-us/overview> (IE) respectively.

¹² <https://www.opic.gov/who-we-are/overview>. Viewed 29 August 2016

American firms as de facto agents of US foreign policy and noted that in emerging markets America's political and economic goals are highly dependent on direct investments by US businesses in factories and other hard assets (Garten 1997, pp. 68-71).

Established in 1971, OPIC has operated at no net cost to American taxpayers for thirty-eight years. OPIC generates operating profits by providing direct loans, loan guarantees, political risk insurance and supporting private equity investment funds that co-invest with US companies in emerging market projects. OPIC has backed over 4,000 projects and sustained more than 277,000 jobs.¹³ OPIC's joint government private-sector financing and project management ability position it as a model for another emerging foreign policy role which is to supplement the increasingly insufficient government allocations of global 'foreign aid' or official development assistance (ODA).

In the last two decades Government supported OFDI agencies have become an integral part of the global development assistance program. A 2016 Centre for Strategic and International Studies report notes that official government and NGO donor resources are insufficient to fulfil commitments to Sustainable Development Goals, the Paris climate undertakings and support continuing crisis needs in conflict-afflicted states. As a result, the international development community has recognised that private sector engagement is essential if long-term, sustainable economic growth and poverty eradication objectives are to be achieved. Jobs, economic growth and increased local taxes are the key to achieving those objectives and FDI can deliver all those outcomes (Savoy et al. 2016, pp. 3-4).

¹³ <https://www.opic.gov/who-we-are/faqs>. Viewed 29 August 2016

OFDI agency facilitation of government co-funding and risk sharing provides a model for private sector engagement in development assistance programs because it enables companies to pursue approved development projects that deliver host and home country commercial benefits. This model has already changed the global development finance architecture. Prior to the 2002 UN Monterey Conference titled *Financing for Development*, aid agencies had pressed official development assistance donors to meet the target of 0.7% of gross national income in order to finance global development objectives. The Monterey Conference accepted that ODA levels were inadequate and that private-sector investments were a necessary source of additional funding. Since 2002 OFDI support agencies have played a significant role in influencing FDI flows to the point where a ‘watershed’ 2015 UN conference in Addis Ababa acknowledged the central role of the private-sector to the achievement of development funding objectives. By 2015, private-sector FDI from developed to developing countries had reached five times the level of public sector ODA. The Addis Ababa conference concluded that in future the role of ODA should be as a ‘catalyst’ to mobilise private resources for development projects through ‘blended, pooled, or risk mitigating tools’ (Savoy et al. 2016, pp. 3-4).

The longstanding US, European, Japanese and more recent OFDI support agencies in China, Brazil, Singapore and India have had a significant influence on the flow of global capital to developing economies. Policymakers deploy these agencies to achieve broader foreign and national security objectives (Savoy et al. 2016, p. vi). Despite these notable precedents, the potential role for an Australian OFDI support agency apparently has not been identified by economic diplomacy protagonists in either the aid community or business representative

bodies. Surprisingly, only one of my interview respondents was even aware of an OFDI support agency’s influence on overseas corporate activity in Indonesia. This respondent observed that Japanese executives were more strongly influenced in their investment decisions by national rather than corporate policy priorities.¹⁴

9.6 Conclusion

The example of more than twenty government supported OFDI agencies provides the basis on which I conclude that the Australian government could, and should, establish such an agency as a mechanism to promote substantial private-sector investment and economic development in Indonesia. Appropriate management and sectoral investment selection by the agency could benefit Indonesia with jobs, economic growth and increased local taxes. Over and above private sector economic benefit, Australia’s benefit would be development of the strong and productive relationship which the Defence Department has determined is critical to Australia’s national security.

An Australian OFDI support agency’s geographic mandate would ideally include all ASEAN states, and its charter would balance an overt security and foreign policy emphasis with a ‘patient capital’ support role for commercial FDI ventures. Agency-backed projects would help to bridge the Australian cultural and commercial divide with the region and more closely align Australia’s interests with those of Indonesia and the broader ASEAN community.

¹⁴ A1, 29 May 2017. Face-to-face interview

Operational considerations for an Australian agency are beyond the scope of this thesis. However, a dedicated support agency might offer two potential benefits beyond enhancing the Indonesian security relationship. First, it would overcome the current economic diplomacy failure to support overseas business ventures. Second, and more importantly, it would provide a template for the co-mingling of public development assistance funding with the much larger pool of corporate sector finance in risk sharing development initiatives that achieve overseas aid, FDI and foreign policy objectives.

In summary, a dedicated support agency would be economic diplomacy *smart engagement*. Consistent with the ACLA *smart engagement* ideal, it would deliver the ‘slow and patient nurturing of long-term, sustainable, mutually beneficial relationships ... beyond the pursuit of purely transactional relationships for short-term self-interested gain (Ang 2017, p. 23).

