

ASEAN-Japan Centre = Bank Indonesia

Economic Reform and Monetary Policies in Indonesia : Do They Work?

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1. Indonesian Economy in the Long-term Perspective
2. Discontinuous Industrialization
3. Post-Boom Economic Reform
4. Monetary Policies amid the Economic Reform

1. Indonesian Economy in the Long-Term Perspective

Fundamental Conditions for Sustained Growth

1. The world 4th largest population
2. Demographic bonus (1970s~2030s)
3. Stable legal foundation of democratic regime

1. Indonesian Economy in the Long-Term Perspective

Natural Resources ··· Curse or Opportunity?

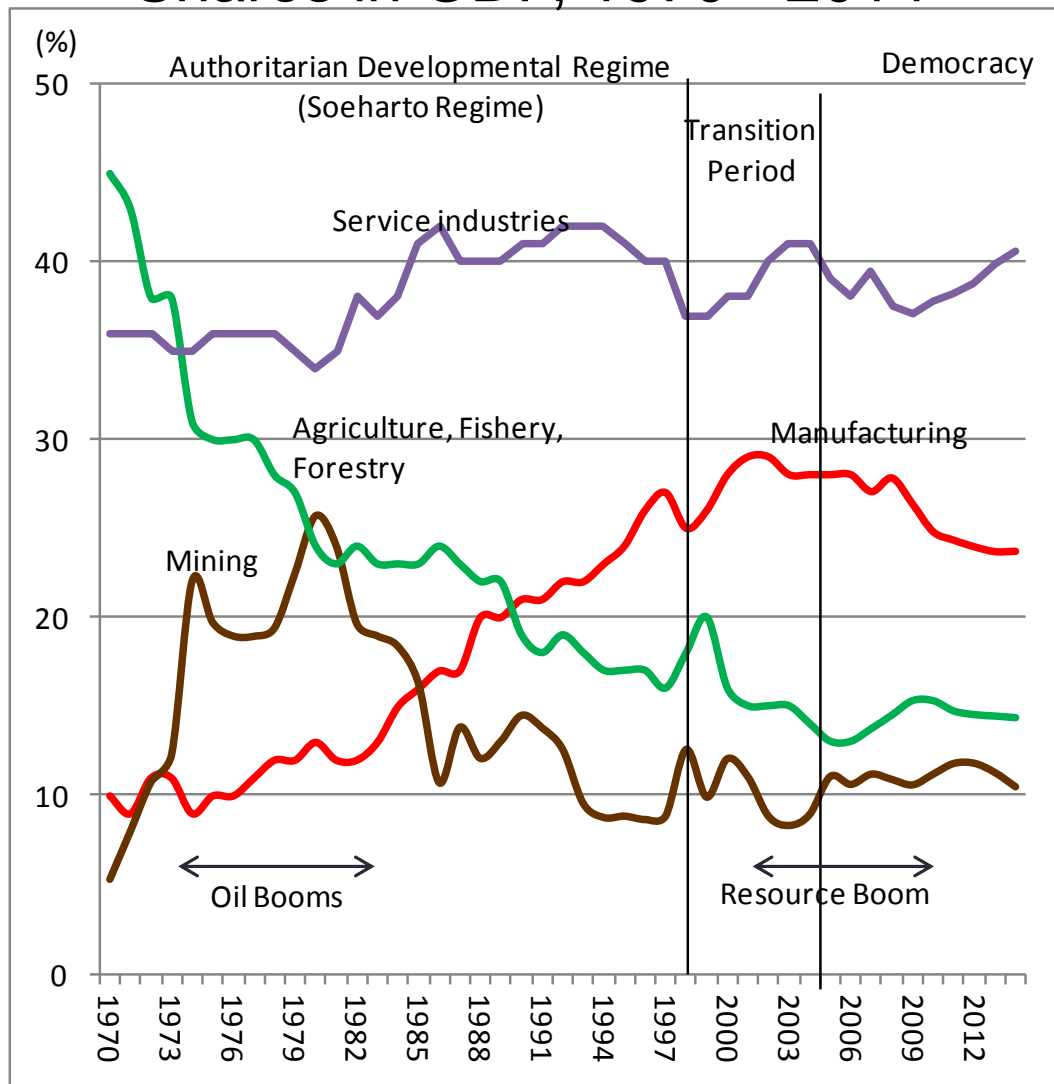
1. The world 4th largest population
2. Demographic bonus (1970s ~ around 2030)
3. Stable legal foundation of democratic regime
4. Rich endowment of natural resources
= Repeated resource booms → the Dutch disease
→ Discontinuous industrial development

