

# INDONESIA UPDATES 2011

Canberra, 30 September 2011

## ECONOMIC UPDATE

Chris Manning (ANU) and

Raden M. Purnagunawan (Padjadjaran University)

# FOUR MAIN MESSAGES

---

- ▶ *The Indonesian economy has been performing well on macroeconomic stability and growth, as well as employment and poverty.*
  - There has been a great deal of *international investor* interest in the country, domestic sources of growth are strong
  - Indonesia will not be completely immune to the effects of a global recession on commodity prices but in good shape to deal with them
    - Of course, much depends on what happens in China.

- ▶ At home, there are concerns about the government implementing coherent policies for sustaining growth
  - Budget constraints related to high levels of fuel and energy subsidies
  - Poor quality, and under-investment in infrastructure
  - Signs of taking easy options in promoting industrial development, with uncertain outcomes for employment
- ▶ While labour markets have improved, solutions to youth unemployment have been elusive.
- ▶ The longer term Master Plans is innovative but extremely ambitious and indicative of more protectionist mind set

# OUTLINE

---

## *CHRIS*

1. Indonesia emerging on the world stage
2. Recent Macroeconomic Developments and Policy
  - ▶ Growth, investment and exports
  - ▶ Inflation, exchange rates and monetary policy
  - ▶ Fiscal policy
  - ▶ Speculation about impacts of a global recession

## *WAWAN*

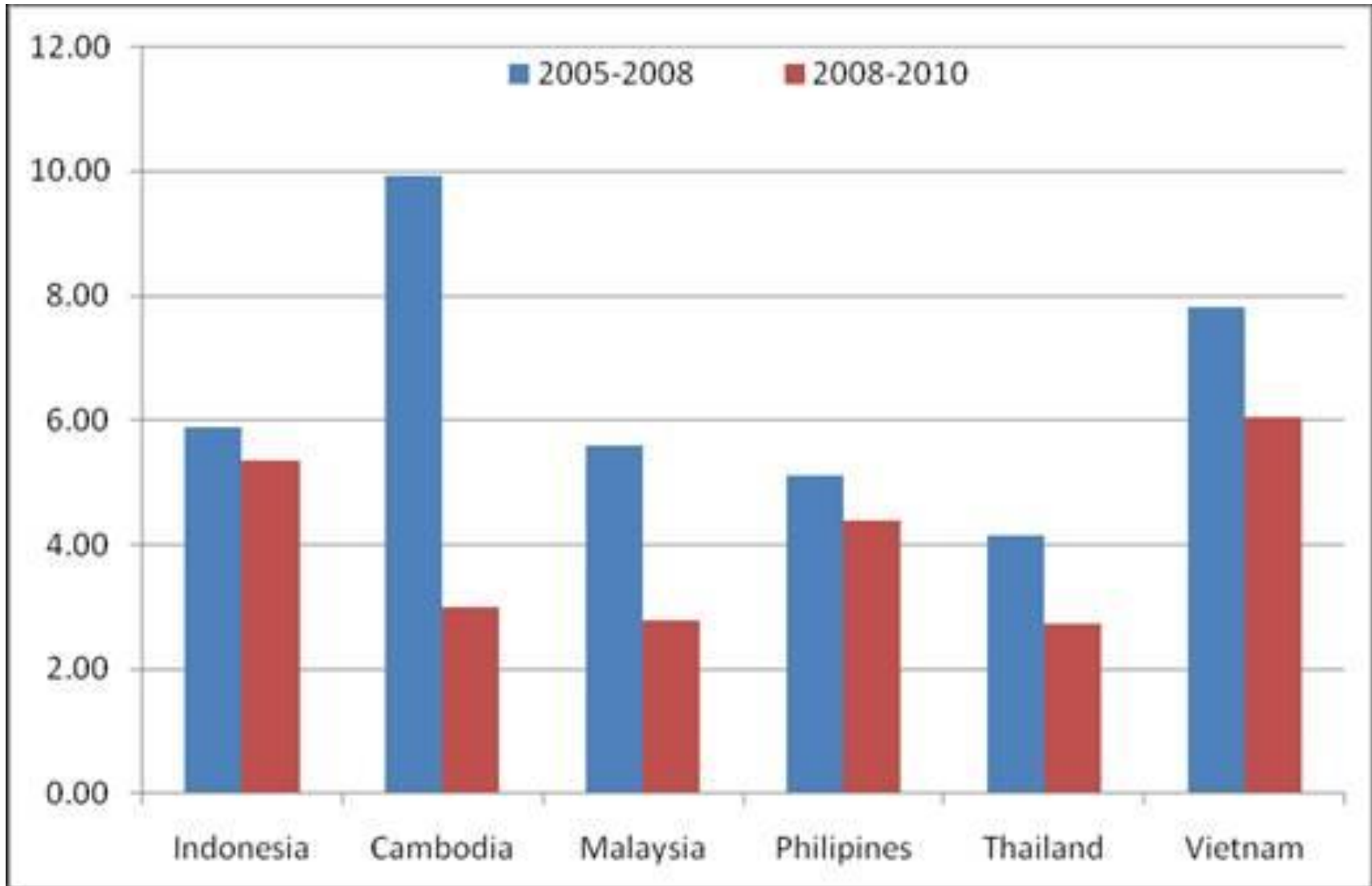
3. A More Dirigiste (Interventionist) Industrial Policy?
4. Youth unemployment and the migration ban
5. The Master Plan: New directions in longer term development policy

# I. Indonesia on the world stage: growing in confidence

- ▶ A strong belief in Jakarta that Indonesia is on the cusp (*diambang pintu*) of becoming a major economic power, partly international links but more important through potential in domestic market
  - *International*: Exports will exceed 200 billion in 2011, in top 21 exporters; broad based with a big commodity-natural resource component
  - *Domestic*
    - 18<sup>th</sup> largest economy, demographic dividend, and fourth largest population:
    - Indonesia' middle class large, growing rapidly and a huge appetite for consumer goods
      - grown by over 50% from 80 to 130 million in 2003-2010

- ▶ Confidence in ability to handle crises generated in the world economy
  - Recovery in economic growth after the AFC now complete (Figure 1)
  - Ability to get through the GFC largely unscathed, reportedly because of the strength of the domestic economy
    - Chatib Basri will show some data to suggest otherwise
- ▶ Role in International Economic Forums
  - Indonesia joins the G-20 (third fastest growing economy in G-20), for the first time seriously considered as a candidate to join the BRICS
  - Chairmanship and leading role in ASEAN and 2013 to chair APEC (first time since the landmark Bogor meeting in 1994)

