

Indonesia Navigating Beyond Recovery: Growth Strategy for an Archipelagic Country

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Presentation

Growth Performance and Sustainability in Enhanced Engagement
Countries

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What Motivated Us

- Like other Asian economies, the global economic crisis hit Indonesia through trade
 - Exports collapsed
- Resilience in domestic demand (private consumption, fiscal stimulus, and private investment) has maintained growth
 - Brief dip in private consumption but successful Presidential election boosted consumers sentiment (“Yes we Can”)
 - Soft landing of private investment
 - Strong banking sector despite volatility in liquidity
 - Remarkable performance in services relative to manufacturing
- The benefit of maintaining certain “minimum contribution” of domestic demand on growth

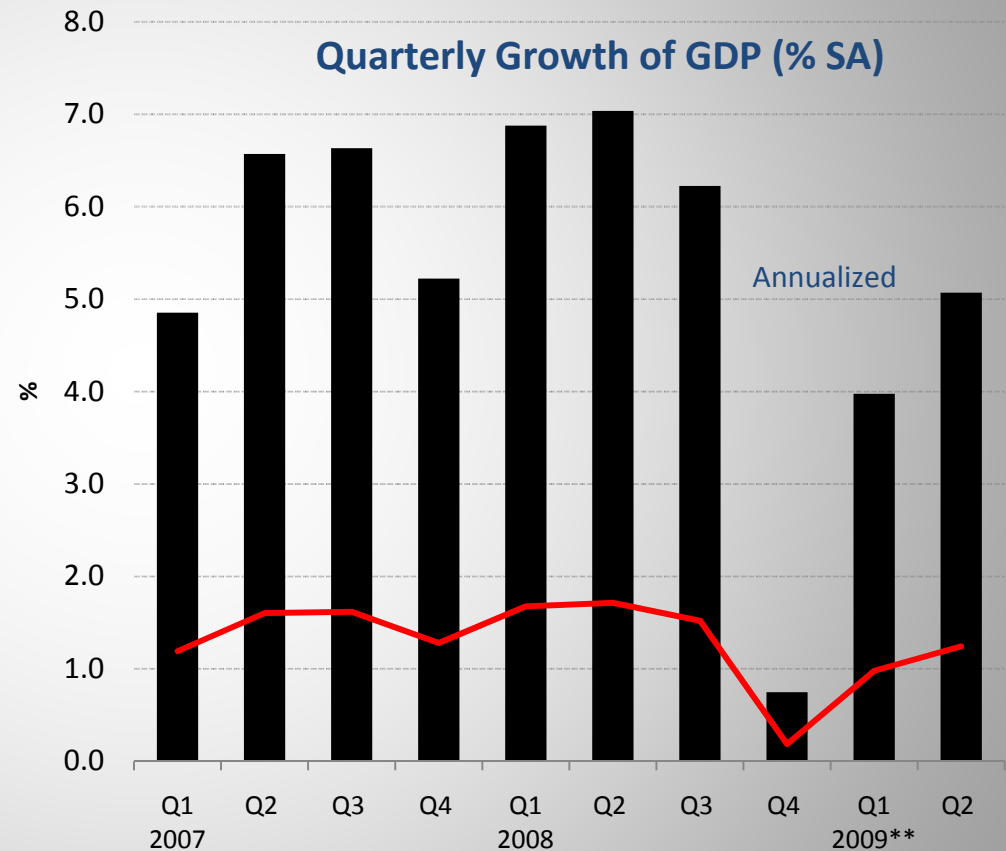


Areas of Concerns

- Does domestic demand have the capacity to deliver “thrust” to sustain growth?
 - What would be the obstacles preventing domestic demand to have maximum impact on growth?
 - Is being an archipelagic economy mean anything for Indonesia ?
 - Given the current state of play :
 - Deficiencies in physical and soft infrastructures;
 - Rising sentiment for protectionism in labor intensive sectors, particularly in Java;
- what would be the another sensible entry point to push economic reform?