Chapter 10: Conclusion

This is the thesis of a conceptual pluralist. It looks to diverse sources and theoretical traditions in a quest to establish if Australian direct investment could contribute to the development of a stronger bilateral relationship with Indonesia. Others have had this ambition but the goal of a robust political, economic, cultural and security relationship with Indonesia seems as elusive now as it was to Foreign Minister Gareth Evans three decades ago:

I look forward to the day when the interests of Australia and Indonesia are so varied and so important that we no longer talk of ‘the relationship’ as though it were a patient of precarious health, sometimes sick, sometimes healthy, but always needing the worried supervision of diplomatic doctors (Evans 1988, pp. 6-7)

Today’s diagnosis would likely be that the ‘the patient’s’ condition is unchanged even though the patient has grown substantially in size and complexity.

My objective in writing this thesis has been to examine the interconnections between security imperatives and commercial opportunities in the Australia-Indonesia relationship. Australian analysts are increasingly apprehensive about the ongoing relational uncertainty between the two states. The 2016 Defence White Paper’s assessment was that ‘a strong and productive relationship’ with Indonesia was vital to Australia’s security (Commonwealth of Australia 2016a, p. 59). Hugh White has entreated Australians to take Indonesia very seriously because it is fast becoming as important to Australia as China is now to the US (White 2013, p. 30).

Furthermore, the relationship is increasingly asymmetrical: Indonesia has no particular need for a strong relationship with Australia (Lindsey 2017b, p. 4) but, as my analysis illustrates, there are Indonesian sourced threats to Australia's national security, making a strong relationship with Indonesia vital to Australia.

These security considerations and a knowledge of Australia's corporate apathy towards Indonesian investment opportunities have provided the impetus for my examination of the prospect that Australian FDI might help build a stronger relationship with Indonesia.

My analysis required answers to these three sub-questions:

1. What accounts for Australia's lack of effective bilateral political and economic engagement with Indonesia?
2. Why is a strong and productive relationship with Indonesia critical to Australia's national security?¹
3. Could FDI as an Australian economic diplomacy initiative help mitigate Indonesian sourced threats to Australia's security?

10.1 Culture and foreign policy

Cultural differences and strategic foreign policy preferences are pivotal to the enduring uncertainty in this relationship. Australia's political and economic engagement with Indonesia has been insubstantial for most of its seven decades of post-independence history.

¹ '[A] strong and productive relationship with Indonesia is critical to Australia's national security', (Commonwealth of Australia 2016a, p.125)

Chapter 3 examined why the relationship is uncertain. One explanation lies in the dissimilarity in language, religion, history, culture, ethnicity, population size, political system and legal practices of the two countries. More detailed analysis, though, illustrates that most Australian political and business elites have not attempted to cross these cultural barriers to presage the development of trusted relationships in Indonesia. One early step must be to reject the 'smug self-satisfied superiority that distinguishes Australia's approach to all things Asian' (Behm 2016).

Hofstede's measures of cultural difference set out in Chapter 3 identified several qualities that confounded ill-informed 'outsiders' trying to engage with Indonesia's dominant Javanese culture. First, is the Indonesian preference for consensus, group harmony and in-group decision making which is highly discordant with the accepted Australian preference for individualism and personal assertiveness. Second, is the deep Indonesian regard for tradition and established practices so that new relationships are built slowly and are based on a regard for local cultural traditions. Long lead times, recurrent meetings, banquets and social events can frustrate unaware Australian counterparts focused on short-term transactional goals. The third distinction is a deference to age and position which is less evident in Australian corporate or political settings.

Differences in bilateral security and foreign policy priorities are much more overt. Australia has a security dependence on 'great and powerful friends' (Shephard 1992, p. 1) based on the ANZUS security pact and a seemingly lock-step commitment to support US foreign policy endeavours. Indonesia's equally long-standing commitment is to Non-Aligned Movement principles. Indonesia's Constitution precludes entering into security treaties with great

powers or hosting a foreign military presence. Chapter 4 examines how such foreign policy misalignments limit bilateral defence treaty opportunities with Indonesia and constrain Australia's ASEAN involvement.

ASEAN's commitment to non-alignment, consensus-building, discreetness, informality and non-confrontational bargaining has advanced multilateral economic and security cooperation and minimised great power engagement in Southeast Asia for five decades (Phillips & Hiariej 2016, p. 425). However, as illustrated in Chapter 4, the increasing US-China rivalry may lead to the need for an alternative and closer Australia-Indonesia relationship, and create opportunities for alignment with other regional middle power states. Australia's *2017 Foreign Policy White Paper* looks for development of closer economic and security cooperation with the Indo-Pacific middle power democracies of India, Japan, Indonesia and South Korea. A subsequent Indonesian proposal envisaged ASEAN and India as the 'backbone' of a new Indo-Pacific regional architecture. These developments may signal a need for Australia to invest more heavily in relationships outside of the US alliance. If so, the Australia-Indonesia relationship would have even greater strategic significance.