..Indonesian growth has been stable compared to other neighbouring countries in recent years



## II. MACROECONOMIC DEVELOPMENTS AND POLICY

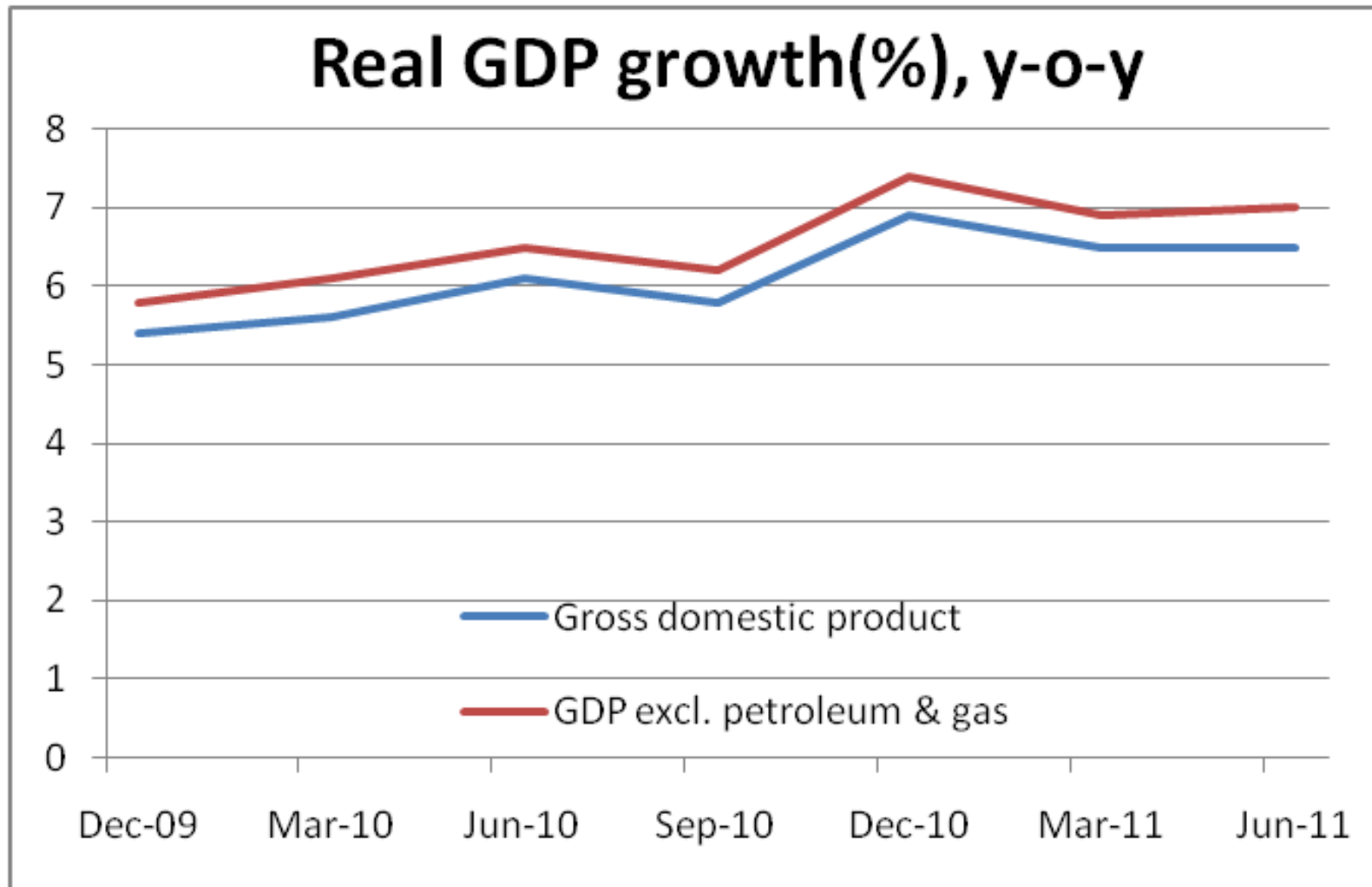
- ▶ Indonesia well placed for a sharper than expected downturn in the world economy in 2011 and 2012
  - Overall economic growth steady at 6.5 percent
  - Foreign reserves were at a record high (\$120 billion, six months exports earnings and debt repayments)
  - Inflation was down to below five percent
  - Investment (especially FDI) up significantly