The Sky is Clearing Up for Indonesian Economy

- The economy continues to show its resilience from the global economic crisis
- GDP continues to expand at 4 percent (y o y) or 2.3 percent (q o q)

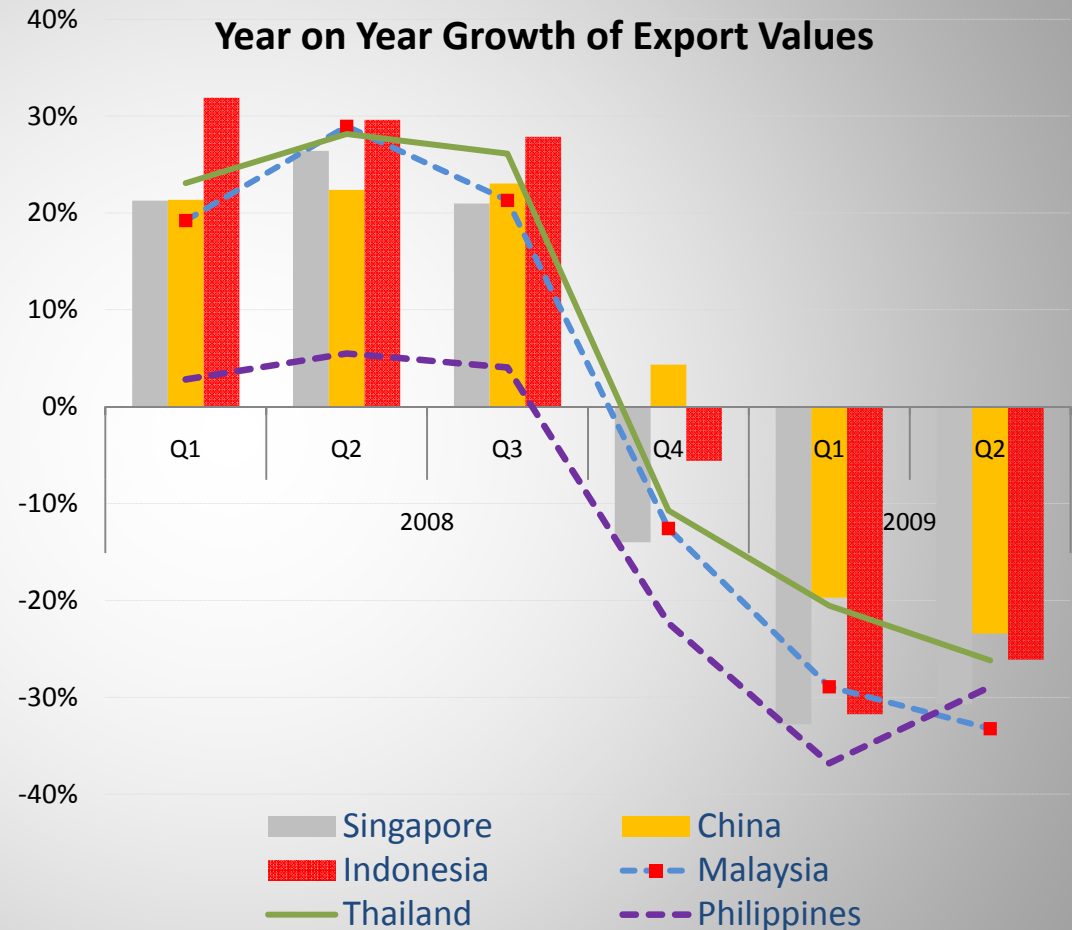


Source: BPS, authors calculation

Note: seasonally adjusted using X12 method

