

Indonesia = Japan 2nd Industrial Dialogue
JICA mission @ Bappenas

Indonesia's Challenges toward Industrial Upgrading

11 August 2017

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1. Indonesia's Advantages
2. Challenges Facing Indonesia
 - From Deindustrialization
to Reindustrialization
 - Weak Productivity
 - Weak Financial Intermediation
3. Assessing Economic Reform Policies
4. Conclusion

1. Indonesia's Advantages are Double-edged Swords

1. The world 4th largest population
 - (+) Demand & supply base
 - (-) Hotbed of poverty and unemployment
2. Demographic bonus (1970s ~ 2030s)
 - (+) Locomotive of growth
 - (-) One chance, hard to catch up after that
3. Rich natural resource endowment
 - (+) Resource booms repeat
 - (-) Dutch disease risk → Discontinuous industrial development cf. East Asia

1. Indonesia's Advantages are Double-edged Swords

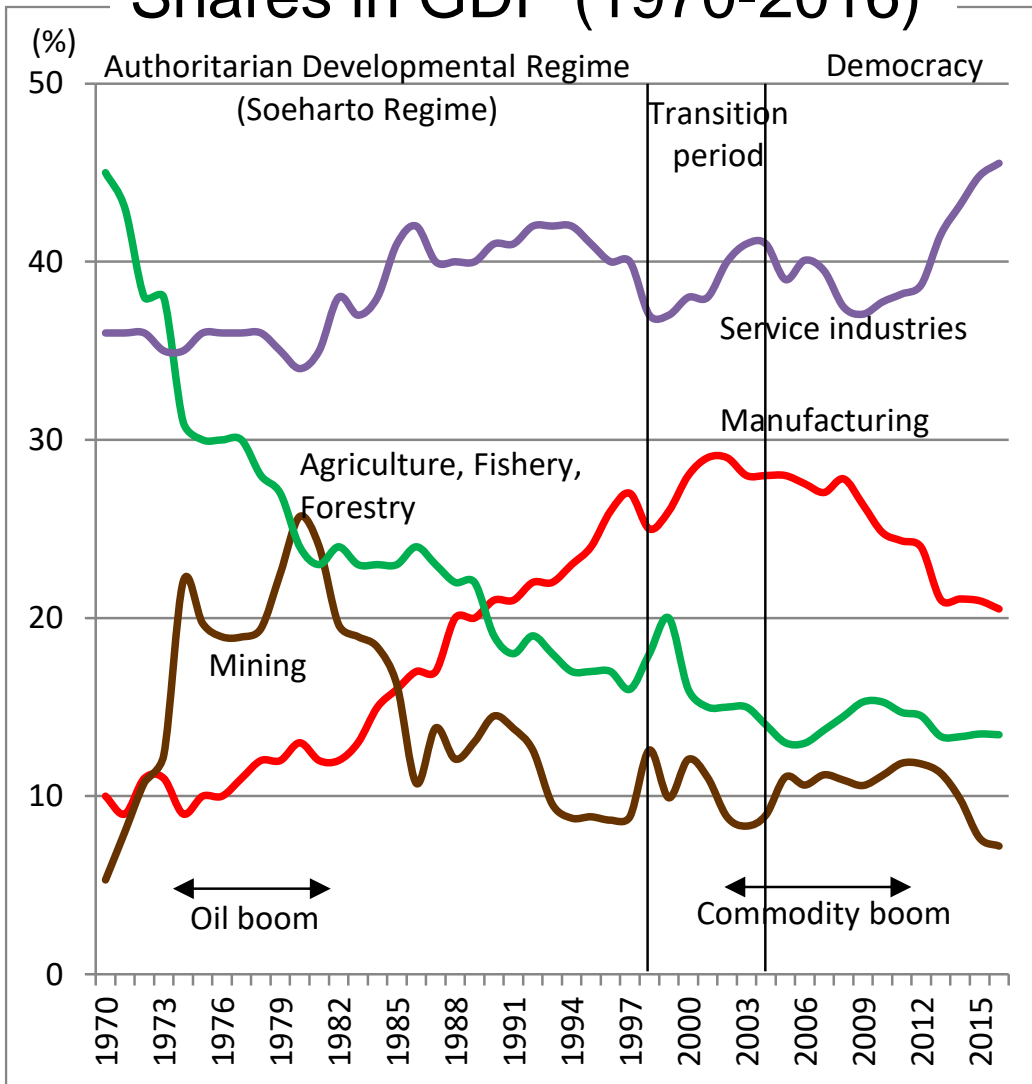
➡ Needs right policy intervention for promoting