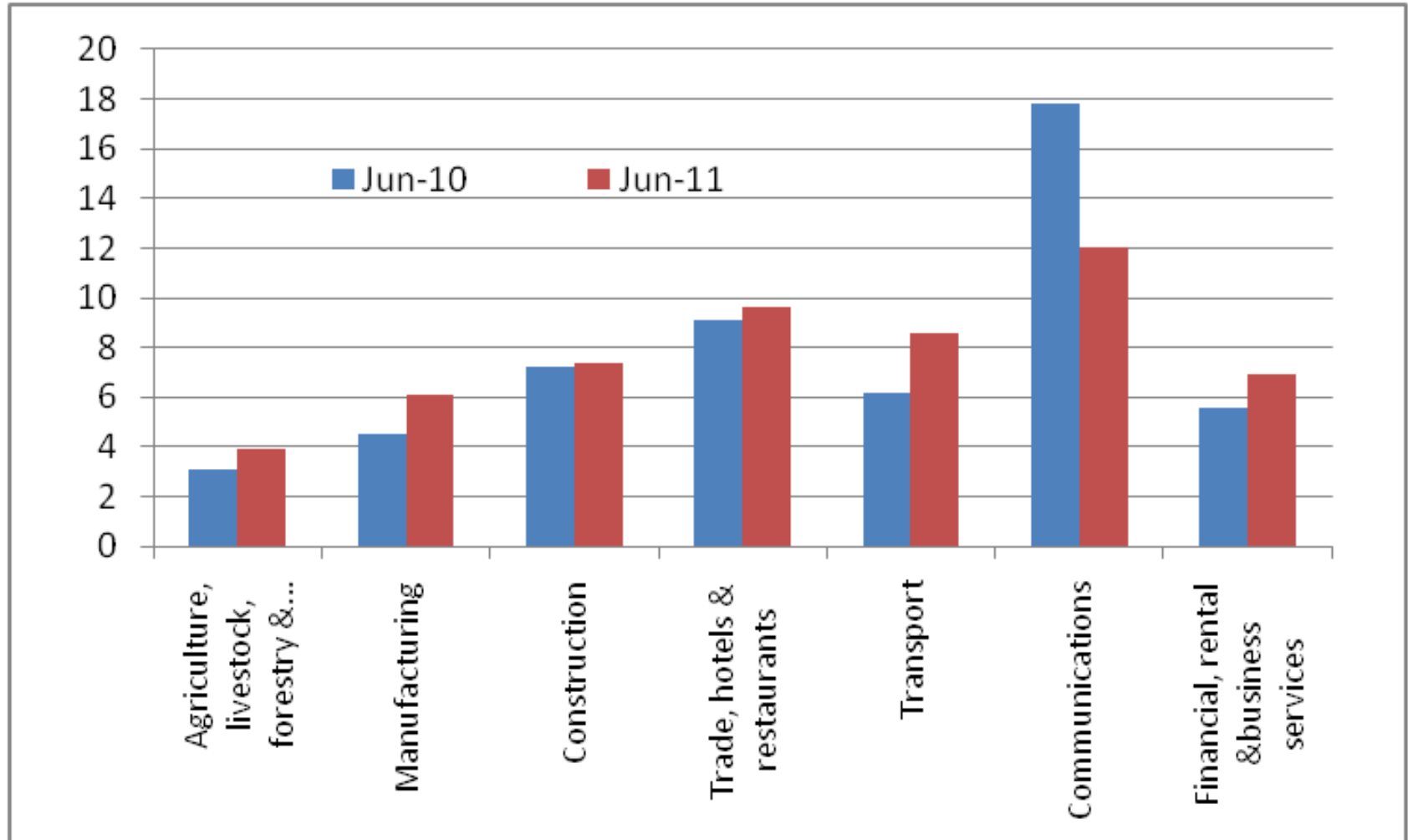
## ECONOMIC GROWTH

- ▶ Generally trending up, very slowly
- ▶ The revival of growth in manufacturing, and *tradable* commodities more generally
  - agricultural production steady
  - in industry, growth of 6 percent
  - rebound of *TCF industries* after a decade in the doldrums: example of footwear (50% growth in exports in 2010, 20-30% 2011)
- ▶ Services: sustained quite high rates of growth (7%)
  - Still extraordinary growth of communications of close to 20 per cent

## ... Growth is strong but could be much better



# Some revival growth of Manufacturing , but services still dominate..

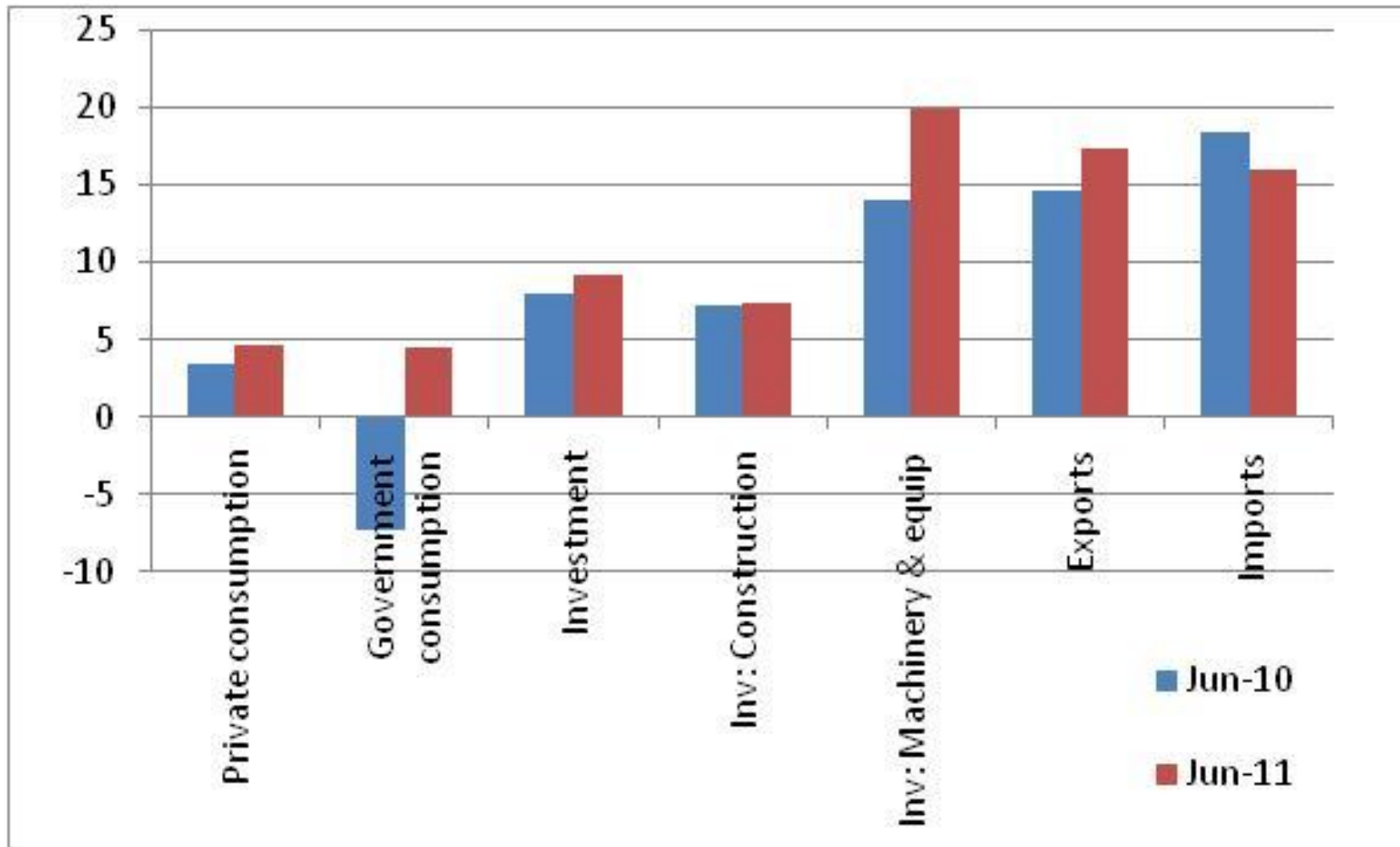


## INVESTMENT

- ▶ Investment up to 9% from 7% in the first quarter
  - Partly high rates of capital inflow, much of it FDI (over the US10 billion mark in the first half of 2011)
  - Investment specially manufacturing
    - *foreign* in chemicals, basic metals and machinery
    - *domestic* especially in primary industries (oil palm, coal, food processing)
    - multinationals such as Toyota, Suzuki and Nissan to expand operations for domestic market: ambitions of Indonesia becoming the automotive hub in Asia.

