Indonesia—Continued US Partner or China's Next Debt Diplomacy Victim?

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14. ABSTRACT
Indonesia looking to build and bolster their growing middle class and archaic infrastructure recently agreed to more than $50B USD in China's One Belt One Road (OBOR)-based investment. However, due to China's predatory loan tactics and inability to complete projects on time, Indonesia like other OBOR partners (Greece, Djibouti, Pakistan and Sri Lanka) faces ballooning debt repayments. An all too eager China stands ready and willing to negotiate alternative payments options in the form of political support, land purchase, land lease or military basing rights, all of which impact US standing in the region. Without additional US engagement and investment, China's OBOR-based debt diplomacy will coerce Indonesia into

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Introduction

The Republic of Indonesia's (ROI) strategic significance and strength as a regional power player in Southeast Asia continue to rise. Since its break from Japan and the Netherlands in 1945, its transformation following robust and steady economic growth remains the envy of many in the region. A wide breadth and abundance of natural resources and prime geo-strategic positioning combined with an industrious populace propelled the ROI's growth and resultant gross domestic product (GDP) to the top of the world's rankings.[i] Additionally, as a democratic, Muslim-majority, secular nation with a desire to remain a neutral participant in the region, its regional status enjoys repeated courting by both Eastern and Western powers.

In April of 2018 after months of deliberation, the ROI signed an enormous $23.3B USD investment agreement with China as part of the One Belt One Road (OBOR) plan also known as the Belt and Road Initiative (BRI).[ii] Combined with smaller previous investments, this deal brings China's total ROI OBOR investment to over $50B USD. While these deals focusing on transportation, energy, and communications (the fine details remain secret) signify a potential boon for the ROI economy, they also permit Chinese government entities and private companies to develop key Indonesian industries with Chinese hardware, technology, rule sets, manpower, and leadership.[iii] With project delays mounting and ballooning debt repayments looming, China's debt diplomacy negotiators stand ready to discuss alternative repayment options in the form of political support, land lease, land purchase, or military basing rights. The end result (by Chinese design) finds Jakarta facing a precarious predicament where China wields growing influence over its neutral perspective and position. Absent additional US engagement and investment, China's OBOR-based debt diplomacy will coerce the ROI into adopting more pro-Chinese policies, complicating US operations in the region.

Background: The Republic of Indonesia's Economic Importance

The ROI represents one of the world's great post-World War II success stories.[iv] Previously known as the colonial Dutch East Indies, the ROI broke from Japan and the Netherlands during World War II, gaining its independence in 1945. The world's largest archipelagic nation, the ROI underwent significant growth and transformation over the past 70 years. Through democratic governance, natural resources, manufacturing, shipping and regional trade, it—the world's largest Muslim-majority nation—boasts the largest economy in Southeast Asia ($1T USD GDP/5.1% GDP growth rate), the world's fourth largest population, and is the third-most populous democracy.[v] Furthermore, forming the Southern land border of the Strait of Malacca, it serves as strategic gatekeeper between the Indian and Pacific Oceans—the world's busiest and arguably most strategically important shipping lane linking Asia and the Middle East and moving more than 25% of the world's goods.[vi]

Serving as a gatekeeper for the Strait of Malacca comes with threats from piracy and terrorism; the daunting task of defending this vital economic artery falls heavily to the ROI. Territorial and offshore waters in the Strait persist as high-risk areas for piracy and armed robbery against ships. Indonesian waters remain the most dangerous in the world, accounting for more than 20% of all piracy incidents reported world-wide.[vii] Terrorist organizations such as Jemaah Anshorut Daulah (JAD), Jemaah Islamiyah (JI), Islamic State of Iraq and ash-Sham (ISIS) Indonesia all pose credible threats to not only the ROI but to every country who conducts trade via or in the vicinity of the Strait of Malacca. While it spends approximately $8B on defense, anti-piracy, and combating regional terrorists yearly, the ROI consistently seeks additional funding, platforms, training, and support in this important protection endeavor.[viii]

An Association of South East Asian Nations (ASEAN) and Group of Twenty (G20) member, the ROI prides itself on playing a major role in both regional and world economics and leadership. As a key ASEAN member, it helps foster economic growth, social progress, and cultural development in Southeast Asia via joint endeavors with other members and its adhering to the rule of law and the United Nations Charter.[ix] As a G20 member, the ROI provides its economic cooperation and decision making to strengthen the global economy, reform international financial institutions, improve financial regulation, and implement key economic reforms.[x] It successfully uses these fora to work with Eastern and Western powers to secure funding (for maritime infrastructure and capabilities in particular) and advance its agenda—most importantly becoming a world sea power.[xi]