10.2 Threats to Australia's security

I addressed my second sub-question by first establishing why defence analysts have determined that a strong relationship with Indonesia is vital to Australia's security, and identifying possible Indonesian threats to Australia's security. As Indonesia does not currently have the military capability to threaten Australia's *sovereignty* and is unlikely to

acquire that ability within the defense planning horizon (Commonwealth of Australia 2016a, p. 40), the focus of my analysis has been on perceived threats to Australia's *national* security.

National security is a constructed concept that defies formal definition, but it can be described as the protection of 'how we live in our community and our sense of well-being' (Leahy 2013, p. 38). In the Australian political context non-traditional threats to national well-being are associated with acts of terrorism, 'illegal' immigration or human and narcotics trafficking. Of these, only terrorism is the subject of a formal security threat assessment, but the assessment does not seek to establish the possible causes or origins of those threats. My analysis establishes the cause of several threats to Australia's national security that may originate from Indonesia.

My findings are based in part on an analysis of Indonesia's *2015 Defence White Paper*. The Paper highlights terrorism and separatism arising from religious intolerance and inter-ethnic violence as significant threats to Indonesia's national security. In addition, the return of radicalised Islamic State fighters to Indonesia and the failure of programs to de-radicalise convicted terrorists exacerbates the potential for extremist violence to damage Australia's interests in Indonesia or elsewhere.

Looking to the causes of terrorism also strengthens the need for a strong and productive Indonesian relationship. Poverty is often cited as a cause of terrorism, but academic studies indicate that it is not poverty alone that fosters violence. Rather it is poverty in combination with repressive institutional settings that fosters the possibility of terrorist violence (Kurrild-Klitgaard et al. 2006; Piazza 2008). Poverty levels in Indonesia have halved since 2000 to

about 10% and economic growth is sufficient to maintain unemployment near 5.5%. However, Indonesia's transition to democracy and building of institutions such as the Corruption Commission has either stagnated or has begun to regress (Warburton & Aspinall 2017; Lindsey 2017; Robison & Hadiz 2017; Hadiz & Robison 2017). A worst-case outcome is the prospect of an authoritarian nationalist or extreme Islamic government being elected: that would pose a strategic challenge for Australia (Dibb 2012, p. 28). Such a prospect underscores why the Defence White Paper calls for Australia to develop a productive relationship with Indonesia.

10.3 Could FDI contribute to a stronger relationship?

I used a four-step process to answer my third sub-question, which was to examine the possibility that FDI might help mitigate Indonesian sourced threats to Australia's national interests. Since there is little significant research into the impact of FDI on bilateral security relationships, I sought to develop a hypothesis. This analysis began in Chapter 6 by identifying in trade-security studies, causal mechanisms by which trade has been shown to restrain bilateral conflicts. Chapter 7 examined the implications of these findings when FDI is substituted for trade as the independent variable in six established mechanisms through which trade influences security. I then used this analysis to develop an FDI-security hypothesis which informed my analysis of the potential security benefits of Australian FDI in Indonesia.

However, the knowledge that Australian FDI can bring security benefits will only be helpful if there is a reasonable commercial basis for companies to pursue investment opportunities. If

either Indonesia does not require inward FDI, or Australian companies do not have the desire or the financial capacity or technical capability to pursue Indonesian investment opportunities, then FDI flows are unlikely. Each of those potential barriers are addressed in Chapter 8. I argued that Indonesia has substantial infrastructure and industrial development needs that are set down in its national development plans. I also confirmed that Australian companies are both willing and able to pursue FDI opportunities: Australian companies are already significant outward global investors in both industrial and service sector projects.

The final step in establishing if Australian FDI might influence the Indonesian relationship was to question why Australian companies had not already pursued Indonesian investment opportunities. Cultural difference and path dependence provide part of the answer. Another reason for Indonesia being host to less than 1% of Australia's OFDI is the low corporate risk tolerance of Australian companies. The low risk threshold is attributable to the combination of Australia's long period of satisfactory GDP growth and managerial short-termism which does not reward longer term development initiatives.

Low risk tolerance and short-termism impact the OFDI decision making of most trans-national company executives. Yet, unlike Australia, company executives in the UK, US, Japan and the Netherlands are substantial investors in Indonesia. Why? One possible explanation is the influence government backed OFDI support agencies in those countries (and many others) have on corporate investment location decisions. The global impact of these long-standing government backed OFDI support agencies, and the potential benefit of such an agency in Australia were examined in Chapter 9.