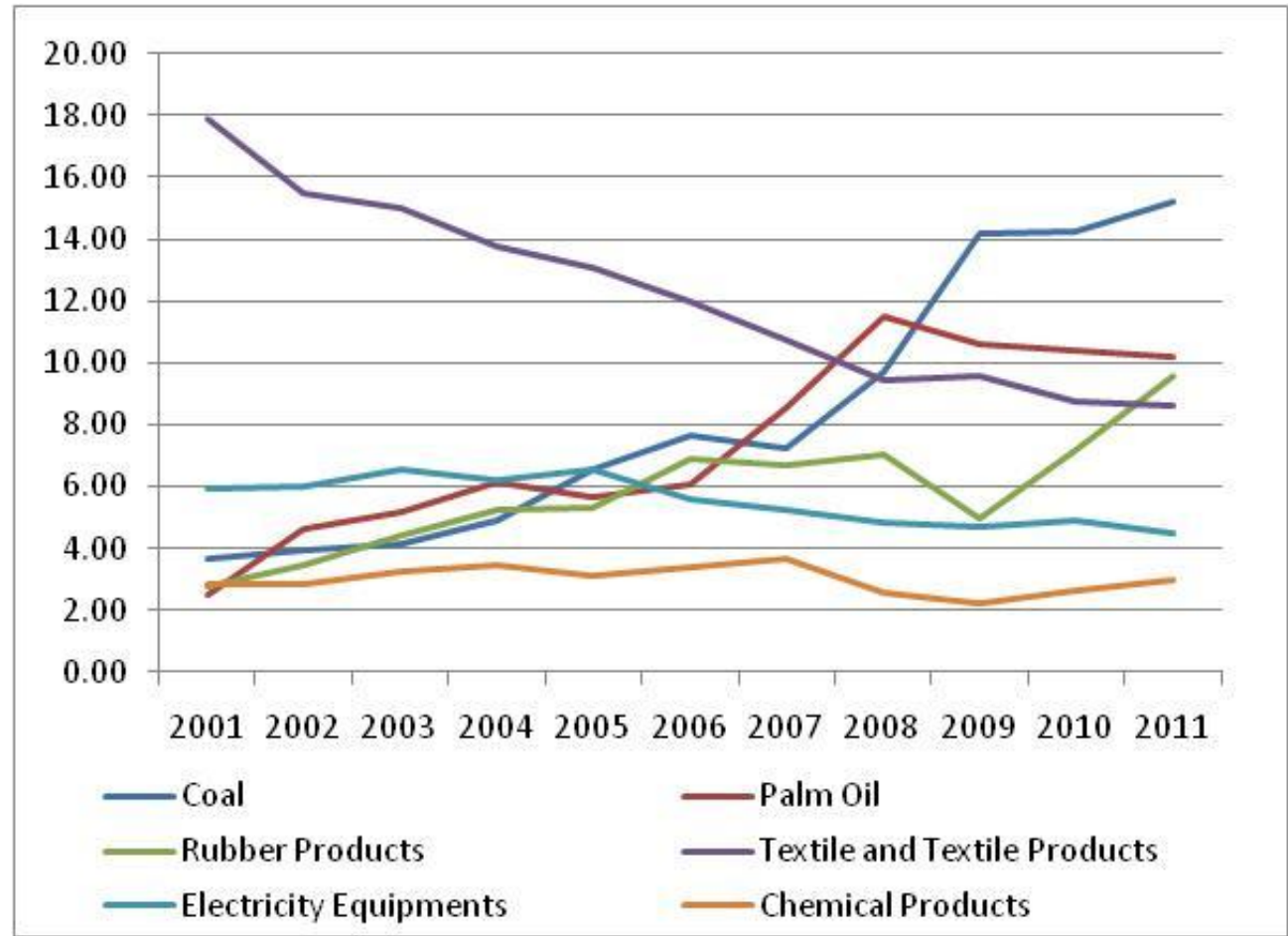
- ▶ Indonesia more competitive despite appreciation of exchange rate
  - But mainly because of developments abroad, than at home: eg:
    - JETRO study shows rising wages in both China and Vietnam in textiles, transport and electronics
- ▶ Exports growing by 15-20% accompanied by increases in imports of machinery
  - Changing composition (see McLeod in BIES, April 2011)