Despite its many economic strengths, the ROI's archaic infrastructure and mediocre per capita income continue to hinder economic growth. Its infrastructure is in dire need of major upgrades; many of its key ports and roads struggle to accommodate the type and frequency of current sea- and ground-based shipping equipment and requirements.[xii] A large percentage of the population continues to live at or below the poverty line. This pushes its per capita income to the bottom half (currently 99th) of the world rankings.[xiii] As a world and the regional economic power, this ranking signals potential trouble unless wage growth and the middle class increase at a fairly rapid pace. To address these issues and increase overall production, effectiveness, and efficiency, Indonesian leadership turned to direct foreign investment in an effort to quickly bolster and extend their economic boom.[xiv]

As democratic partners, the United States and the ROI enjoy a strong and extensive relationship. With multiple diplomatic, economic, and military bilateral agreements, the two countries recognize the other's strategic importance. To that end, current US Vice President Mike Pence and former Pacific Command Commander Admiral Harris stated: "The US-Indonesia strategic partnership is critical to the national interests of both nations, and will grow more so in the years to come."[xv] However, with China's recent OBOR investment, Washington pulling out of the Trans-Pacific Partnership (TTP) free trade agreement, and the United States recently falling out of the top five of Indonesian foreign investors,[xvi] Jakarta and other ASEAN nations have started questioning the current and future resolve of the United States in the region.[xvii]

China's OBOR: Expansion and Influence Cloaked in Investment

Creating a Sino-Centric Geopolitical sphere of influence to shift the global balance of power to the East underscores China's stated National Agenda since the turn of the century. Growing China's economy to be the world's largest is key to this agenda. To meet this goal, Chinese leadership employs a whole-of-nation approach with three key plans. The first plan, "Made in China 2025," sets China on course to become the world's manufacturing power by 2048.[xviii] The second, "China's Current 5-Year Plan," directs China to lead in the advanced industries of semi-conductors, robotics, aviation, and satellites by 2020.[xix] The third, "OBOR," reestablishes a 21st century version of the ancient Silk Road to enable and ensure Chinese regional and ultimately global economic superiority.[xx] This combined government and private-sector approach is already bearing fruit as it fuels China's rise and unprecedented growth over the past decade, cementing its position on world stage. Based on manufacturing, production, and trade, China's economy ranks even with that of the United States, and by most estimates, overtakes America by the end of the decade, making China the world economic leader.[xxi]

OBOR is the largest, most-ambitious, and expensive economic endeavor ever untaken by a nation state. A 21st century expanded version of the ancient Silk Road, OBOR looks to connect Asia (manufacturing) with the Middle East (energy), Africa (raw materials) and Europe (markets) via air, land and sea as well as digitally (telecommunications). OBOR currently includes 66 countries in Asia, Africa, and Europe. The initiative consists of over 400 projects approaching approximately $1T USD in Chinese foreign investment with new projects added almost every month.[xxii] To compare, in 2017 USD the US Marshall Plan to rebuild Europe post-World War II totaled $130B.[xxiii] China has already spent approximately $1T in OBOR investment—more than seven times the previous largest foreign economic endeavor in history.[xxiv] Even more incredibly, China plans to spend a total of $6T USD on OBOR by 2030, more than 45 times the Marshall Plan. If it succeeds, OBOR is estimated to account for more than 30 percent of global GDP.[xxv]

> "OBOR…serves the Chinese leadership's vision of a risen China sitting at the heart of a Sinocentric regional order…This vision reflects Beijing's desire to shape Eurasia according to its own worldview and its own unique characteristics. More than a mere list of revamped infrastructure projects, BRI is a grand strategy that advances China's goal of establishing itself as the preponderant power in Eurasia and a global power second to none."[xxvi]

OBOR's economic power hinges on a whole-of-nation approach focusing on Chinese government and private business investment and infrastructure agreements with neighbors, friends, and other willing participants (both current and potential) as a peaceful and prosperous alternative to the current Western order. Typical investment projects include sea and airport development and construction, road and rail expansion and improvement, energy generation and production, and fiber optics and information technology modernization.[xxvii] Using a hub and spoke approach, China's efforts center on securing trade routes and associated facilities (primarily sea lines of communications {SLOCs} and ports) from Asia to the Middle East, and from the Middle East to Africa. The endeavor provides Beijing with key SLOCs and port hubs from Asia (manufacturing) to the Middle East (energy) to Africa (raw materials) where China can grow and secure its economic supply chain, ultimately fueling its rise to preeminent global economic power (see **Figure 1**).