Notwithstanding the paradox of OFDI support agencies operating in economies whose officials avow orthodox neoclassical free market economies principles, these agencies serve to varying degrees as functional government agents. They help to facilitate overseas economic development objectives and to pursue foreign policy objectives. For example, the US government's Overseas Private Investment Corporation declares that its purpose is to promote growth in developing economies and to advance U.S. foreign policy and national security priorities. Government backed OFDI agencies support offshore projects by providing, in various forms, so called 'patient' or long-term capital necessary to sustain investment ventures in developing economies through the high-risk establishment phase of development. Agency support is usually only extended when standard commercial alternatives are not commonly available. My analysis establishes that OFDI support agencies have served to enhance economic growth, create employment opportunities and increase local tax revenue, subject to appropriate host country policy settings and development priorities (Savoy et al. 2016, pp. 3-4).

Chapters 8 and 9 established that FDI can have conflict mitigating capabilities. They also established that Indonesia has a requirement for inward FDI, that Australia has the capability to satisfy part of that requirement, and that government backed OFDI support agencies facilitate long term foreign investment projects in developing countries. Consequently, I argue that an Australian government supported OFDI agency is one economic diplomacy initiative that could help mitigate Indonesian sourced threats to Australia's security. That conclusion rests on the expectation that Australian FDI will contribute to economic growth,

jobs and tax revenue in Indonesia and that development benefits will flow-on to poverty reduction and the maintenance of political and institutional governance standards.

10.4 Contribution and further research

My findings have practical relevance for Australia's economic diplomacy policy because an Australian OFDI support agency could be established within the financial framework of the current development aid program. That initiative could be consistent with such agencies overseas and like those agencies, its purpose would be to create a source of long-term, patient capital to facilitate Australian FDI projects in strategically significant countries like Indonesia. As illustrated in Chapter 9, that initiative would supplement the formal donor aid budget with private sector OFDI investment capital.

Finally, my thesis suggests two further research projects. The security effects of post-1980s flows of FDI to developing economies seem to be under-researched. Despite growing recognition in IR and development economics literature of the scale and reorientation of FDI flows to developing states, there is little analysis of the security impacts of these changes. Empirical studies to date have been constrained by the lack of availability and comparability of FDI data from developing countries, but data quality is improving. The hypothesis developed in this thesis has not been empirically tested, so a large and significant research project is warranted when adequate data sets are available.

Another apparent research opportunity is an examination of the theoretical and even operational implications that would attach to the establishment of an Australian OFDI support agency. In circumstances where the Australian government's official donor aid

program is being reduced, the prospect that an OFDI agency like those operating elsewhere could serve to co-mingle private and public-sector investments to achieve both commercial and foreign policy objectives would be a timely research initiative. Such an initiative may offer a sustainable remedy for the lingering anaemia of Australia's bilateral relationship with Indonesia.

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Appendix I

Definitions – Australia’s well-being and national values

For clarity, my definitions of what constitutes the primary *referent objects*¹ of Australia’s national security are:

- Threats to the *wellbeing* of Australia’s citizens – wellbeing itself is an uncertain measure that may be based on issues of income, employment, health, education, environment, personal safety, civic governance, access to community services or a broad measure of life satisfaction.² My analysis uses the Australian Unity Index of Wellbeing developed in 2001 by Deakin University.³
- Threats to Australian *national values*⁴ – the measure of which is provided by an Immigration Department values statement that forms part of a residency visa application requirement: The major provisions of the Australian Values Statement are:
 - respect for the freedom and dignity of the individual, freedom of religion, commitment to the rule of law, Parliamentary democracy, equality of men and

¹ Baldwin 1997, p, 13

² See: OECD Regional Well-being Indicators – <<http://www.oecd.org/regional/how-is-life-in-your-region.htm>> viewed 7 May 2017.

³ See: Australian Unity Wellbeing Index, <<http://www.acqol.com.au/reports/auwbi.php>> viewed 18 May 2017.

⁴ See: Australian residency visa declaration – Australian National Values. <<https://www.border.gov.au/Trav/Life/Aust/Values-statement/living-in-australia-values-statement-long>> viewed 5 December 2016.

women and a spirit of egalitarianism that embraces mutual respect, tolerance, fair play and compassion for those in need and pursuit of the public good

- equality of opportunity for individuals, regardless of their race, religion or ethnic background
- English language, as the national language

(Commonwealth of Australia 2016c)