- Growth
 - Industrial upgrading
 - Equity
- ← investment
-
- The diagram consists of the word 'investment' in red text on the right. Three arrows originate from its left side: a solid black arrow points horizontally to the left towards the word 'Growth'; a solid black arrow points diagonally down and to the left towards the word 'Industrial upgrading'; and a dashed black arrow points diagonally down and to the left towards the word 'Equity'.

2. Challenges Facing Indonesia

Rise and Fall of Manufacturing Share

Shares in GDP (1970-2016)



- Under the authoritarian developmental regime, the manufacturing share constantly increased, even in the oil booms.
- “Full-set industrialization” (resource-based + labor-intensive + capital-intensive industries) progressed.
- However, In the 2000s commodity boom, Indonesia moved to deindustrialization.

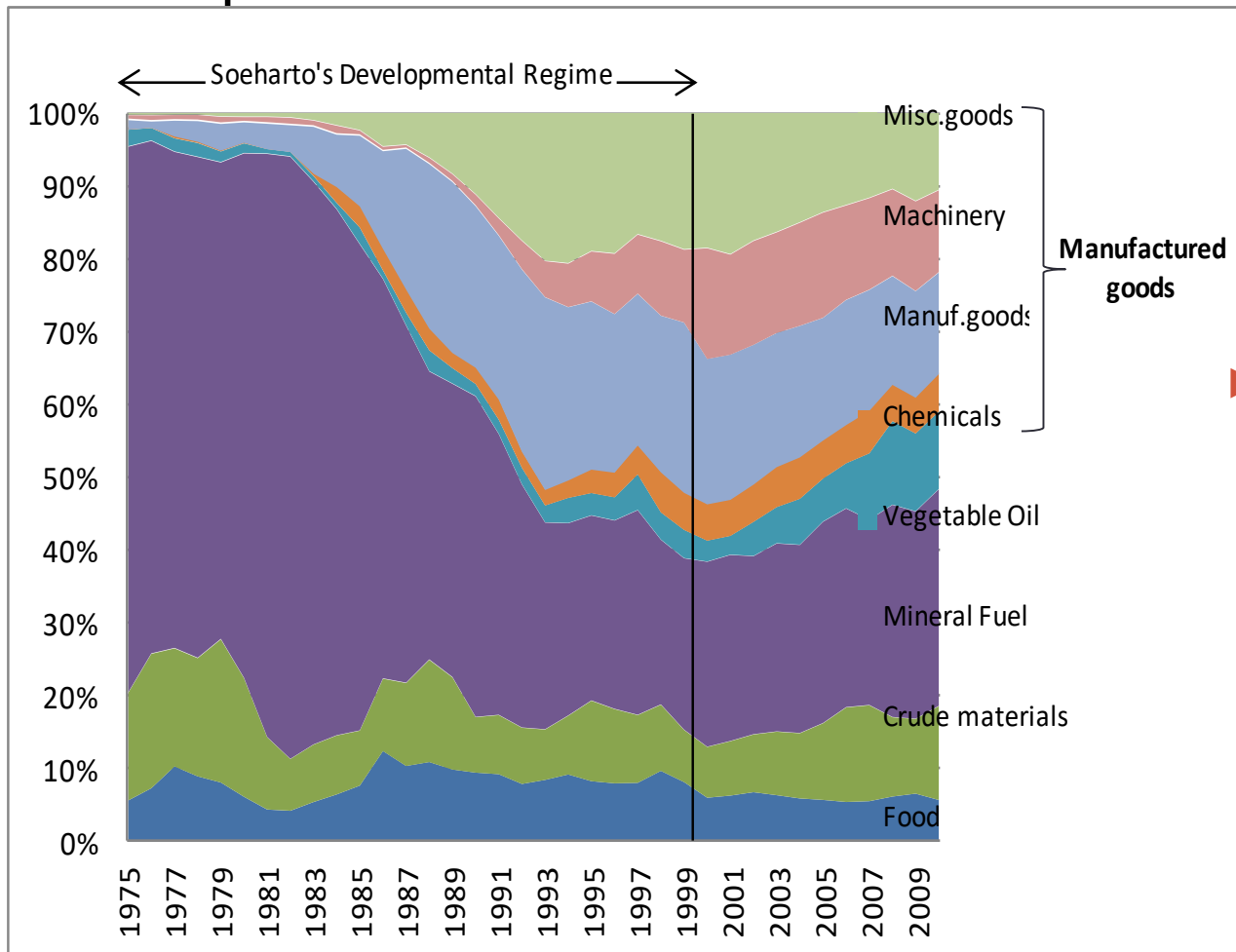
Note: Base year of GDP is 2000 up to 2012, and 2010 after 2013.