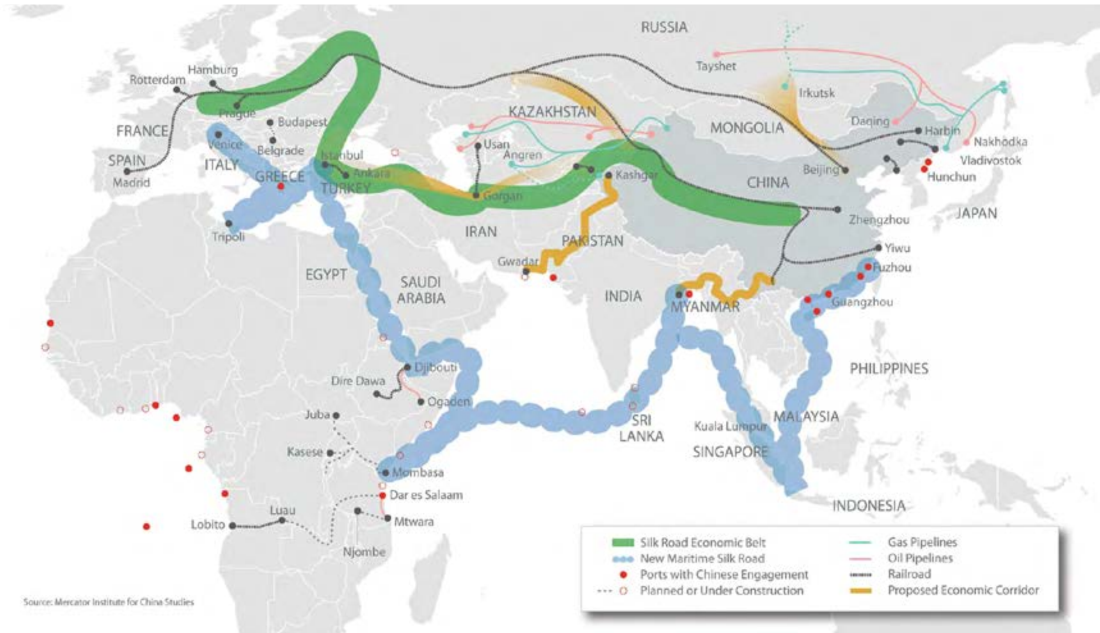

Figure 1. China's One Belt One Road (OBOR) Initiative[xxviii]

As this 21st century Silk Road develops and expands, China will utilize new markets to build and strengthen relationships in an effort to gain economic and political influence. As this influence builds, China expects (and plans on using) their international legitimacy to increase—despite historic and documented blemishes such as currency manipulation, corruption, and human rights violations.[xxix] China plans to use this newfound legitimacy to: First, counter regional rivals such as India, Japan, and South Korea; and second, diminish US political and military influence in the region by securing key SLOCs to reduce its dependence on vulnerable choke points and provide bases from which to extend military (primarily naval) capabilities.[xxx]

China's Debt Diplomacy

As OBOR's first projects near completion and initial loan repayments come due, the once-positive reactions from many participants are starting to sour and turn to concern and fear.[xxxi] A majority of the optimistic forecasts offered by China during the initial OBOR agreements are not coming to fruition as its government and businesses find themselves significantly behind schedule on project delivery. As delays mount and the associated forecasted income streams remain dormant, OBOR partners find themselves struggling to repay their ballooning debts. This is due to predatory loan practices and estimates made by China during OBOR agreements (planning for best case project completion and productivity output) as well as the absence of detailed feasibility studies typically required by similar international loans (increasing OBOR partners' debt-to-GDP ratio from under 50% to over 85%).[xxxii] This phenomenon has given rise to a new OBOR moniker: "debt diplomacy."[xxxiii]

An even darker side of debt diplomacy is starting to emerge. As multiple OBOR partners cannot repay their debts and risk default, China offers alternative repayment options—debt forgiveness in return for political support, land lease, land acquisition, and/or military basing rights.[xxxiv] Athens, Greece (political—uncharacteristic pro-Chinese voting on the international stage), Hambantota, Sri Lanka (land lease and military basing rights), Doraleh, Djibouti (land lease and military basing rights), and Gwadar, Pakistan (land purchase and military basing rights) are each OBOR partners who succumbed to China's debt diplomacy trap.[xxxv] Recent reporting from Cape Town, South Africa and Mombasa, Kenya indicate similar debt diplomacy negotiations focusing on alternative repayment options are currently ongoing with China.[xxxvi]