cf. East Asia

2. Discontinuous Industrialization

Rise and Fall of Manufacturing Share

Shares in GDP, 1970 - 2014

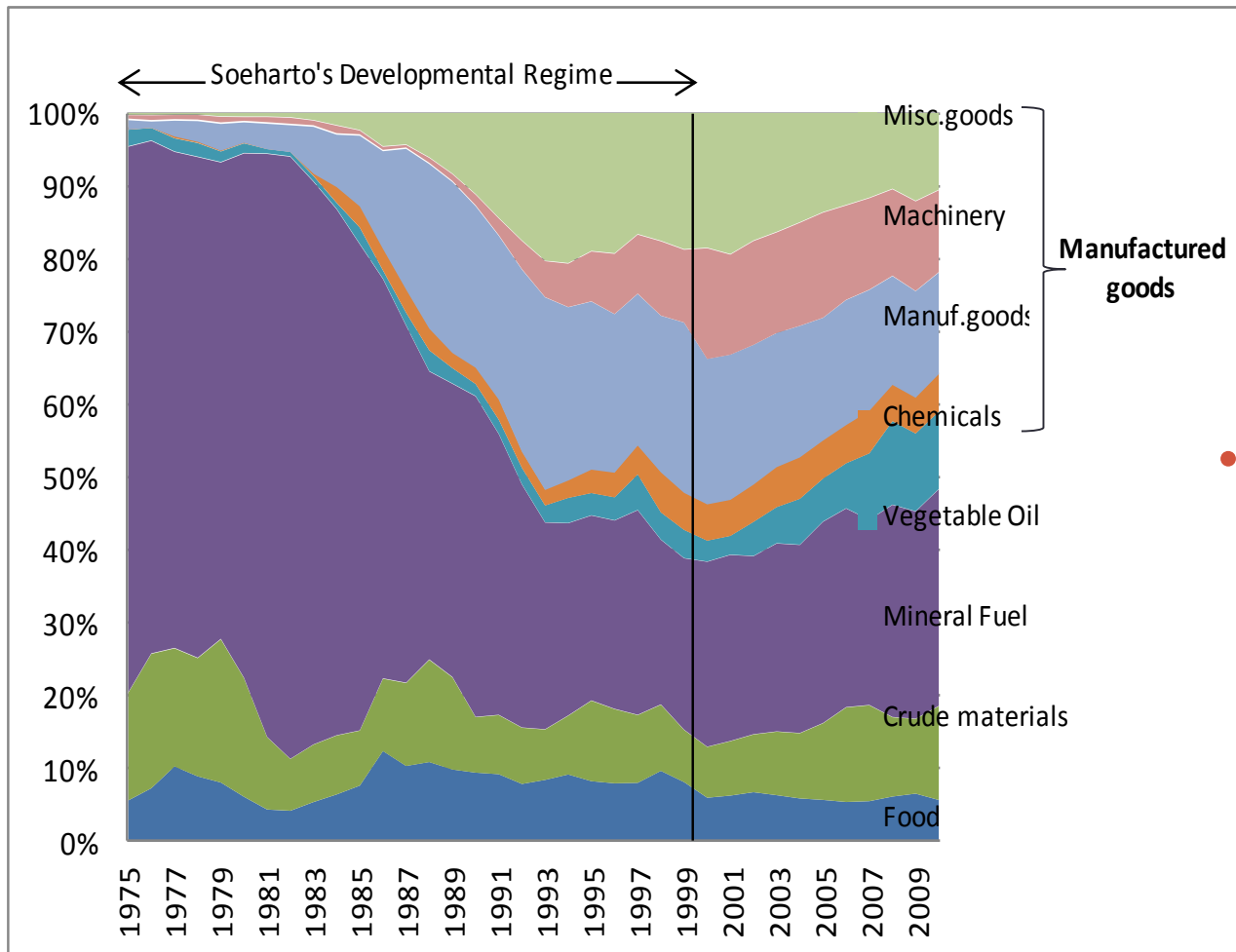


Source: BPS Indonesia (Central Agency of Statistics).

- Under the Soeharto's authoritarian developmental regime, the manufacturing share constantly increased, even in the oil booms.
- In the 2000s, deindustrialization started, while agriculture and mining shares slightly picked up.