# .. Investment and Export continued to grow (year on year)

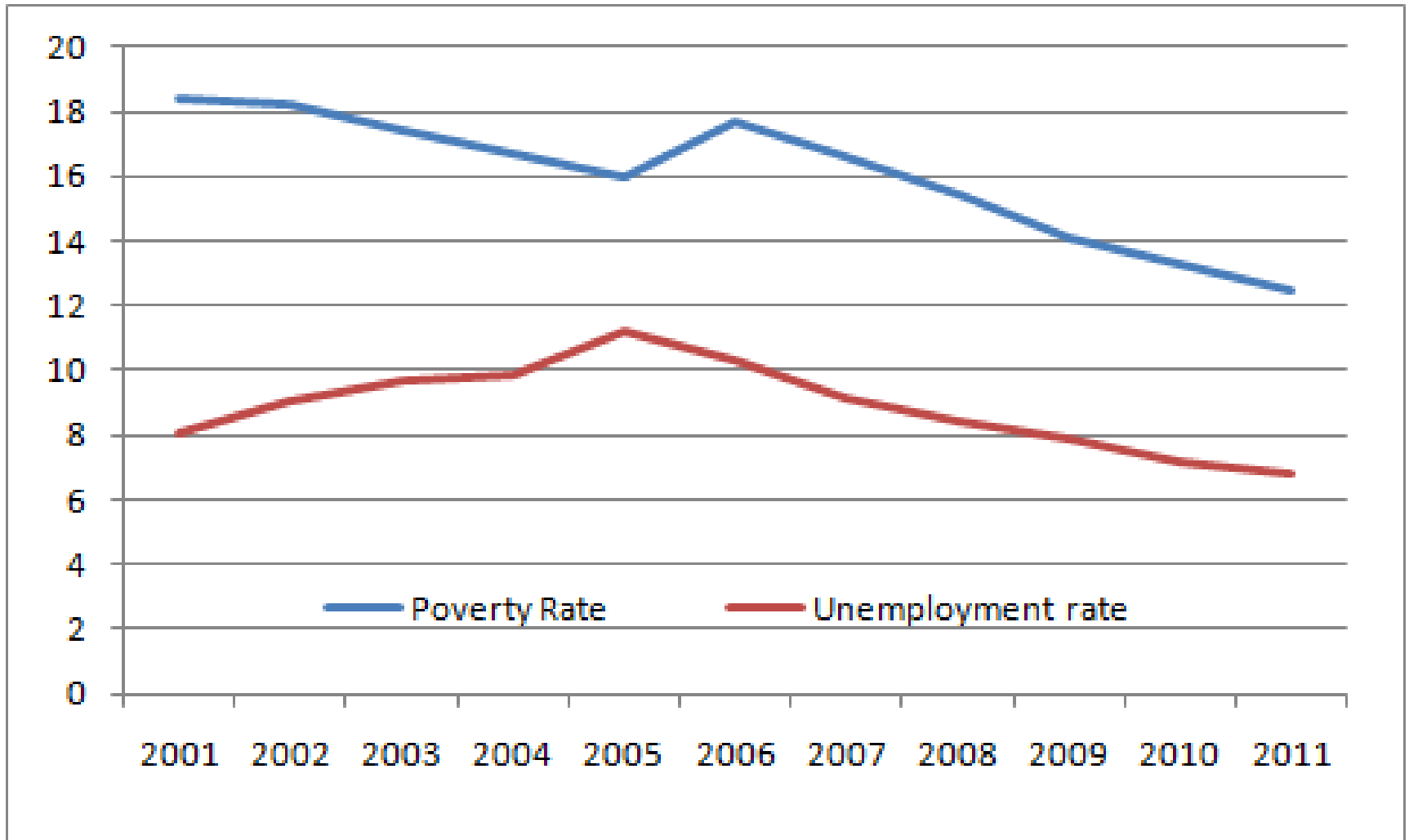


# ..The export composition has changed

- ▶ Coal has eclipsed gas as the single largest commodity export in 2011
- ▶ Coal and Palm Oil rapid growth has shifted the locus of export activities away from Java



# Positive implication for poverty and unemployment rate



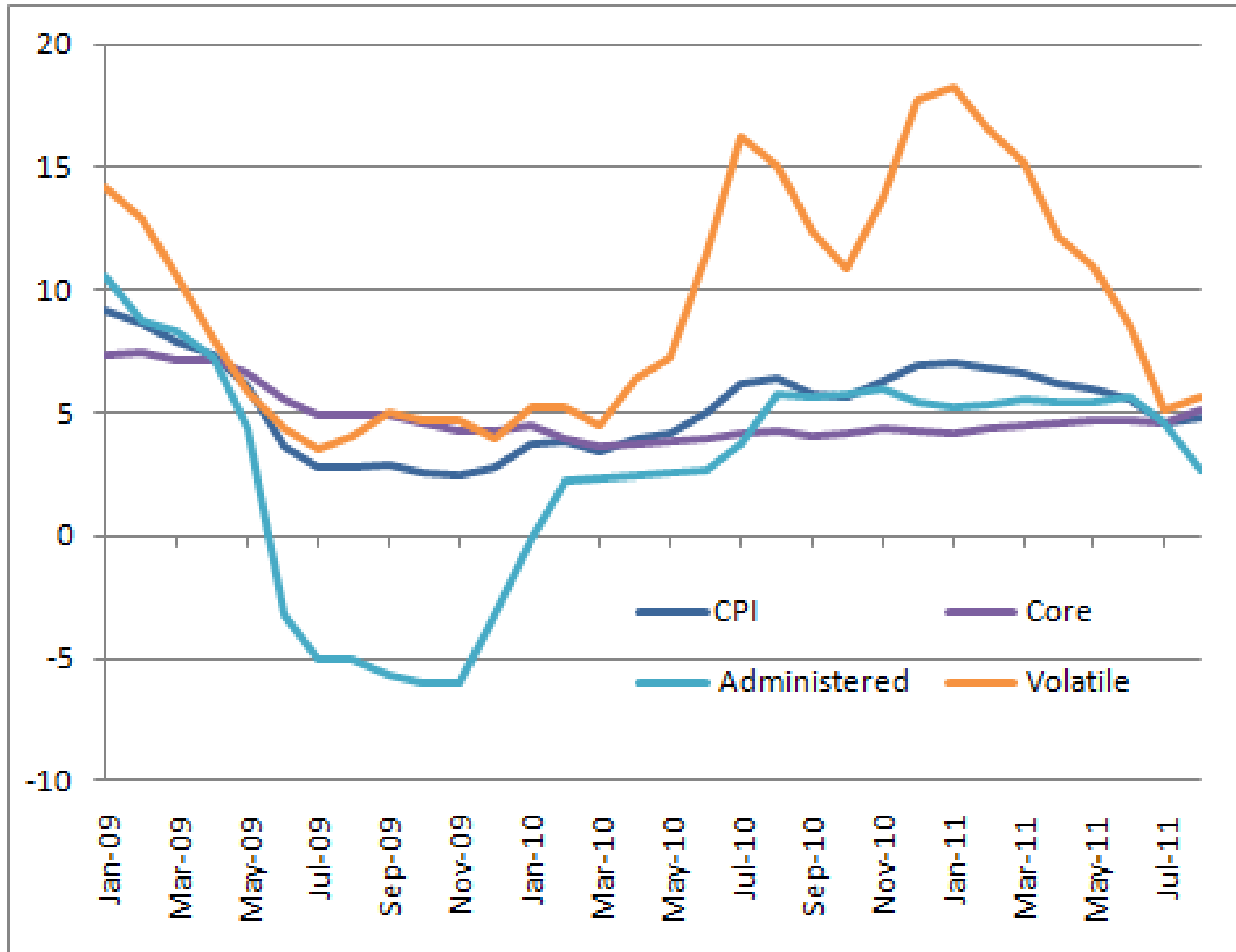
Notes: 2011 employment data is from Sakernas 2011 (February round)