Mayday..Export Engine just Collapsed

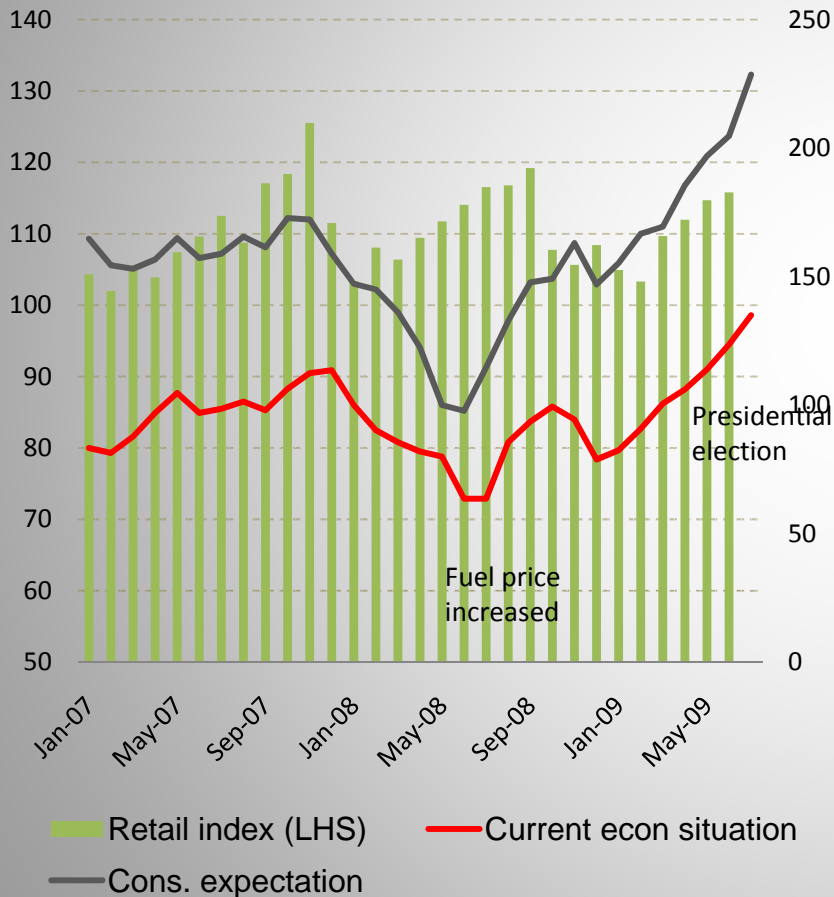
- Exports value contracted by 28 percent (y o y), the worst contraction ever since 2000.
- Signs of recovery, exports value bounced back by 17 percent in the 2nd quarter 2009 (q o q)
- Strength remain uncertain
- Competitiveness issues in manufacturing products