Appendix II

Chronology of Peace Theory Literature

Table II.1. Chronology of democratic and capitalist peace theory literature

Study author and date	Study conclusion	Addition to prior studies	Data description
1. Kant (1795) – (1957) translation	Conditions for Perpetual peace: A republican (democratic) government; ‘cosmopolitan law’ for trade and economic interdependence and a ‘pacific union’ based on international law. The basis to overcome anarchy and secure peace.		
2. Babst (1972)	Independent nations with elective governments did not engaged in war between 1789 and 1941 (p. 55).	The inaugural empiric test of DPT. ¹	Wright (1942), <i>A Study of War</i>
3. Rummel (1983)	Violence does not occur between libertarian states; the less free a state the more violence it engages in (p. 67).	Employs a broader data set and more rigorous analytics than Babst.	Babst (1972), Rummel (1979), Small & Singer (1976)
4. Maoz & Abdolali (1989)	Both democracies and autocracies have equal overall conflict involvement.	Democracies are quick to enter conflicts but refrain from escalations to war. Like democracies, autocracies do not war with each other (p. 30-32).	Analysed all MID ² s 1816 -1976.
5. Morgan & Campbell (1991)	Shows only weak support for the democratic peace theory. Conclusion – ‘the argument might have some merit’ (pp. 206-7).	‘Democracy’ is not a uniform or consistent force for peace. Effort is required to identify economic or other confounding variables (p. 210).	MIDs 1816-1976. 91 wars from 960 MID ² s. Historically few democracies so low prospect of dyadic democracy war (p. 196-7).
6. Bremer (1992)	Tested six likely war factors.	Introduced dyads as the	1816-1965 standard

¹ DPT = Democratic peace theory

² MID = Militarised interstate dispute

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Study author and date	Study conclusion	Addition to prior studies	Data description
	Found territorial contiguity, no security alliance, neither state being an advanced economy, only one state being a democracy as the likely dyadic dispositions for conflict (p. 338).	standard unit for MID research. Noted that priorities of earlier peace research 'may be seriously distorted' (p. 338).	MID Correlates of War data.
7. Dixon (1993)	Two empirical facts: - Democratic states overall war about as often as others. - Democratic states virtually never war with one another (p. 64).	Prior explanations of conflicts are inconsistent. Results indicate that normative democratic dispute management processes provide an explanation for nonviolence (p. 64).	~ 250 post WWII interstate security disputes (p. 43).
8. Cohen (1994)	Democracy-peace correlation only holds for North Atlantic/West Europe post 1945 (p. 220). Other explanations of causality are likely to be more compelling.	Possibly a hidden third factor. Reverse causality or historic circumstances may provide a better explanation (p. 210).	Case study review of twentieth century conflicts.
9. Layne (1994)	Realism is superior to DPT as a predictor of dispute outcomes. DPT appears to play no discernible explanatory role in the 4 case studies examined (p. 38).	Challenges DPT empirics – the sample size is small, the frequency of war is low and not all democracies are war capable (p. 39).	Detailed case study analysis of 4 MIDs.
10. Chan (1997)	The literature presents a 'disjunction' of theoretical expression and empirical practice (p. 60). Disagreements are an iterative process of criticism and response (p. 62). Ten further research topics identified (pp. 82-84).	There is a failure in 'conceptual clarification' that explains much of the theoretical debate (p. 85).	A detailed review of DPT literature extant to the study date.
11. Russett et al (1998)	Prior studies show joint democracy and economic interdependence reduce MIDs. This study presents shared IGO membership as the 'third leg' or pacific union' in Kant's tripod'.	One standard deviation additional shared IGO membership showed a 23% reduction in MIDs.	Study empirics are time bound to the Cold War era and spatially to Euro zone states.
12. Waltz (2000)	If democracies are reliably	Contrary to liberal	A commentary on

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Study author and date	Study conclusion	Addition to prior studies	Data description
	peaceful then we have ‘a purported fact begging for an explanation’ (p. 7). But since David Hume it’s known that an association of events does not infer a causal relation (p. 9). He endorses Mueller’s view that ‘it is not democracy that causes peace but other conditions cause both democracy and peace’ (p. 9). ³	institutionalist views post-Cold War resilience of NATO does not invalidate realist theory. Rather it illustrates the ‘subordination of institutions to national purposes’ (p. 18).	DPT.
13. Oneal et al (2003)	Provides causal findings that higher levels of trade interdependence markedly reduce conflict risk. Likewise, for shared IGO membership (p. 388).	These empirical findings are based on unique dyadic level data analysis and confirm most liberal peace theory tenets. A negative finding that security alliances do not reduce MID prospects is an exception (p. 388).	A large data set of 10,000 dyadic states from Correlates of War 1816-1992 MID data, Polity III democracy data, modified IMF <i>Directions of Trade</i> data, <i>Yearbook of International Organisations</i> for joint IGO membership and derived measures for military capability and security alliance membership (pp. 376-378).
14. Ward et al (2007)	By replicating previously accepted DPT data but adding a predictive out-of-sample modelling element the study highlights the weak predicative capabilities of earlier studies (p. 584).	This study is sceptical of DPT model adequacy. When one state’s repetitive aggression (or victimisation) is isolated, DPT conclusions are challenged. Modelling annual not aggregated period data weakens DPT orthodoxy (p. 597).	Usual Correlates of War MID, Polity II, GDP and population data (p. 598).

³ John Mueller, *Is War Still Becoming Obsolete?* paper presented at the annual meeting of the American Political Science Association, Washington, D.C., August 1991.