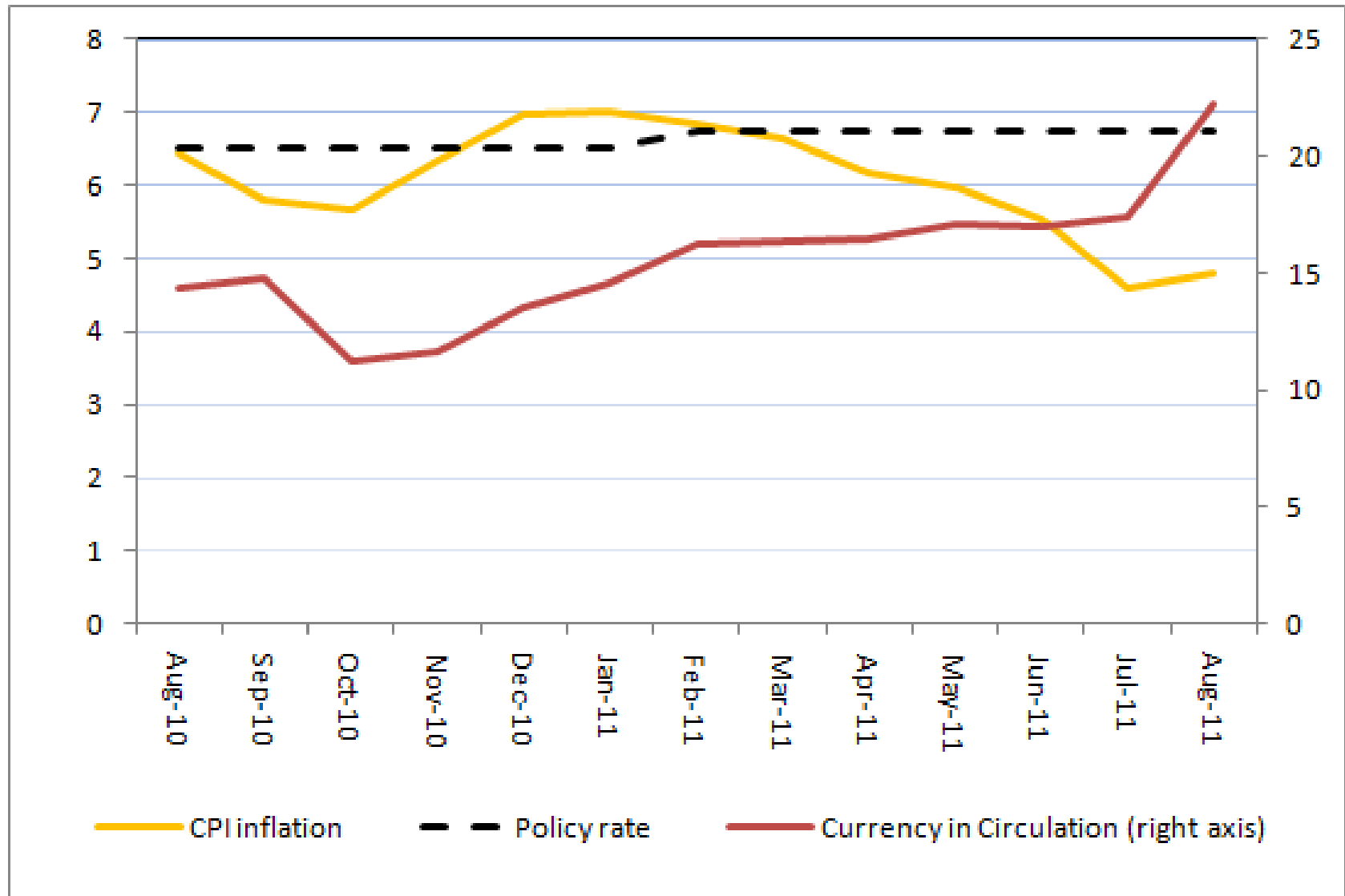
## INFLATION, EXCHANGE RATES AND MONETARY POLICY

- ▶ CPI rate slows significantly driven by falling food price (good harvests, imports boost stock pile), and despite capital inflows and buoyant exports
  - Possible shock from Thai government policies, rising world prices, and impact on budgets of the poor
- ▶ Bank Indonesia decided in September to keep interest rates on hold at 6.75 percent, for the seventh successive month in a row.
- ▶ The turbulence abroad spilled over to the Jakarta stock exchange falling to just under 3700 in August, from above 4000 earlier in the year
  - small relative to movements in many other parts of the world and below level at the beginning of the year