Source: BPS Indonesia (Central Agency of Statistics).

2. Challenges Facing Indonesia

Export : Repeated Dependency on Resource

Export Structure: 1975 - 2010

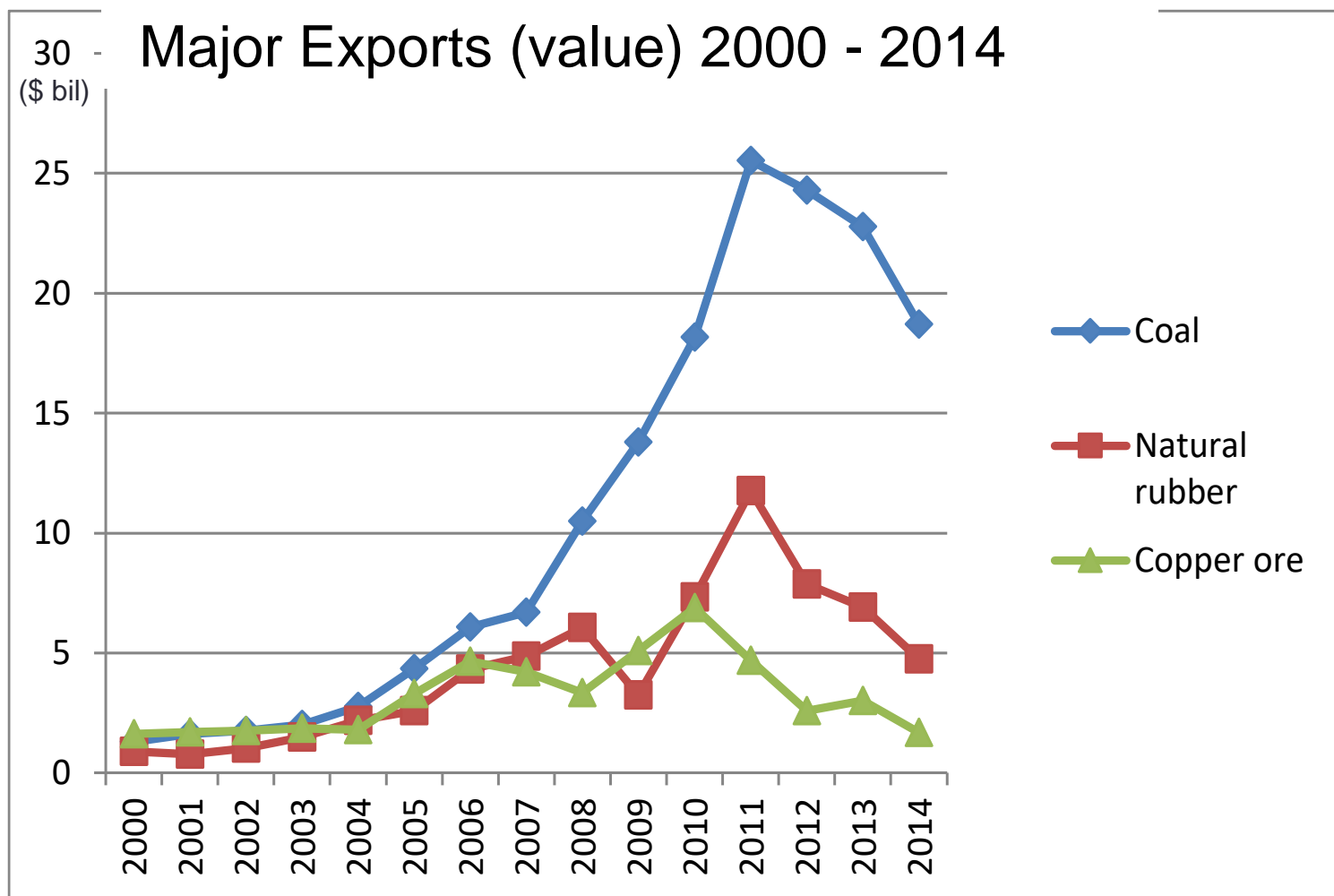


Source: UN Comtrade. Manufactured goods = SITC 5 - 8