China's OBOR Courting and Coercing of the Republic of Indonesia

China understands the ROI's strategic value in the region and globally. As Southeast Asia's economic leader, gatekeeper to the Straits of Malacca, democratic and Muslim exemplar, and key ASEAN and G20 member, China sees the ROI as a difficult but critical acquisition for its OBOR plan.[xxxvii] China is primarily concerned with the Strait of Malacca. As the key access path to the Middle East and Africa and passageway for over 65% of China's imports and exports, the Strait of Malacca is China's most strategic choke point.[xxxviii] A blockade or reduction of Chinese shipping or naval vessels via this waterway would almost cripple China's economy and significantly limit its power projection capability. China has placed significant importance on maintaining access and gaining partnership and/or ownership of this important strategic location. To that end, while it continues courting the ROI primarily for its strategic location along the Straits of Malacca, it maintains backup plans via Gwardar, Pakistan and Kyaukpyu, Myanmar in the event Jakarta cannot be swayed.[xxxix]

China identified a window of opportunity where Jakarta was actively soliciting foreign investment, and the United States, in the midst of an election and change of power, left foreign aid stagnant and made a mediocre situation worse by withdrawing from TTP.[xl] Seizing this opportunity, China embarked on a significant campaign to persuade the ROI to join OBOR. Over the past three years, China successfully lobbied for, proposed, and signed multiple OBOR-based agreements with the country, culminating in a $23B energy and infrastructure deal approved in April of 2018,[xli] bringing China's total OBOR investment in the ROI to over $50B USD with additional projects under discussion.

Prior to the April 2018 deal, the OBOR investment agreements totaled fifty projects at approximately $27B USD. While many of the specific details remain secret, funding for most of these OBOR projects originated from long-term loans via Chinese banks; many are the sole responsibility of Chinese-owned companies and Chinese workers. The projects included several manufacturing plants and multiple transportation and infrastructure projects—all of which should have been completed by the summer of 2018.[xlii] Due to a host of issues, including financing, visas, and land acquisition problems, only nine of the fifty projects are complete—a familiar trend in OBOR-partner countries.[xliii] Given China's latest investments, the ROI now sits as the second largest borrower in the 66-nation OBOR program—Pakistan remains first the with $66B USD in debt.[xliv] China's 2018 investment raised the ROI's debt-to-GDP ratio from 48% to an estimated 56%.[xlv] While still manageable, this ratio is approaching the 60% limit imposed by the country's debt-management constitution.[xlvi] Recent reporting indicates the Beijing-based Asian Infrastructure Investment Bank (AIIB), a Chinese lender with substantial investments in the ROI and close ties to the Chinese government, is already in negotiations with senior government officials over land acquisition and other options as innovative solutions for OBOR investment repayment (shoring up finance gaps).[xlvii]

As the ROI embarks on this new path with China, close monitoring of their relationship and financial transactions will be critical to the region's future. With a debt-to-GDP ratio close to constitutional mandated limits, any problems repaying Chinese loans, taking on additional Chinese debt, prolonged pro-China political shifts or Chinese land lease, sale, or military basing agreements more than likely signifies that China's coercive debt diplomacy has succeeded.[xlviii] Once this debt diplomacy tactic succeeds (from China's perspective), a subsequent outlook and policy shift towards Beijing may occur. The short-term shift of the world's third largest democracy away from the democratic United States and to communist China would signify a major blow to the current world order and an enormous windfall for China.[xlix] Furthermore, as a powerful player in ASEAN, the G20 and gatekeeper of the Strait of Malacca, the ROI's shift may be the start of a domino effect in which other powerful countries, many of which are on the fence regarding China, choose to follow Jakarta's lead and explore a Sinocentric world order.[l] While the longer-term effects are difficult to predict, it is clear that the US ability to conduct unencumbered operations in many areas of the Pacific (specifically Southeast Asia) would become significantly more complicated and difficult.[li] This demonstrates (especially in this new era of great power competition) that the United States can ill afford to allow the ROI's shift toward China and should quickly enact an aggressive strategy to prevent it.[lii]