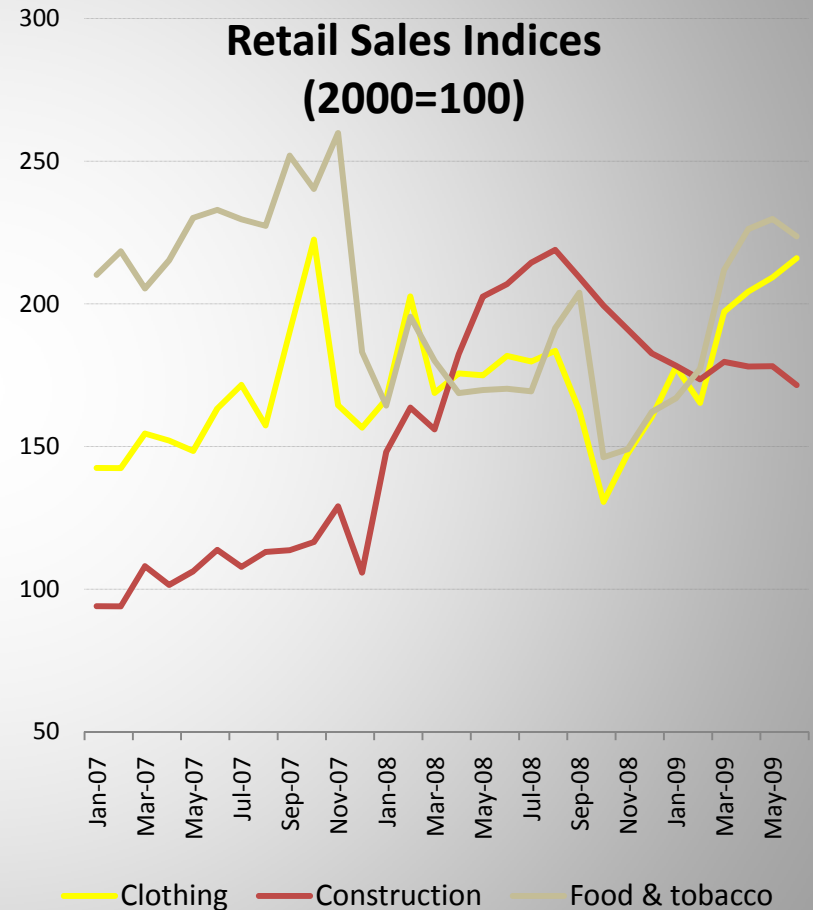
Source: BPS, authors calculation

Consumption is Maintained

Confidence Indices



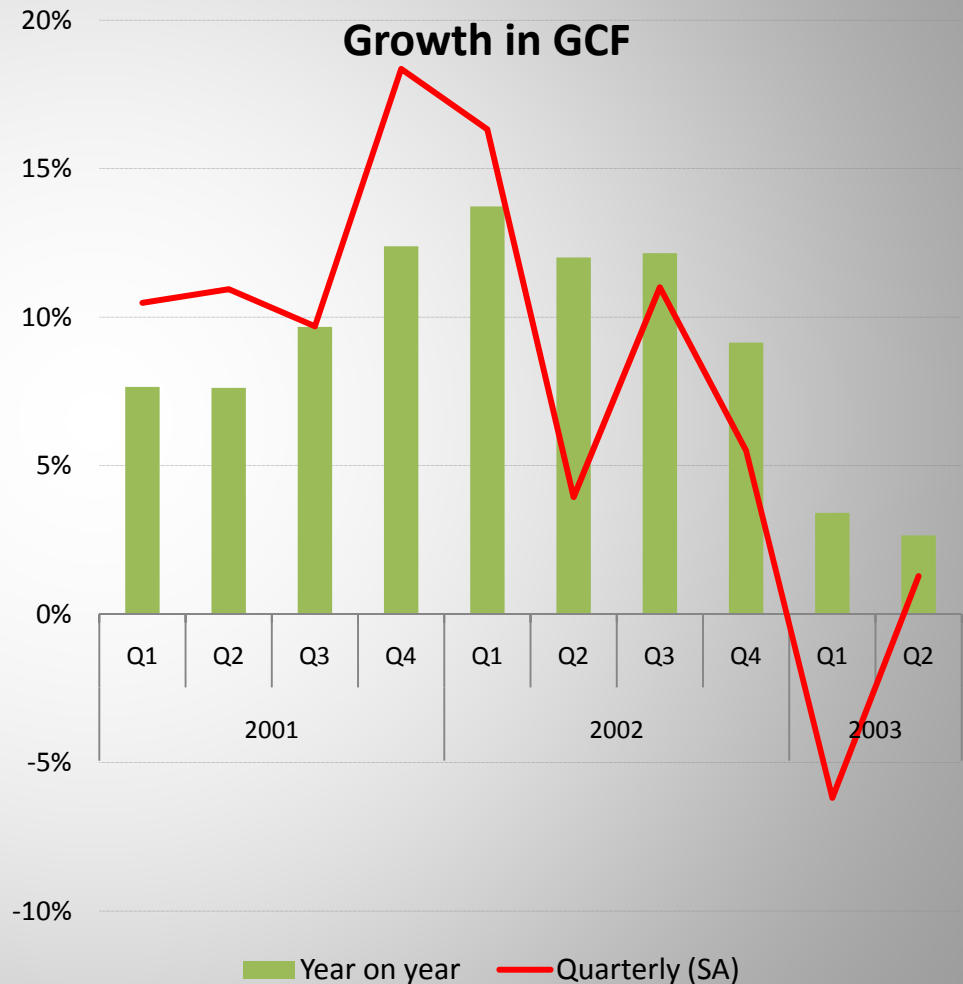
Retail Sales Indices (2000=100)



Source: CEIC, authors calculation
 Note: all series were seasonally adjusted using X12 method

Investment has Softened

- Growth of private investment has weakened
- Liquidity constraints and re-pricing of risk. Massive sell-off in October 08 following global credit crunch
- Improvement in liquidity situation and credit ratings should help investment flowing