▶ After the oil boom, exports shifted from crude oil to manufactured goods (5% in 1982 to 59% in 2000).

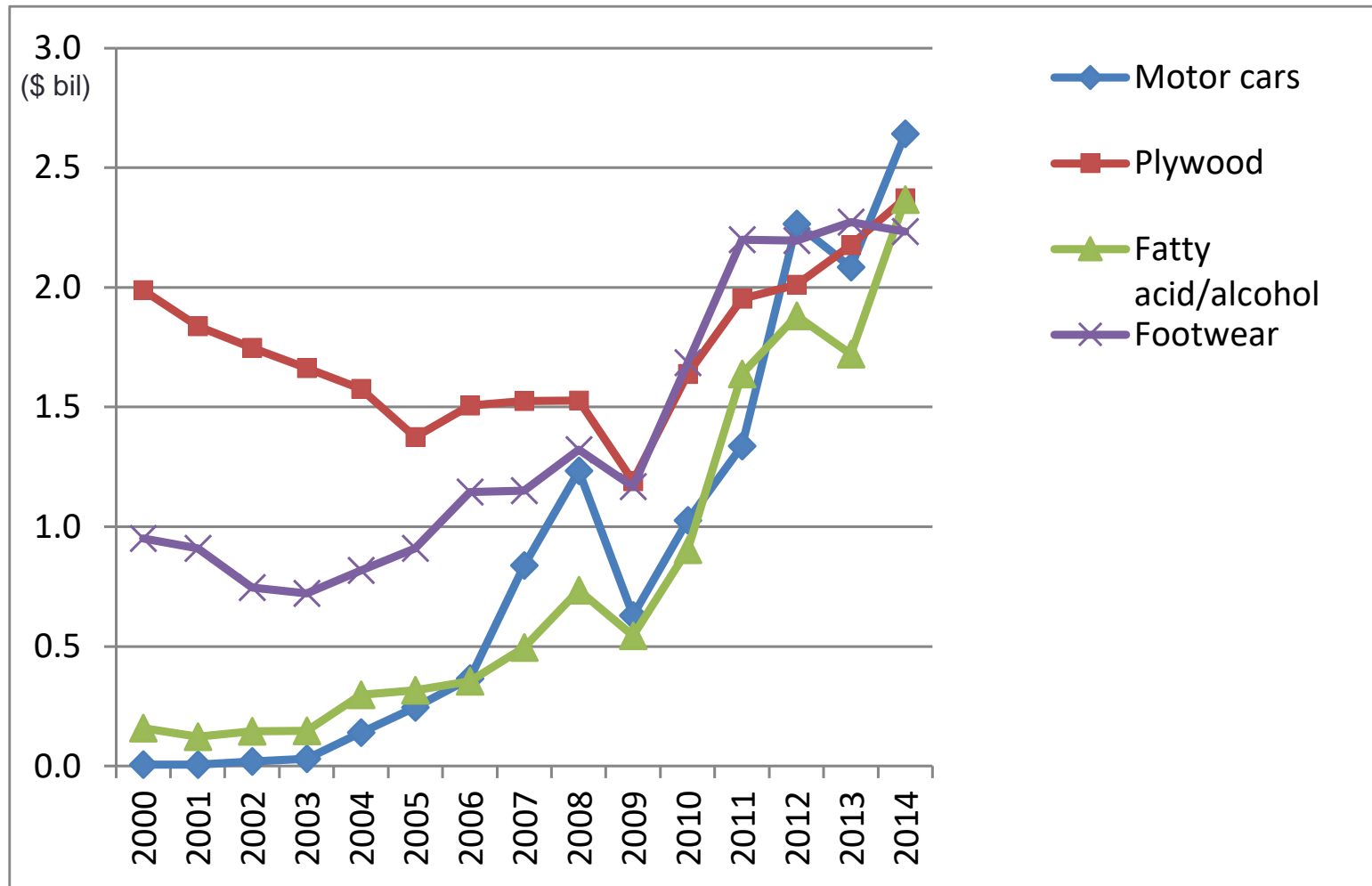
▶ In the 2000s commodity boom, manufactured exports decreased to 41% (2010). Minerals (coal), vegetable oil (CPO), and low-processed resources dominated exports.