Rise and Fall of Manufactured Exports

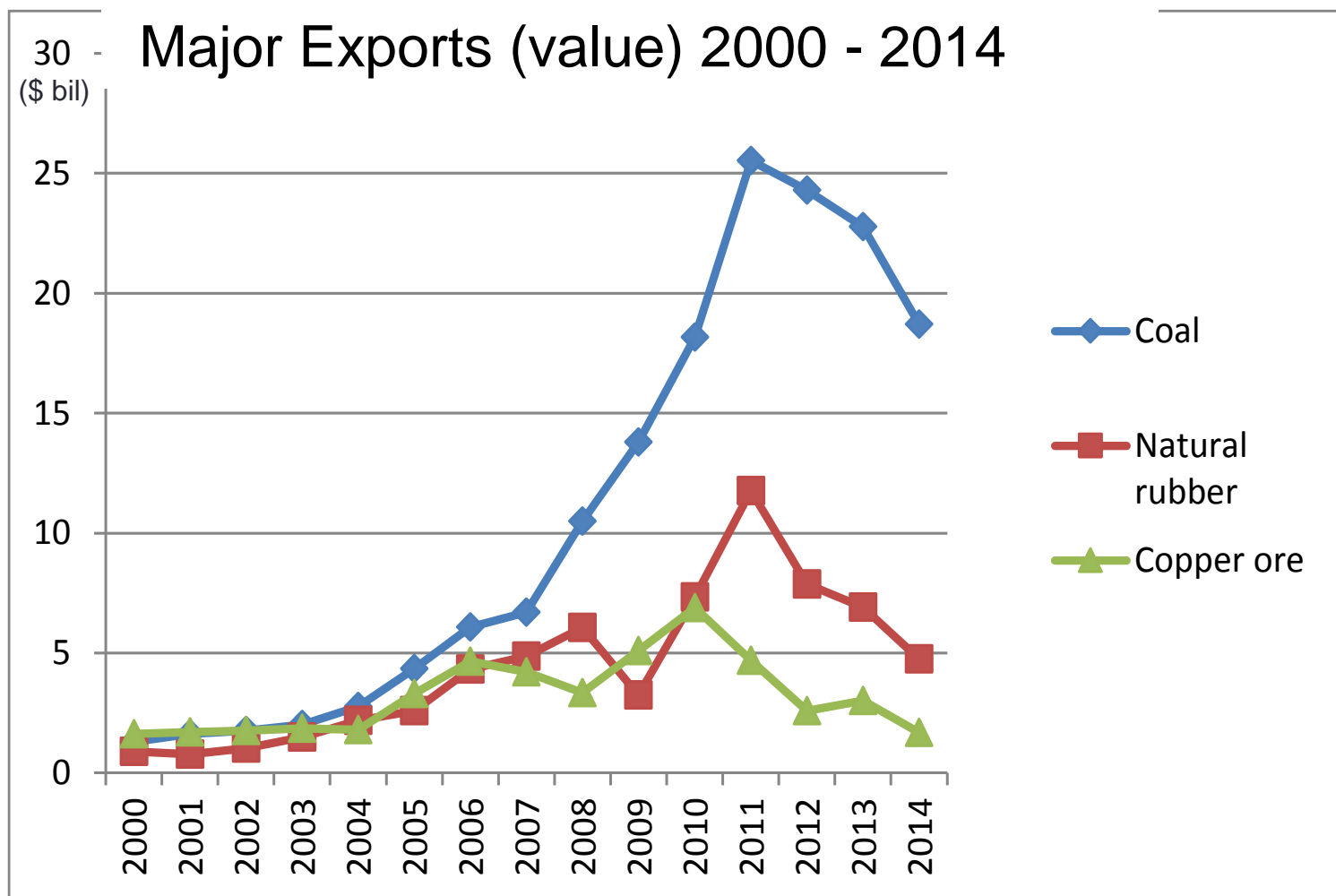
Export Structure: 1975 - 2010



Source: UN Comtrade. Manufactured goods = SITC 5 - 8

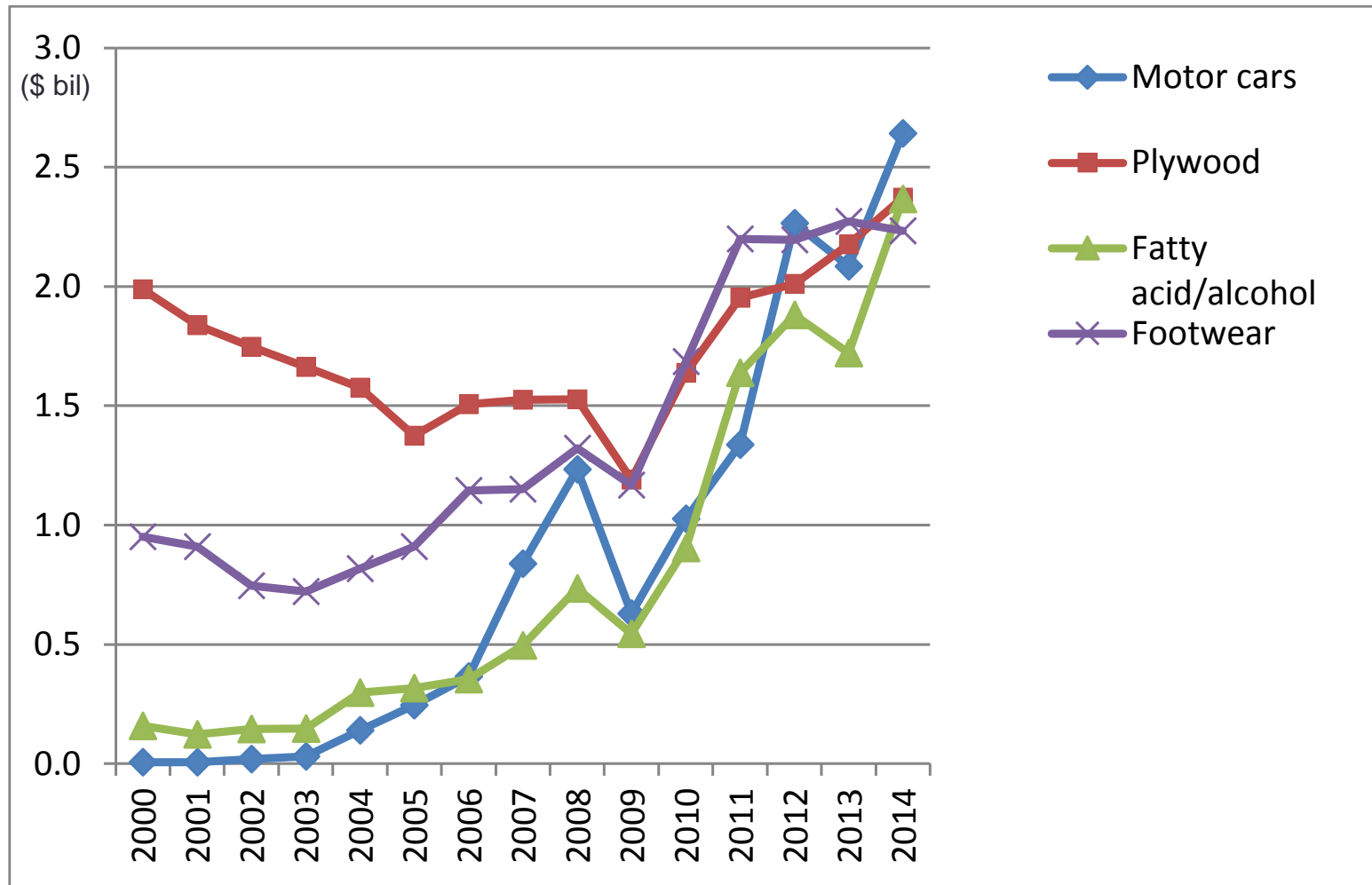
- Major exports shifted from crude oil to manufactured goods (5% in 1982 to 59% in 2000) under the Soeharto regime.
- After its collapse, manufactured goods decreased (41% in 2010), and minerals and vegetable oils (coals and CPO) increased in their export shares.

The 2000s Commodity Boom was Over...



Source: Compiled based on data from *World Trade Atlas*.

Some Manufactured Exports Picking Up



Source: Compiled based on data from *World Trade Atlas*.