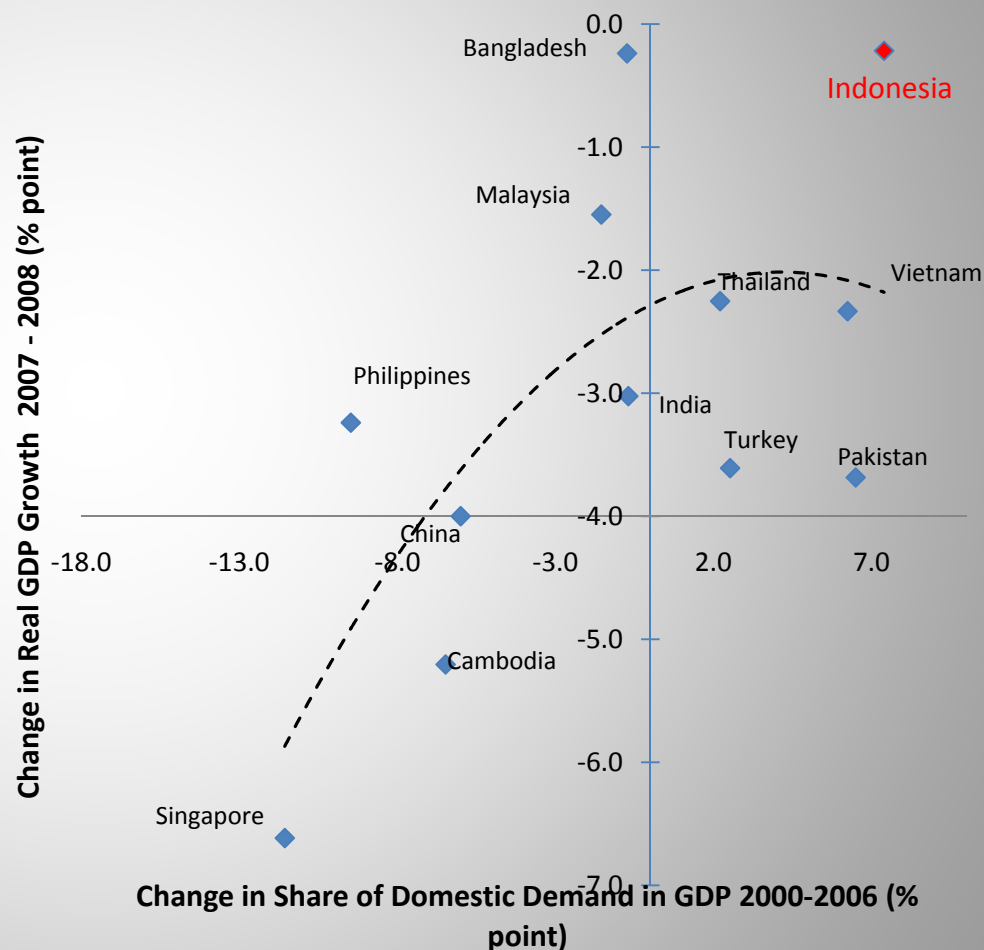


Source: BPS, authors calculation

Note: seasonally adjustment using X12 method

Domestic Demand: not a Unique Experience

- The global crisis is a true test for those that maintain their domestic demand
- Importance to have “minimum contribution” of domestic demand in growth