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*.

Challenge 1: From Deindustrialization to Reindustrialization

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

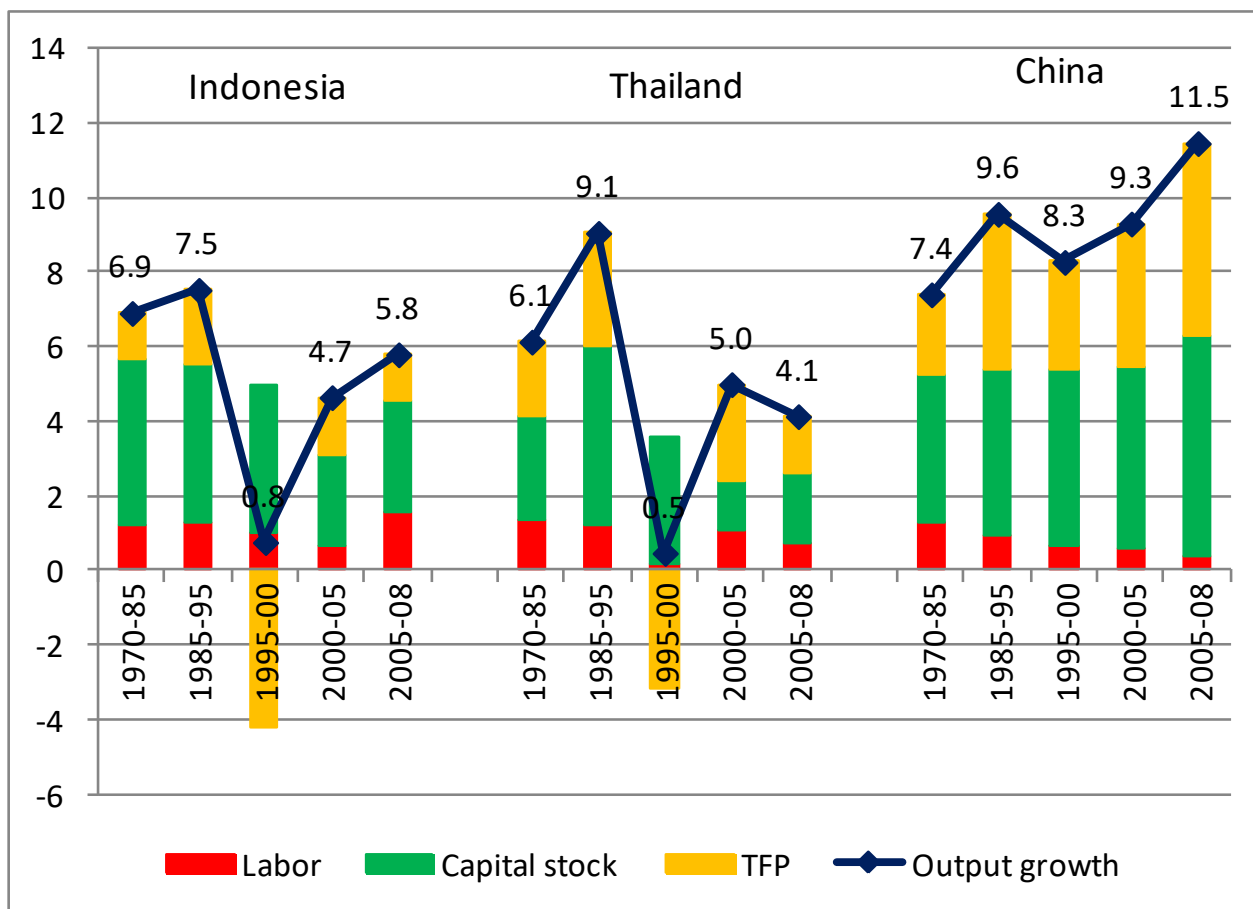
Source: *World Trade Atlas* and BPS.