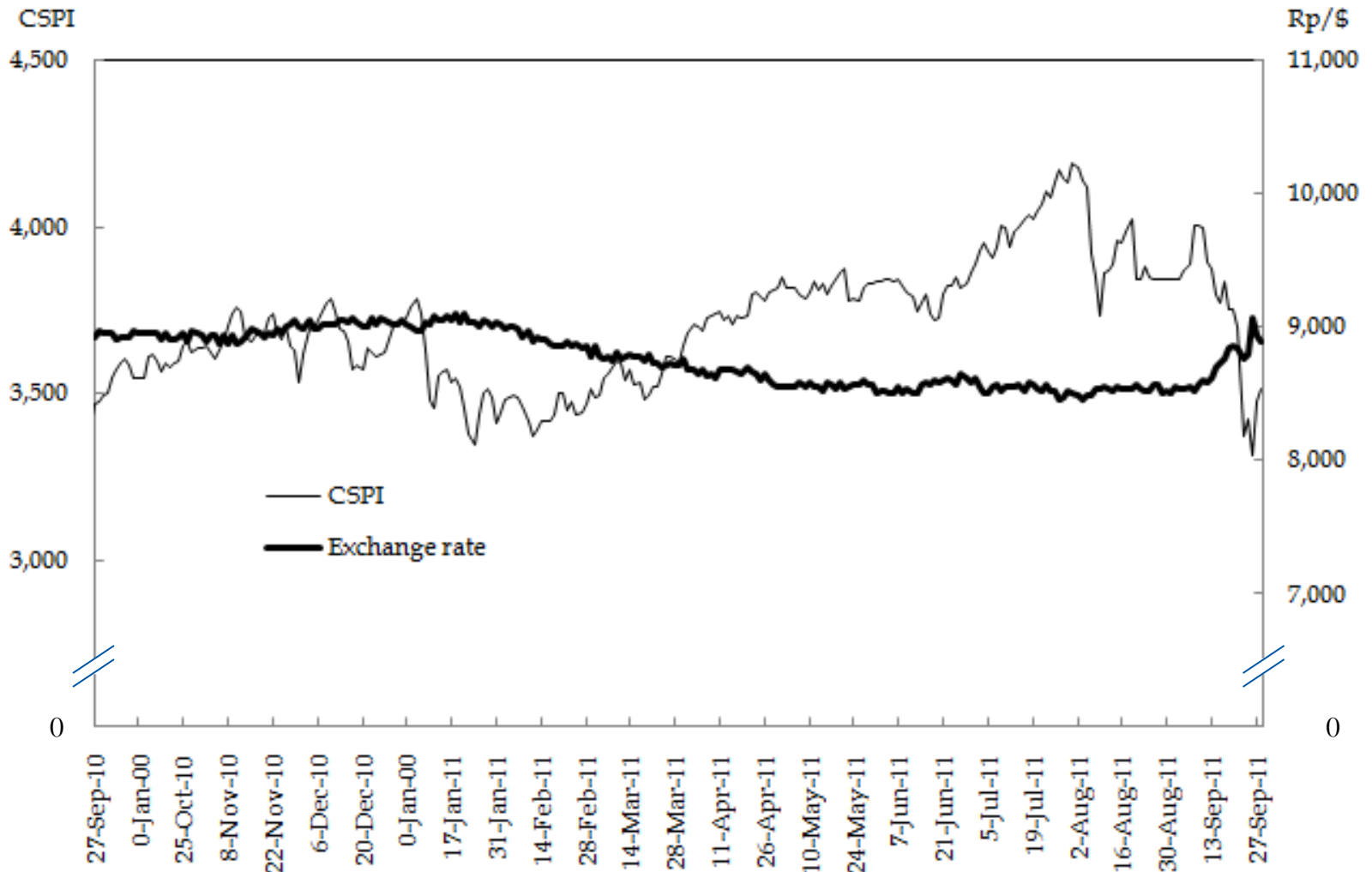
# Inflation has remained low



# Stable monetary condition



### Composite Stock Price Index (CSPI) and Exchange Rate



## THE 2012 BUDGET

- ▶ *Overall spending* is planned to rise 7.4 percent decline in the deficit to 1.6 percent of GDP from 2.1% projected for 2011
  - President's commitment to achieving a balanced budget by 2014
    - Fear of international downturn
  - *Capital spending* is slated to rise by a significant amount (19 percent), especially on railways and airports, and on road maintenance
  - *Issues*
    - significantly slower growth would mean slashing capital expenditure and put many pressing infrastructure needs on hold for another year
    - Slow disbursements in capital spending continue to plague development programs (commentaries by Haryo and Anggito)
    - Cost of Subsidies very high: almost 20% of the proposed budget in 2012, over 20% in 2011

- ▶ What are the likely impacts of world recession: Big question is what will happen to China
- ▶ Positive
  - Indonesia less exposed to world economy: was not badly affected by GFC (growth 4.5% in 2009)
  - Banking sector not exposed in overseas markets: Indonesia has been awash with capital
  - Capital inflows in the form of FDI quite large and less mobile
  - Macroeconomic conditions favourable and conservative fiscal policies
- ▶ Negative
  - Exposed to capital flight and shock to commodity prices

## IV. Industry Policy: a more dirigiste approach?

- ▶ Government shows signs of greater intervention in industry policy
- ▶ Less policy direction and coordination among the economics ministers than the first SBY government
  - Action not always taken, but quite volatile discussions in the media, and sometimes public disagreement among ministers
- Two cases in recent times (below), but a uncertainty about the implementation of the investment law in a range of fields (eg. education, health, telecommunications: See Magiera, BIES, August 2011)

# On Tax incentive

- ▶ Tax holidays for investors, especially in large capital and resource-based industries. Companies announcing they will apply:
  - POSCO,
  - Kuwait Petroleum (\$6-7 billion)
  - Hankook Tire (\$353 million)
- Autotomotives companies will also join? GM, Peugeot, Nissan, Toyota, Suzuki...
- ▶ Allowed for in the investment law not in line with its spirit of non-discrimination
- ▶ Is this necessary?



# Luxury Tax: The Blackberry case

- Recent announcement of possible taxes on luxury goods, such as Blackberry, in response to Research in Motion (RIM) decision to set up in Malaysia (Penang).
  - Indonesia a major consumer of blackberry (75% of world market)
  - Indonesia had pressured RIM to establish data centres and content censorship
  - Penang's advantage in infrastructure and service industries
  - Another example of Indonesia missing the boat in electronics
  
- ▶ Sadli's Law: Good times bring bad policies?

# Have labour market conditions really improved?

- ▶ Unemployment has decreased steadily at almost 1 % per annum
- ▶ Employment grew 2.7 % per annum on average
  - Especially in community, social and personal services and Manufacturing
  - By 2010, services employed more workers than agriculture, reversing their relative positions five years earlier.

## ..... however

- ▶ The informal sector absorbed 59 % (2010), decreased slightly from 2005 level.
  - Around 30% working less than 35 hours per week in 2011, half were involuntary
- ▶ The number of casual workers continued to increase significantly, by 30 percent over 2005-2009, when the number of regular workers barely increased.
- ▶ Real wages have not improved in the last five years, especially for industry and agriculture sector (Papanek, 2011).

# Youth Unemployment is still a big problem

- ▶ Feared to trigger political turmoil - Egypt Case
- ▶ Youth unemployment (ages 15-24) have been decreased significantly (from 33 percent in 2005 to 21 percent in 2010)
- ▶ High, compared with the neighbouring countries
- ▶ Characteristics ??
  - Choosy youth ? (Manning and Junankar, 1998)
- ▶ Youth employment
  - Highly informal and around one-third are underemployed, especially in rural areas

## Problems

- ▶ Skills below the level required by employers (WB, 2011).

## .. More vocational school enrollment ???

- ▶ **Plan to convert the proportion of general to vocational upper-secondary schools to 30:70 by 2015**
  - Has been informally shelved recently
    - No strong connection yet between industry and vocational schools
    - Most skills for the workplace are best acquired post-secondary school
    - Wage premium of vocational to general were small and decreasing significantly (Newhouse and Suryadarma, 2011)

## .. Revitalize vocational training centers (BLK) ?

---

- Only 11 % effective out of 162 existing BLK (MoMT 2006)
- Poor facilities and outdated equipment, especially after decentralization
- Limited connect with the priority sector in the Master Plan (WB 2011)
- High cost per student

# Problems with skill certification ?

- ▶ Regulated under the Labour Law 13/2003 and Government Decree no 23/2004
  - BNSP (National Certification Body) is the only agencies that can set and certifying national competency/skill standards
- ▶ Issues :
  - Do not fully adopt the existing international standards which are also already applied in Indonesia
    - Need to re-examine and re-asses standards
    - Lost of time and resource
  - Has not yet recognized by most firms, especially foreign firms

# .. Additional pressures to the labor market:

## The moratorium

- ▶ Ban on the export of domestic workers to Saudi Arabia
  - Impact on welfare in sending regions
    - 15-20 thousand workers/month usually sent to Saudi Arabia
    - potential loss of remittances from Saudi:Rp 3 trillion (\$354 million)
  - Government Responses
    - allocate Rp 1.4 trillion (US\$162.5 million) from the community development fund (PNPM) for training and education programs targeting women in most affected region
- ▶ Can the gap be filled with more skilled manpower: eg. nurses, hospitality workers?
  - In the short-run unlikely, the supply side not ready.