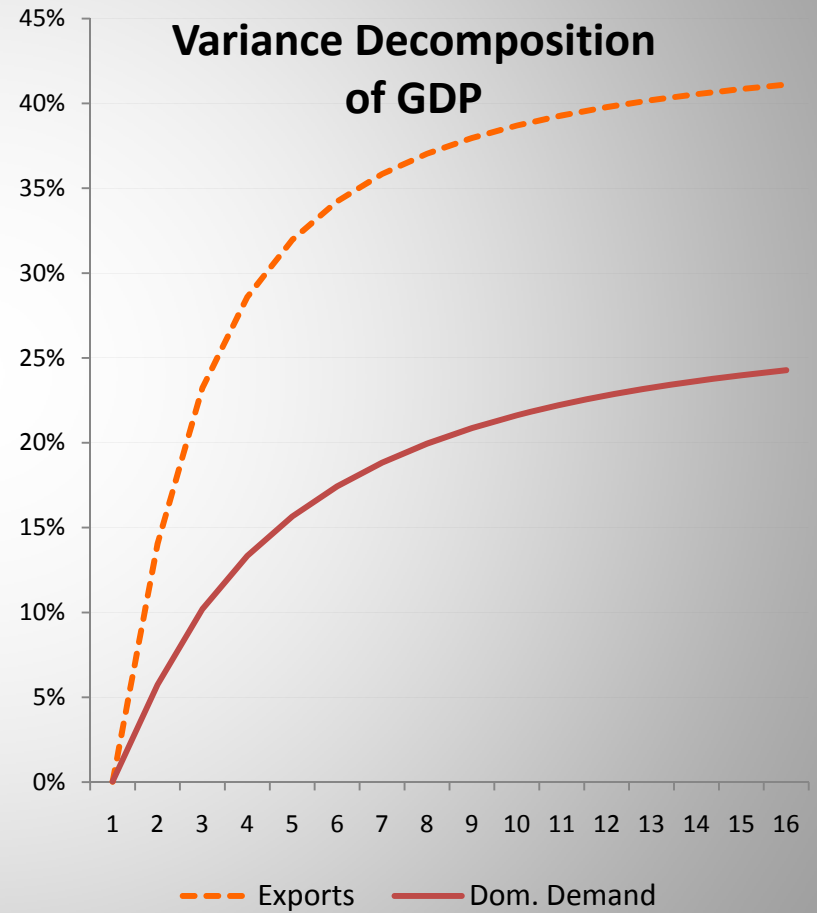


Source: EIU, authors calculation

Aftershocks of Exports and Domestic Demand to GDP



Source: authors calculation



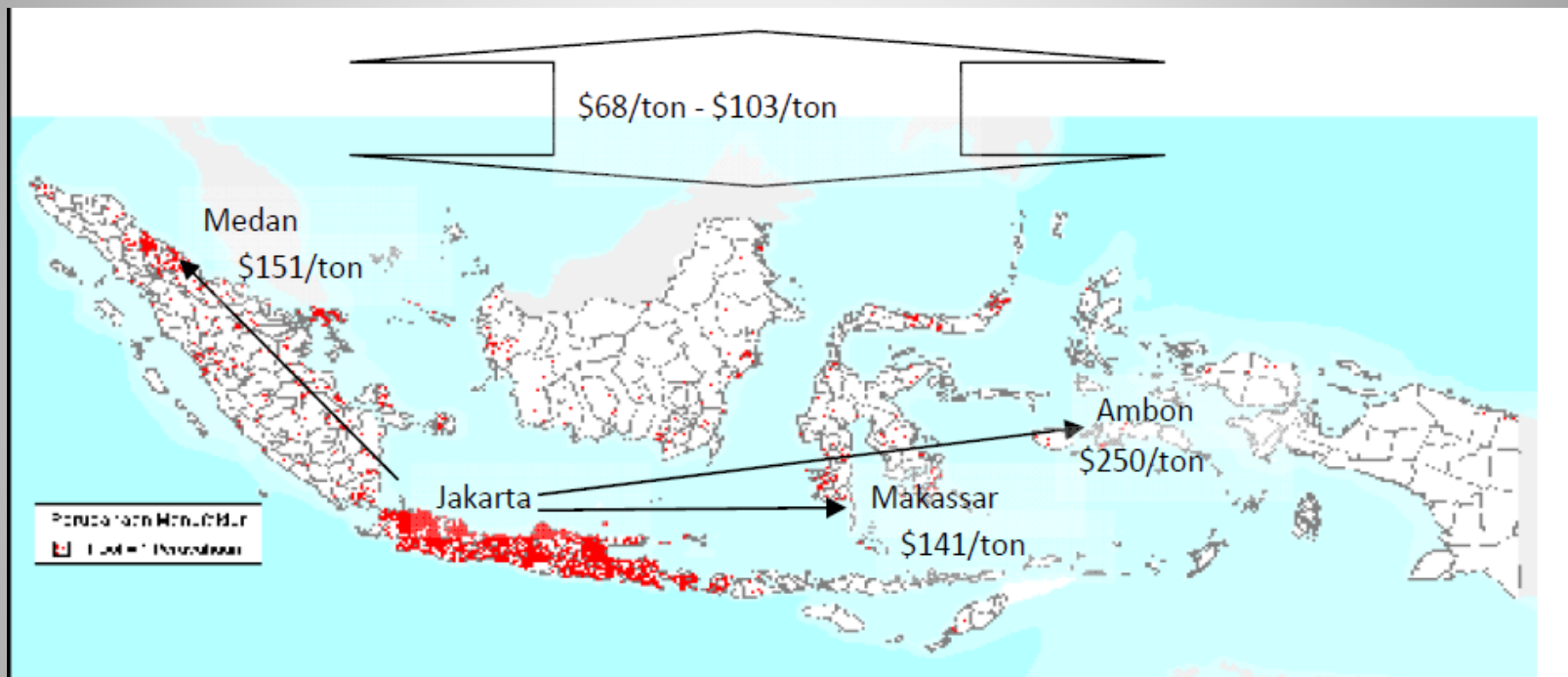
How Bad is the State of Logistics in Indonesia?