The peak and the end
of the 2000s commodity boom

Challenge 2: Weak Productivity

Sources of Economic Growth Labor, Capital, and Productivity (TFP)



- China's source of growth shifted from labor to capital, and to productivity.
- Indonesia's source of growth started from capital, moved to labor. Productivity has made the least contribution. = "The Myth of Asia's Miracle"
- ➡ Indonesia should focus on enhancing productivity.

Selected Indicators of Technological Capabilities in ASEAN and other Asian countries

Country	Number of ISO 9001 certification		High-technology exports (% of manufactured exports)		R & D expenditure (% of GDP)	
	2000	2010	2000	2010	2000	2008
Cambodia	1	6	n.a.	n.a.	0.05	n.a.
Lao PDR	0	9	n.a.	n.a.	0.04	n.a.
Myanmar	4	26	n.a.	n.a.	0.11	n.a.
Brunei	193	61	9	n.a.	0.02	n.a.
Philippines	1,027	944	73	68	0.14	0.11
Viet Nam	184	2,036	11	6	0.19	n.a.
Singapore	3,900	3,934	63	50	1.85	2.66
Indonesia	1,860	6,524	16	11	0.07	0.08
Thailand	2,553	6,799	33	24	0.25	0.21
Malaysia	2,355	8,614	60	45	0.47	0.63
Total/ Average	12,077	28,953	49	39.6	0.32	0.77
Korea	15,424	24,778	35	29	2.30	3.36
India	5,682	33,932	6	7	0.77	0.76
Japan	21,329	58,836	29	18	3.04	3.45
China	25,657	297,037	19	28	0.90	1.47

Note: In high-tech exports, the figure of Burnei is at 1998, those of Korea and Viet Nam at 2009 instead of 2010.

