

Economic Growth : Did Indonesia push its luck too far?

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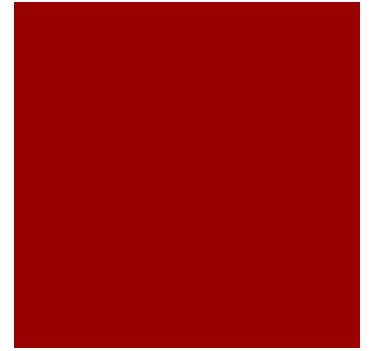
Ash Centre Harvard Kennedy School

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Harvard Kennedy School, Nov 21, 2015

Questions to be addressed

- What are the lessons learnt from the Indonesia's growth story post AFC?
- What are the challenges in the future?
- Will Indonesia be able to shift into high gear?



Indonesia's growth: good but not enough

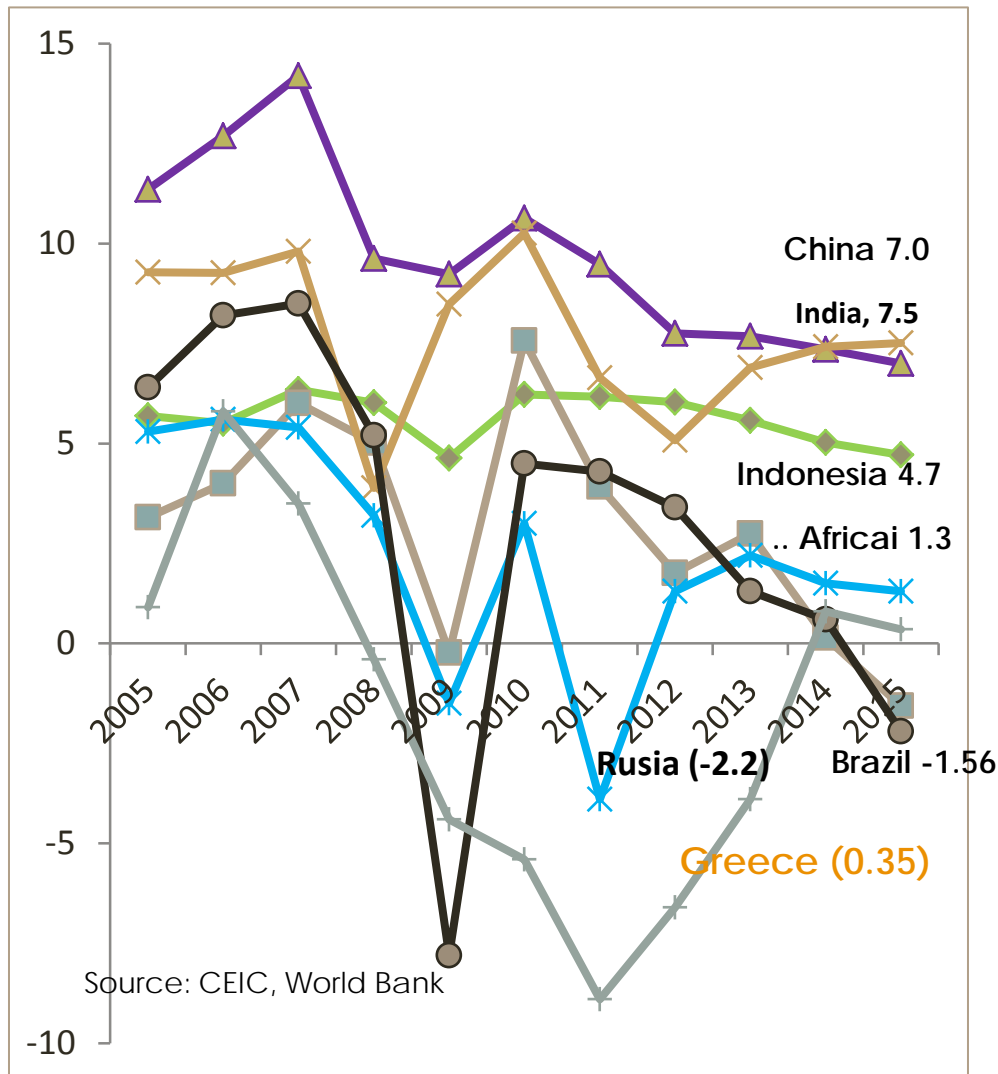
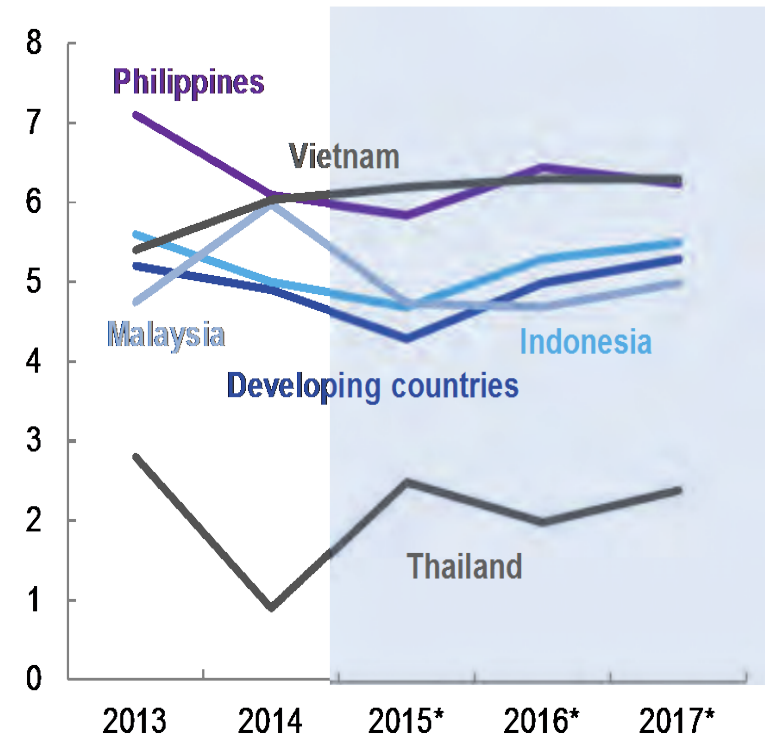