... Quite bad

| | Indonesia | China | Malaysia | Philippines | Thailand | Vietnam |
|---|-----------|-------|----------|-------------|----------|---------|
| Trade policy indicators (2006-2008, latest) ^a | | | | | | |
| Trade Tariff Restrictiveness Index (%) | 4.47 | 5.06 | 3.01 | 3.80 | 6.65 | Na |
| Simple average of MFN (%) | 6.93 | 9.67 | 8.37 | 6.27 | 9.94 | 16.81 |
| Ranking in Logistics Performance Indicator (2008) ^b | | | | | | |
| Domestic cost | 93 | 73 | 37 | 19 | 28 | 17 |
| Quality of infrastructure | 44 | 30 | 28 | 87 | 31 | 60 |
| Timeliness | 58 | 36 | 26 | 69 | 28 | 65 |
| Average \$/per-container for exports and imports(2009) ^c | | | | | | |
| | 682 | 503 | 450 | 818 | 710 | 818 |

Source: World Bank a) World Trade Indicators (2008), b) Logistics Performance Indicator (2008), c) Doing Business (2009)

With Whom shall we Trade more with?



Source: BPS, Census of Manufactured Industries (2004); survey by ORGANDA; World Bank, Doing Business 2009; and author calculations. **Each point indicates a single manufacturing establishment**

A Republic with not so Integrated Market

- Noticeable in goods produced mainly in Java
- Prices are slow to adjust in some regions.
- Remoteness contributed to price differential (Varela et.al, 2009)

| REGION | RICE | WHEAT FLOUR | SUGAR | COOKING OIL | SALT | CEMENT |
|--------------------|--------|-------------|--------|-------------|-------|---------|
| EAST JAWA | 4,250 | 3,800 | 6,000 | 4,450 | 1,600 | 38,000 |
| W. KALIMANTAN | 4,400 | 4,000 | 5,800 | 4,500 | 2,400 | 37,500 |
| E. KALIMANTAN | 4,500 | 4,000 | 6,500 | 4,500 | 2,000 | 37,000 |
| S. SULAWESI | 4,400 | 3,500 | 6,500 | 4,500 | 2,000 | 30,500 |
| EAST NUSA TENGGARA | 4,200 | 4,500 | 5,800 | 6,300 | 2,000 | 31,000 |
| Merauke | 5,000 | 7,000 | 7,000 | 6,670 | 3,000 | 62,000 |
| Nabire | 6,000 | 10,000 | 11,000 | 11,000 | 4,000 | 230,000 |
| Paniai | 10,000 | 7,500 | 8,000 | 7,000 | 8,000 | 60,000 |

Source: MoT

Concluding Remarks

- Paying attention on domestic demand in pushing economic growth has never been more important these days
- Indonesia is an island economy: need to remove barriers for integrating domestic market
 - Overcoming infrastructure barriers and lowering transaction costs
 - Ensuring competitiveness and productivity of logistics and services providers
- Framing reform in the context of integrating domestic market could rally support from many stakeholders
 - Reducing those barriers are the interest of manufacturers that are struggling to regain cost competitiveness and agro-producers that want to access thicker markets
- How would this change path of regional development?