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Study author and date	Study conclusion	Addition to prior studies	Data description
15. Gartzke (2007)	Democracy 'cohabitates with peace. It does not by itself lead nations to be less conflict prone' (p. 167).	Presents theory and empirical support for capitalism and not democracy as the peace originator (p. 180). Asserts peace is attributable to intellectual and financial capital being 'enticed not conquered', foreign policy goals of mature democracies overlapping and global capital market signalling aiding communications (p. 166).	Extensive innovation of MID, Polity II and GDP data pp. 182-184.
16. Mousseau (2009)	Introduced a 'contract intensive economy' as the DPT third variable to explicate the 1961-2001 era of democratic peace. The causal mechanism is economic and not attributable to the governing institutions (pp. 53-54).	Introduced density of life insurance contract coverage as the proxy for a 'contract intensive economy' (p. 65). Premise is states that respect the rule of (contract) law have leaders that respect the sovereign rights of other states (p. 62).	Dataset is insurance contracts for sixty-five states, much of it only for 1978-2000 (p. 66).
17. Dafoe (2011)	Gartzke's 2007 claim that capitalism not democracy disposes peace is based on three flawed sample selection issues. When 'corrected' capitalist peace claims are no longer compelling (p. 259).	Dafoe accepts there are 'plausible causal connections between capitalism, income per capita, and democracy' in the peace hypothesis. But democracy remains a basic (though not sole) element of the liberal peace (p. 259).	Re-examination of Gartzke's 2007 data set.
18. Ungerer (2012)	Reverse causality (more peace causes more democracy) and capitalist peace theories are under researched. Using Lakatosian research methodology shows many prior DPT studies were flawed (p. 2).	Negative peace (the lack of conflict) needs to be matched with further positive peace (why harmony) research. Reverse causality and the contract intensive economy are promising DPT research issues (p.	DPT studies subjected to a Lakatosian research review to reveal progressive research contributions (pp. 15-22).

Study author and date	Study conclusion	Addition to prior studies	Data description
		25).	
19. Crescenzi & Kadera (2015)	Understanding how global economics impact international relations demands better theories of state and market interactions. It is simplistic to aggregate state level experience to represent the systemic condition (p. 7).	Democracy and economic development have complimentary roles in explicating the democratic peace. Those who claim either is solely accountable have the difficult task of identifying and empirically testing the causal mechanisms (p. 7).	Based on Gartzke and Weisiger (2014) data file with modified Polity scores (p. 4).

Table II.2. Chronology of regional and FDI peace theory literature

Study author and date	Study conclusion	Addition to prior studies	Data description
1. Rosecrance & Thompson (2003)	FDI is a cross-border link that is costly and time-consuming to break. Reciprocal FDI provides the most stable assurance of low conflict between states (p. 377). Whether security fosters investment or investment generates peace or they are mutually reinforcing is uncertain (p. 391).	No prior study had examined the incidence of conflict between states with symmetrical stocks of FDI. FDI conflict moderation exceeds impacts of trade and portfolio investments (pp. 389-391).	Correlates of War conflict data modified to align with periods of available FDI and IMF trade flow data. n = 2418 dyad years (pp. 394-396)
2. Goldsmith (2006)	Few studies test the universality of peace theory or its specific application to non-Western regions. This study finds regional (South America, Asia, Africa) differences in conflict levels by regime type (p. 554).	The Kantian tripod is not sustained when examined in a regional context (p. 556).	Re-examination of Russett & Oneal (2001) data set (pp. 535-536).
3. Goldsmith (2007)	The pacific effect of democracy in Asia is weak but the effect of economic interdependence between Asian states is substantial. Economic interdependence	Strong indications that there are regional differences in motivators of international relations (p. 22).	Correlates of War (2003), Polity IV, trade interdependence from Gleditsch (2002), membership of international

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Study author and date	Study conclusion	Addition to prior studies	Data description
	with non-Asian states and institutional membership, apart from ASEAN, has contrary effects to DPT expectations (p. 5).		organisations from Pevehouse, Nordstrom & Warnke (2003) (pp. 22-23).
4. Altincekic (2009)	FDI and capital openness, not portfolio investment or trade, engender peaceful relations (p. 4). The greater the level of mutual dyadic FDI the lower the prospect of a MID (p. 16).	Identification of an 'FDI' peace.	Gartzke 2007 dataset with the IMF Index of 'openness' replaced with measure for FDI and portfolio investment (pp. 3-4).
5. Bussmann (2010)	When FDI stocks and flows replace trade as the proxy empiric for economic integration the result is a finding of conflict risk reduction (p. 143). The greater the level of global integration (inflow to GDP) the lower the potential for a MID (p. 147).	Confirmation of the role of FDI and indications that peace disposes to greater FDI and not the reverse.	Russett & Oneal (2001) forms the base data set with UNCTAD (2002) sourced for FDI stocks and flows (p. 145).
6. Li & Vashchilko (2010)	For both states and MNC investors MIDs reduce bilateral FDI significantly in high/low income dyads. But security alliances and mutual defence pacts between such dyads promote FDI. Neither of those effects is significant in high/high income dyads (p. 777).	Identification of the different consequence for FDI of a MID depending on the dyadic income mix of the conflicting states (p. 777).	1980 to 2000 FDI, MID, defence pact and GDP per capita data for 29 OECD and 29 non-OECD countries (p. 770).
7. Lee & McLaughlin Mitchell (2012)	FDI does not reduce initiation of disputes but it does diminish the prospect of resolution by military force (pp. 690-693). Empirics support reported examples of MNCs having a role in preventing MIDs (p. 695).	Evidence of MNCs actively engaging with governments to achieve peaceful resolution of cross border disputes (p. 695).	Hensel et al (2008) ICOW data for 1970-2001, World Bank (2009) FDI, FDI/GDP Li & Vashchilko (2010) and Gleditsch (2002) bilateral trade data (pp. 686-690).