Transition of Indonesia's Top 10 Exports (HS4 digit)

	1993	2011	2014
1	Petroleum oil	Coal	Coal
2	Plywood	Natural gas	Palm oil
3	Natural gas	Palm oil	Natural gas
4	Garment	Petroleum oil	Petroleum oil
5	Electrical appliance	Natural rubber	Natural rubber
6	Textile fabric	Copper ore	Motor cars
7	Rubber products	Palm kernel oil	Palm kernel oil
8	Petroleum oil products	Petroleum oil products	Plywood
9	Shrimp	Copper	Fatty acids/alcohols
10	Other textile products	Unwrought tin	Petroleum coke
Top 10 (% of total)	63	52	45
Total exports (\$bil)	37	203	176

Source: *World Trade Atlas* and BPS.



The peak and the end of the 2000s resource boom

3. Post-Boom Economic Reform

aims at domestic demand-led economy

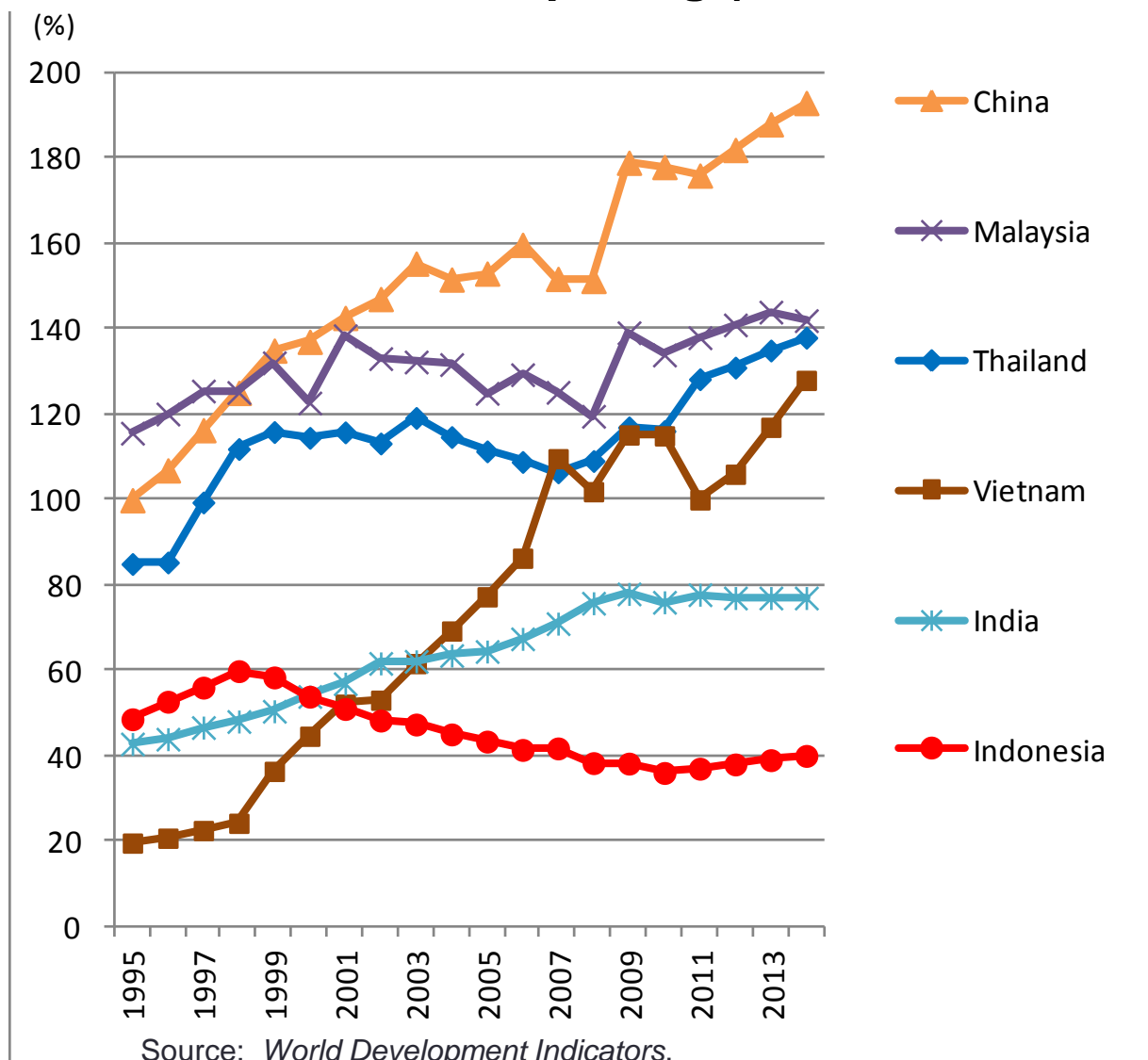
1. Mobilize domestic savings
 - Broaden taxation base
 - Mobilize financial savings (deposit)
2. Promote investment = Re-industrialization
 - Fiscal incentives
 - Credit expansion
3. Reduce business costs
 - Deregulation, rationalization, simplification
 - Improve logistics and infrastructure