Conclusion

The ROI's location, economy, natural resources, democratic populace, and neutral positioning serve to make it a regional power in Southeast Asia. With a return to great power competition and China's rise, the ROI's strategic significance and cooperation as a thriving democracy, ASEAN leader, and G20 member is more important than ever.[liii] Needing investment capital to improve its infrastructure to bolster its economy, it sought foreign investment. While US foreign aid stagnated and Washington exited the TPP, China embarked on a significant campaign to persuade the ROI to join OBOR. Finding China's offer too lucrative to resist, the ROI signed and secured multiple OBOR-based investment agreements culminating in an enormous $23B deal approved in April of 2018.[liv]

Focusing on infrastructure, energy, and communications, China's total OBOR investment in the ROI now exceeds $50B USD. While these deals signify a potential boon for the country's economy, they allow Chinese entities (public and private) to develop these key industries with Chinese hardware, technology, rule sets, manpower, and leadership.[lv] With project delays mounting and debt repayments looming, China's debt diplomacy negotiators stand ready to discuss alternative repayment options—political support, land lease, land purchase, or military basing rights. The end result (by Chinese design) finds Jakarta facing a predicament where China wields growing influence to shift the ROI's neutral perspective and position. The United States must directly engage with and invest in Jakarta or risk the detrimental effects of China's OBOR-based debt diplomacy as it coerces Indonesian polices toward China and complicates US operations in the region.[lvi]

Recommendations

In order to counter the recent OBOR agreements, prevent potential coercion, and the titling of the ROI toward China, the United States should aggressively develop and implement a coherent whole-of-government strategy grounded in information, partnerships, and economic investment. Key steps include: first, make the strategy a national priority; second, create a transparent communications and broadcasting plan that shines a light on bad behavior; third, work with Indonesia and other Pacific allies to develop an investment counterstrategy; and fourth, develop and enact a new Pacific trade plan more comprehensive than TPP and grounded in international trade rules.[lvii] A plan containing these steps and enacted quickly should produce a substantial cooling effect on China's coercion and the ROI's OBOR expectations, ultimately deterring Jakarta's shift towards Beijing.

The first step in a coherent US strategy rests on the ability of US senior policy makers to understand, advocate for, and approve a counter-OBOR strategy.[lviii] This strategy should focus on the ROI to start but also include other nations currently facing the same circumstances. The goals, aims, and consequences of an unchecked OBOR plan need to become a national discussion.[lix] The strategy cannot fall victim to partisan politics or other Washington roadblocks—it needs strong and swift political backing and approval by all branches of government so rapid financing can commence. With policy and funding in place, the following steps can commence.

The second step of this strategy focuses on creating a transparent communications and broadcasting plan that shines a light on China's domineering behavior.[lx] The United States should engage in a frank an open dialog with the ROI's economic leadership and OBOR project managers highlighting China's predatory loan practices, consistent project delays, and coercive alternative payment tactics using independently validated financial data. Comparing China's optimistic data regarding loan and repayment financials, project timelines, and project revenue versus unbiased and validated financial data should help the ROI fully understand its position relative to its coercive Chinese partner. Additionally, highlighting China's domineering behavior, specifically debt diplomacy using Sri Lanka, Pakistan, Djibouti and Greece as examples, should serve as a stern warning to then ROI regarding the threat posed by its current (and any future) OBOR agreements.[lxi]

Step three of the strategy centers on working with Pacific allies to develop an investment counterstrategy.[lxii] OBOR's overarching allure stems from the ease with which a nation can attain massive amounts of foreign capital. However, China is not the only nation willing to invest. Other Pacific powers including Australia, Japan, and South Korea are also eager, especially to counter China in the process.[lxiii] The United States needs to rally these countries and more closely partner with them in an effort to apply foreign investment where needed to counter China's OBOR.[lxiv]

Fourth, the United States should develop and enact a new Pacific trade plan more comprehensive than TPP and grounded in international trade rules. When the United States pulled out of TPP, many nations, especially those in the Pacific, were stunned.[lxv] Years of hard work and negotiation evaporated as the world's strongest economy and associated leadership exited. Weakened and without a leader, many in the Pacific are now looking to China's OBOR as a TPP alternative. To rebalance and strengthen the Pacific, the United States should enact a new transparent, open, and comprehensive trade plan. Key to this plan should be the legal and aggressive enforcement of international trade rules that focus on imposing significant costs (both political and financial) on those who engage in predatory and subversive practices—both governmental and private sector businesses.[lxvi] Violations need to be brought before the World Trade Organization (WTO) to increase awareness and with the long-term goal of exposing and bringing China's predatory, debt diplomacy tactics into view.[lxvii]

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