Appendix III

Global foreign direct investment stocks y Total global corporate assets

Category	Value source	Value type	Value \$US Tr	Adjustment factor*	Est Book Value \$US Tr
All Stock Exchange Listed Cos.	World Bank ¹	Mkt Cap	\$63.3	÷1.8 ²	\$35.2
US Non-listed Cos	Forbes ³ Magazine	Revenue	\$1.6	÷1.2 ⁴ then ÷1.8	~\$1.0
Other Non-listed Cos	Est – US Mkt 50% global	Est revenue	\$1.6	÷1.2 then ÷1.8	~\$1.0
Alternative asset investors*	Towers Watson ⁵	Book value	\$6.3		\$6.3
Total est BV					\$43.5

Table III.1 Estimated total book value of global corporate assets (*Alternative asset investors – real estate, hedge funds, private equity, infrastructure and liquidity)

Notes:

1. The value of inward FDI stock is reported to the World Bank by individual countries but not by ownership category. **2014 Global inward FDI stock \$US 25.1 trillion.**⁶
2. No source of aggregate book value of all global corporate assets exists. The table details the basis on which an estimate of assets by category is derived.

¹ <http://data.worldbank.org/indicator/CM.MKT.LCAP.CD>

² <http://www.starcapital.de/research/stockmarketvaluation> – adjusting market capitalisation to book value

³ <http://www.forbes.com/sites/andreamurphy/2015/10/28/americas-largest-private-companies-2015/#6b0c3aa83095>

⁴ <http://www.starcapital.de/research/stockmarketvaluation>

⁵ <https://www.towerswatson.com/en-AU/Insights/IC-Types/Survey-Research-Results/2015/07/Alternative-asset-s-in-2015>

⁶ <http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx>. Table 3 2014

3. Stock exchange listed companies own the predominant part of all company owned assets. The factor applied to adjust share market capitalisation to book value of assets is the most critical and is the most reliable.

In summary, global foreign direct investment stocks of \$US25.1Tr represent approx. 57% of the \$US43.5Tr global corporate assets. Because there is a significant level of data uncertainty I have used an indicative ratio of 50% in my thesis.

Appendix IV

Ethics Approval

From: Faculty of Arts Research Office <artsro@mq.edu.au>

Sent: Wednesday, 29 March 2017 8:36 AM

To: Jonathan Symons

Cc: Arts Research Office; Yi Ren; Mr Alan McCormack

Subject: Final Approval - Issues Addressed_5201700109(R)

Ethics Application Ref: (5201700109) - Final Approval

Dear Dr Symons,

Re: ('How might Australian foreign direct investment benefit national security relations with Indonesia?')

Thank you for your recent correspondence. Your response has addressed the issues raised by the Faculty of Arts Human Research Ethics Committee. Approval of the above application has been granted, effective (29/03/2017). This email constitutes ethical approval only.

If you intend to conduct research out of Australia you may require extra insurance and/or local ethics approval. Please contact Maggie Feng, Tax and Insurance Officer from OFS Business Services, on x1683 to advise further.

This research meets the requirements of the National Statement on Ethical Conduct in Human Research (2007). The National Statement is available at the following web site:

http://www.nhmrc.gov.au/files_nhmrc/publications/attachments/e72.pdf.

The following personnel are authorised to conduct this research:

Dr Jonathan Symons

Dr Yi Ren

Mr Alan McCormack

NB. STUDENTS: IT IS YOUR RESPONSIBILITY TO KEEP A COPY OF THIS APPROVAL EMAIL TO SUBMIT WITH YOUR THESIS.

Please note the following standard requirements of approval:

1. The approval of this project is conditional upon your continuing compliance with the National Statement on Ethical Conduct in Human Research

(2007).