Policy Packages for the Post-Boom Economic Reform

Post-Oil Boom Economic Reform 1982-1988 Soeharto		Post-Commodity Boom Economic Reform 2011-present 2nd Yudhoyono and Joko Widodo	
1982.1	Export promotion policy	2011.5	Master plan 2011-25
1983.3	Devaluation of Rupiah (28%)	2011.8	Investment incentives: large pioneer Progressive tax exemption: palm oils
1983.6	1st banking reform: free interest rates	2013.5	Low cost eco car program
1983.6	Machinery localization (-1985.1)	2013.8	P1: export promotion
1984.1	Tax reform: introduce VAT	2013.12	P2: export promotion
1985.4	Entrust custom clearance to SGS	2014.3	P3: investment promotion
	Investment (FDI) promotion	2014.?	P4: financial easing
	Export finance (-1990.3)	2015.1	Abolition of fuel subsidy
1986.5	P: bonded zone, tariff refund	2015.9	P1: deregulation, investment promotion
1986.9	Devaluation of Rupiah (31%)		P2: speed up procedures
1986.10	P: tariff reduction	2015.10	P3: cost reduction (electricity)
1987.1	P: non-tariff barriers to tariff		P4: SME financing
1987.6	P: investment promotion		P5: asset revaluation
1987.12	P: export promotion	2015.11	P6: special economic zone
1988.10	2nd banking reform: free entry		P7: labor-intensive industry, land certificate
1988.11	P: import, shipping	2015.12	P8: IGT, aviation, oil refinery
1988.12	P: capital market	2016.1	P9: electric power, logistics
	Institutional reform	2016.2	P10: SME promotion
	Industrial promotion	2016.3	P11: SME export promotion
	Deregulation, rationalization	2016.4	P12: procedure simplification
	Redistribution to the economically weak	2016.8	P13: housing for low income group

Indonesia's Weak Financial Sector

Indicator of Financial Deepening (M2/GDP) 1995~2014



Assessing the Current Economic Reform

aims at domestic demand-led economy

1. Mobilize domestic savings

- Broaden taxation base
- Mobilize financial savings (deposit)

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2. Promote investment = Re-industrialization

- Fiscal incentives
- Credit expansion

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3. Reduce business costs

- Deregulation, rationalization, simplification
- Improve logistics and infrastructure

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still needed

4. Monetary Policies amid the Economic Reform

To revitalize financial intermediation function

1. Promote innovation for deposit mobilization
2. Stimulate demand for credit
(monetary easing, deregulation, incentives)
3. Longer-term financing for development