# V. THE MASTER PLAN

## MASTERPLAN

ACCELERATION AND EXPANSION OF INDONESIA  
ECONOMIC DEVELOPMENT 2011-2025



REPUBLIC OF INDONESIA

# VI. INDONESIA'S MASTER PLAN FOR LONG TERM DEVELOPMENT

- ▶ Setting: the parlous state of infrastructure
- ▶ Focus on improving *connectivity* (and transport and communications corridors) in Indonesia at various levels is new – international, national, regional and local
  - Sea connections especially important
- ▶ Major Role of SOEs and Domestic Industry
  - Developing energy (one third of total capital spending)
  - Major increase in processing industries the resource rich Outer Island regions (export of raw materials banned after 2014)

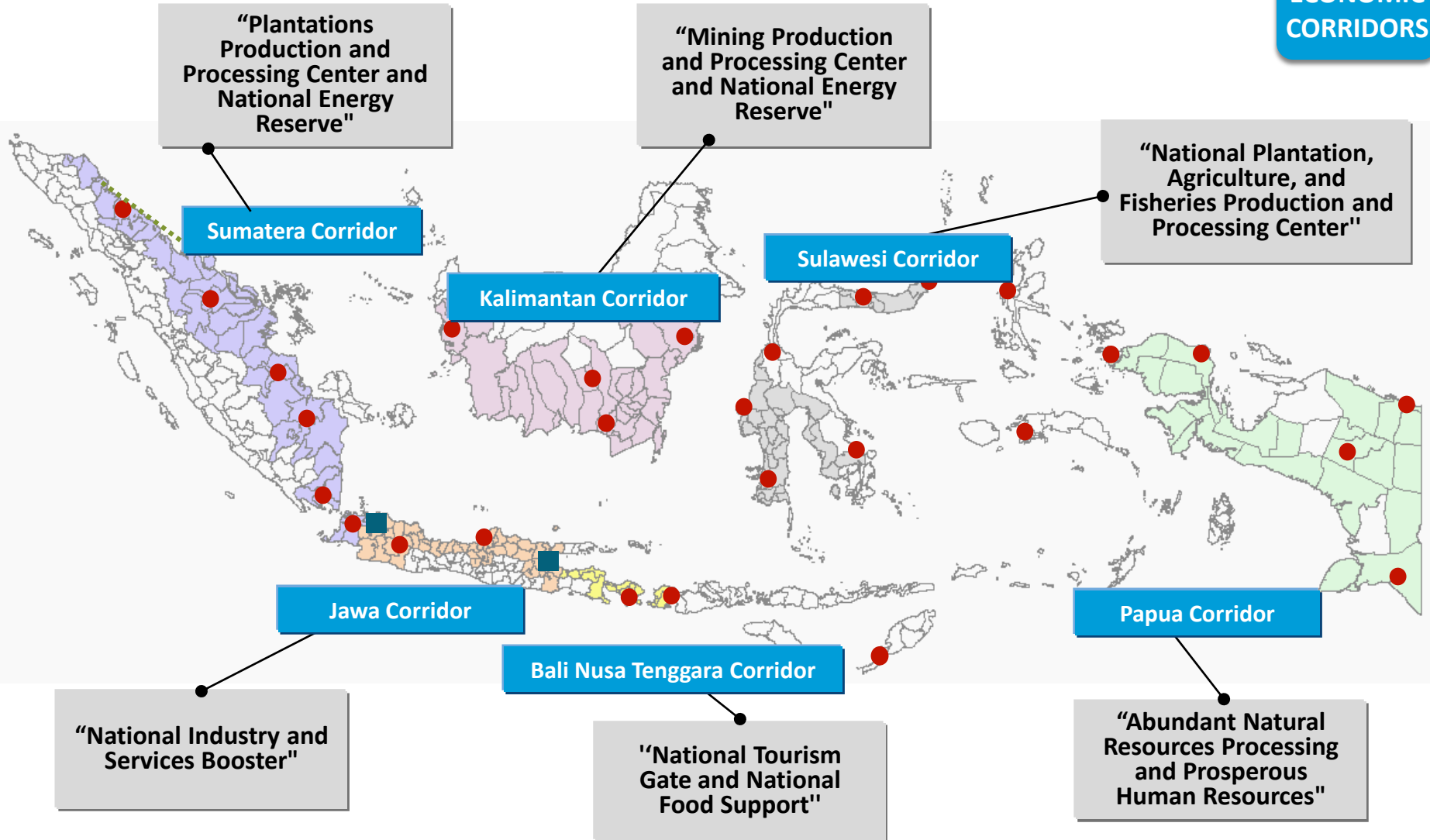
## **Ambitious indeed! Massive needs for capital**

- ▶ Eight main programs (including surprisingly marine tourism in Eastern Indonesia), and 22 main activities
  - more than half of which have links with primary industries, including minerals.
  - encouragement of industrial clusters and special economic zones – not worked so far
- ▶ Six main regions with specialization on key areas of economic activity are distinguished
  - Java to focus on national industry (food and beverages, textiles and transport equipment)
  - Sumatra, Kalimantan and Maluku and Papua as centres of natural resource processing and energy investment

# Indonesia Economic Corridor Development Theme

## Economic Transformation Master Plan

### ECONOMIC CORRIDORS



- 
- ▶ In addition to a physical plan emphasis on institutional linkages and human resources

## SUM UP

A grand plan, regulatory and institutional changes are included, but very doubtful they might be implemented in the time frame set out in the Plan

# CONCLUSIONS

---

1. *The Indonesian economy has been performing well on macroeconomic stability and growth, as well as employment and poverty – domestic sources of growth dominant*
  - Global recession effects unknown but Indonesia not immediately vulnerable
2. *At home, there are concerns about the government implementing coherent policies for sustaining growth*
3. *No obvious solutions to youth unemployment*
4. *The longer term Master Plans is innovative but ambitious and likely to lead to more inward looking strategy of development*

- Budget constraints related to high levels of fuel and energy subsidies
- Poor quality, and under-investment in infrastructure
- Signs of taking easy options in promoting industrial development, with uncertain outcomes for employment
- ▶ While labour markets have improved, solutions to youth unemployment have been elusive.
- ▶ The longer term Master Plans is innovative but extremely ambitious and indicative of more protectionist mind set