2. Approval will be for a period of five (5) years subject to the provision of annual reports.

Progress Report 1 Due: 29th March 2018
Progress Report 2 Due: 29th March 2019
Progress Report 3 Due: 29th March 2020
Progress Report 4 Due: 29th March 2021
Final Report Due: 29th March 2022

NB: If you complete the work earlier than you had planned you must submit a Final Report as soon as the work is completed. If the project has been discontinued or not commenced for any reason, you are also required to submit a Final Report for the project.

Progress reports and Final Reports are available at the following website:
http://www.research.mq.edu.au/current_research_staff/human_research_ethics/resources

3. If the project has run for more than five (5) years you cannot renew approval for the project. You will need to complete and submit a Final Report and submit a new application for the project. (The five year limit on renewal of approvals allows the Committee to fully re-review research in an environment where legislation, guidelines and requirements are continually changing, for example, new child protection and privacy laws).

4. All amendments to the project must be reviewed and approved by the Committee before implementation. Please complete and submit a Request for Amendment Form available at the following website:

http://www.research.mq.edu.au/for/researchers/how_to_obtain_ethics_approval/human_research_ethics/forms

5. Please notify the Committee immediately in the event of any adverse effects on participants or of any unforeseen events that affect the continued ethical acceptability of the project.

6. At all times you are responsible for the ethical conduct of your research in accordance with the guidelines established by the University. This information is available at the following websites:

<http://www.mq.edu.au/policy/>

http://www.research.mq.edu.au/for/researchers/how_to_obtain_ethics_approval/human_research_ethics/policy

If you will be applying for or have applied for internal or external funding for the above project it is your responsibility to provide the Macquarie University's Research Grants Management Assistant with a copy of

Appendix IV: Ethics Approval

this email as soon as possible. Internal and External funding agencies will not be informed that you have approval for your project and funds will not be released until the Research Grants Management Assistant has received a copy of this email.

If you need to provide a hard copy letter of approval to an external organisation as evidence that you have approval, please do not hesitate to contact the Faculty of Arts Research Office at ArtsRO@mq.edu.au

Please retain a copy of this email as this is your official notification of ethics approval.

Yours sincerely

Dr Mianna Lotz
Chair, Faculty of Arts Human Research Ethics Committee
Level 7, W6A Building
Macquarie University
Balaclava Rd
NSW 2109 Australia
Mianna.Lotz@mq.edu.au

Appendix V

Interview Question Template



Alan McCormack

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Doctoral thesis interview questions: 19 May 2017

Michael Helleman | Counsellor (Commercial) and Trade Commissioner, Jakarta

Australian Trade and Investment Commission (Austrade)

Australian Embassy, Jakarta

T + 62 21 2994 5440 | **M** +62 811 944 1001

Very briefly, the purpose of this questionnaire is to obtain qualitative responses concerning the primary issues in my research thesis. Those issues are:

- i. Why is there an enduring fractious national security relationship between Australia and Indonesia?
- ii. Would greater economic interdependence in general, and higher foreign direct investment in particular, contribute to building a more stable Australia Indonesia relationship?

I acknowledge that answers are solely those of the author not the organisation. I also confirm that it is your discretion whether or not to answer a particular question and that confidentiality of the responses is assured.

Alan McCormack

May 2017

Questions:

1. Please provide a brief summary of your Austrade responsibilities?
2. Is there a hierarchy of countries or regions with which Austrade seeks particularly to promote trade and FDI? If so, what priority is attributed to Indonesia or ASEAN states generally?
 - a. Is outward FDI by Australian companies to Asia, and Indonesia specifically, accorded particular recognition in terms of achieving DFAT's foreign policy and or commercial objectives?
3. DFAT policy situates economic diplomacy as a foreign policy priority that supports Australia's regional relationships. In practice, how does economic diplomacy serve to realise DFAT's relational objectives with Indonesia?
4. A recent CEDA *Outbound Investment* report asserts that 'doing business in Asia is difficult is accepted Australian board room folklore' (pp.57-58).¹ Is that consistent with your experience? In relation to Indonesia specifically, are there significant actual or perceived impediments such as cultural differences and corruption that Australian direct investors must overcome?
 - a. What are the most substantial cultural values or practices that impact on personal &/or business relations?
5. Other OECD member countries (US, Japan, Germany, etc.) have agencies that provide commercial assistance to companies investing abroad. What advantage, if

¹ CEDA 2017, *Outbound investment*, <<http://www.ceda.com.au/research-and-policy/research/2017/4/outbound-investment->>

any, do such agencies provide when Australian companies compete for investment opportunities?

6. Finally, in the broadest sense what effect do you consider deeper economic interdependence in general, and foreign direct investment specifically, has on Australia's foreign relations standing with Indonesia?
 - a. Post WWII Aust has overcome a legacy of strong anti-Japanese relations – how was that possible and are there lessons for better relations with Indonesia?
 - b. Is Aust tourism to Bali positive or negative for relations with Indo?