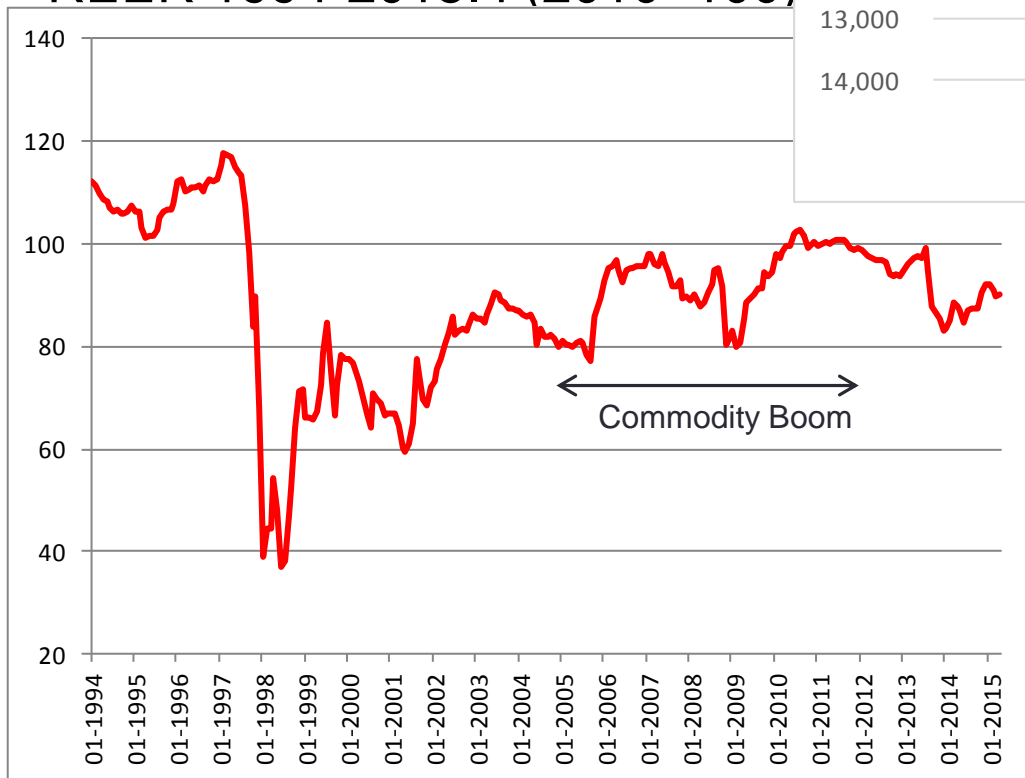
With maintaining monetary stability

4. Manage inflation → mainly due to bottlenecks in production/distribution of staple products
5. Stabilize Rupiah → appropriate REER level

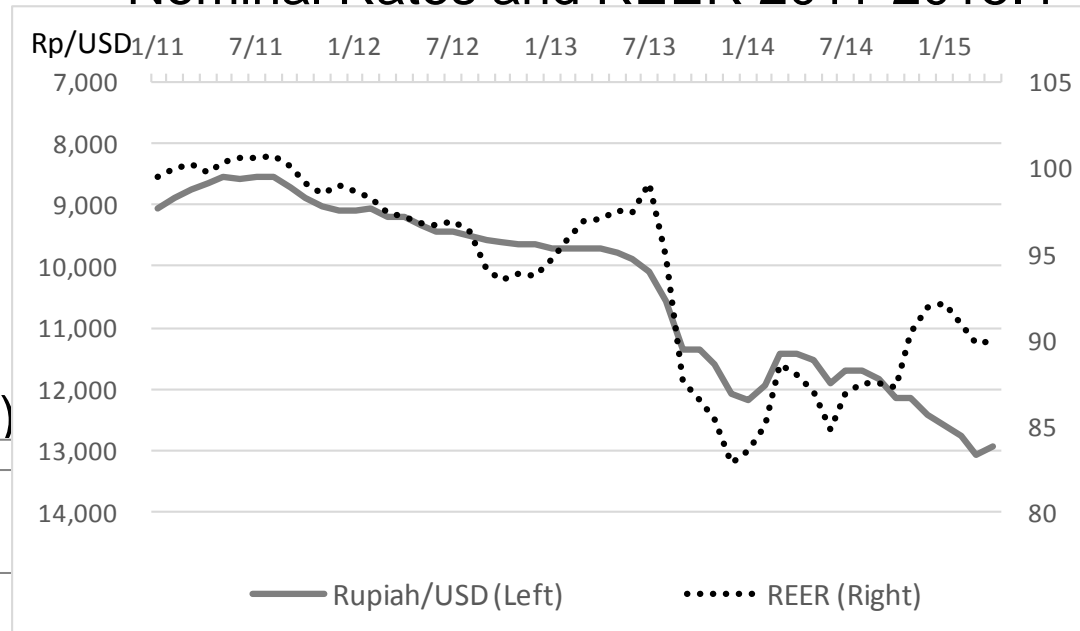
Real Effective Exchange Rates Matter

Real effective exchange rates (REER) are not constantly declining unlike nominal rates.

REER 1994-2015.4 (2010=100)



Nominal Rates and REER 2011-2015.4



Depreciation of Rupiah in terms of REER does not yet reach the pre-boom level.

cf. 1986 devaluation corrected over-evaluation during the oil boom.

Conclusion

- ▶ Indonesia is amid the phase of critical importance, an unrepeatable chance of demographic bonus.
- ▶ It is crucial to boost domestic demand by mobilizing savings, investing it, and reducing business costs. Government efforts for economic reform are not yet sufficiently effective.
- ▶ Indonesia's shrinking financial sector could impede investment cycles in the real sector.
- ▶ Innovative measures to revitalize the financial intermediation function are indispensable for Indonesia to ensure the sustained growth.