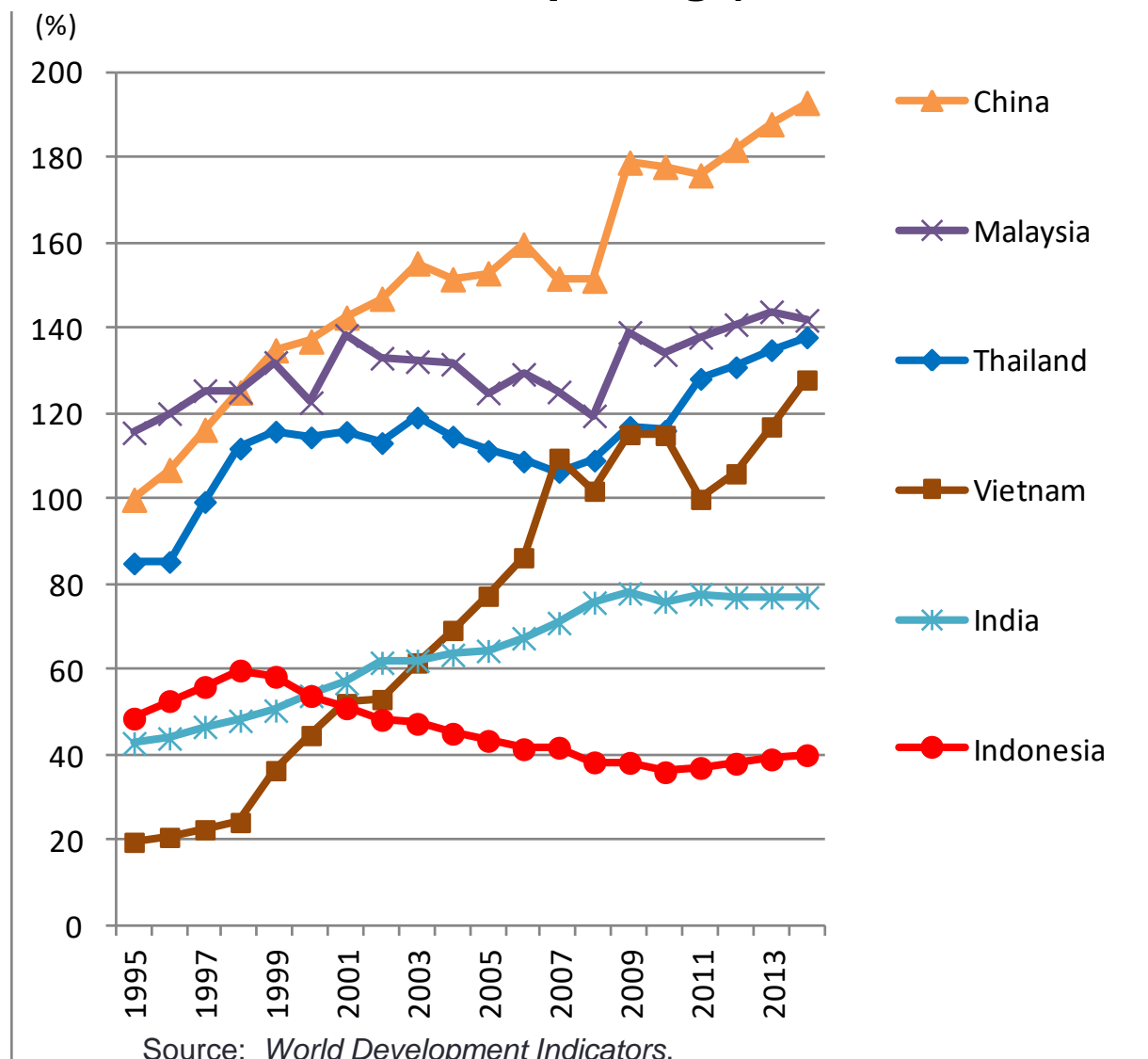
In R & D expenditure, figures of Burnei, Lao PDR, Philippines, and Viet Nam are at 2002.

Those of Philippines, Thailand, and India at 2007, Malaysia at 2006, and Indonesia at 2009.

Source: ISO, *ISO Survey 2011*, and World Bank, *World Development Indicators*.

Challenge 3: Weak Financial Intermediation

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



3. Assessing the Current Economic Reform

aims at domestic-demand-led investment-led economy

1. Mobilize domestic savings
 - Broaden taxation base
 - Mobilize financial savings (deposit)
2. Promote investment = Reindustrialization with higher value added and higher productivity
 - Fiscal incentives
 - Credit expansion
 - R&D promotion
 - FDI utilization
3. Reduce business costs (=improve productivity)
 - Deregulation, rationalization, simplification
 - Improve logistics and infrastructure



but still needed

Conclusion

- ▶ Indonesia is amid the phase of critical importance, an unrepeatable chance of demographic bonus.
- ▶ Higher growth accompanied with industrial upgrading should be pursued. Reindustrialization with higher value added and higher productivity would be the key indicator.
- ▶ It is crucial to make smart policy intervention in order to boost domestic-demand-led growth by mobilizing savings, investing them toward industrial upgrading, and reducing business costs. Government efforts of economic reform need to be more intensified.

Terima kasih !!

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