Figure 2: The outlook for developing countries is subdued, though slightly better for Indonesia (average annual GDP growth, percent)



Note: * World Bank forecast
Source: World Bank staff projections

Indonesia's balance sheet

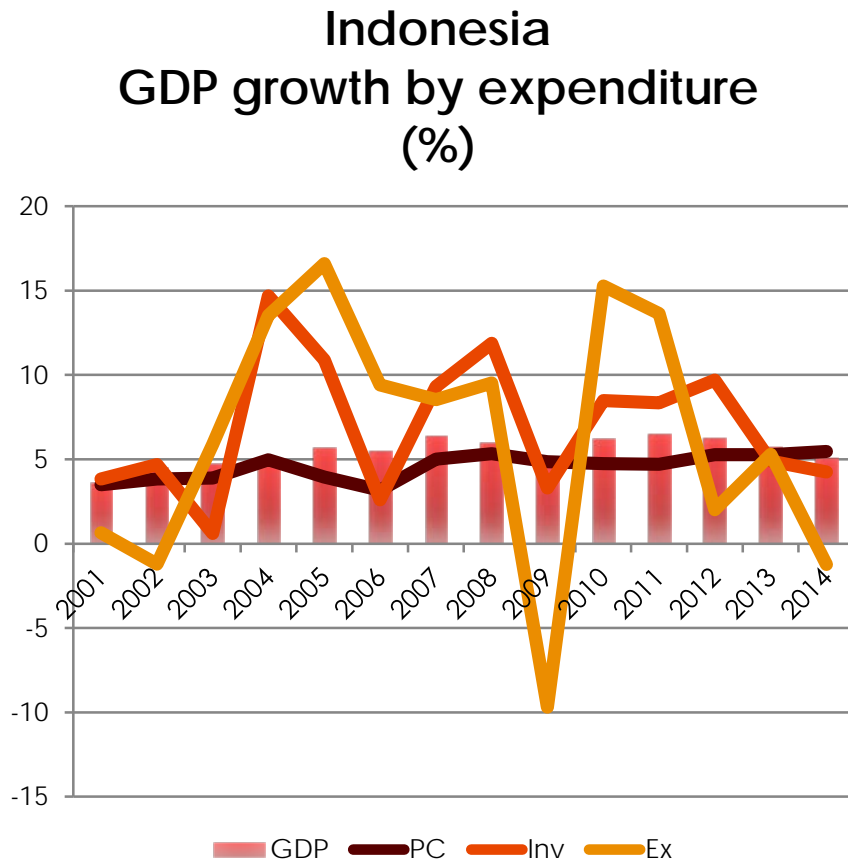
Assets

- Macroeconomic stability
- Demographic dividend
- Strong consumptions
- Relative high GDP growth
- Political stability
- Natural resources (?)

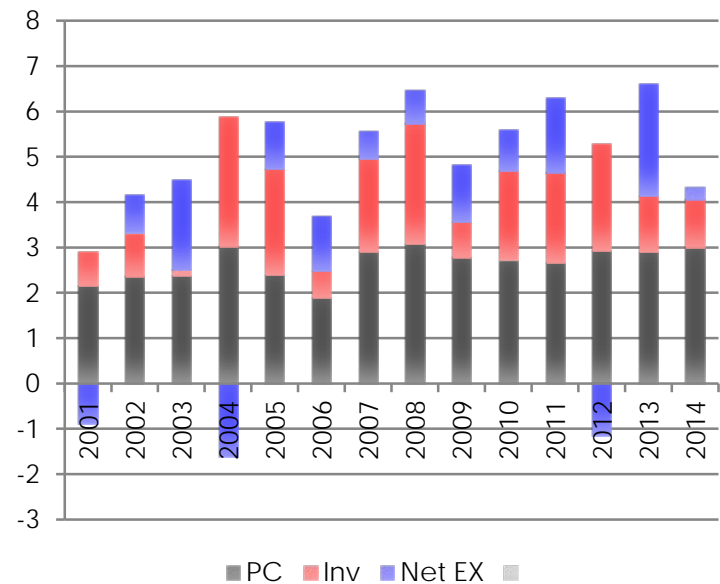
Liabilities

- Poor quality of infrastructure
- Poor quality of human resources
- Low productivity
- Declining competitiveness (esp. labor intensive manufacturing)
- Inequality
- Financing
- Investment climate

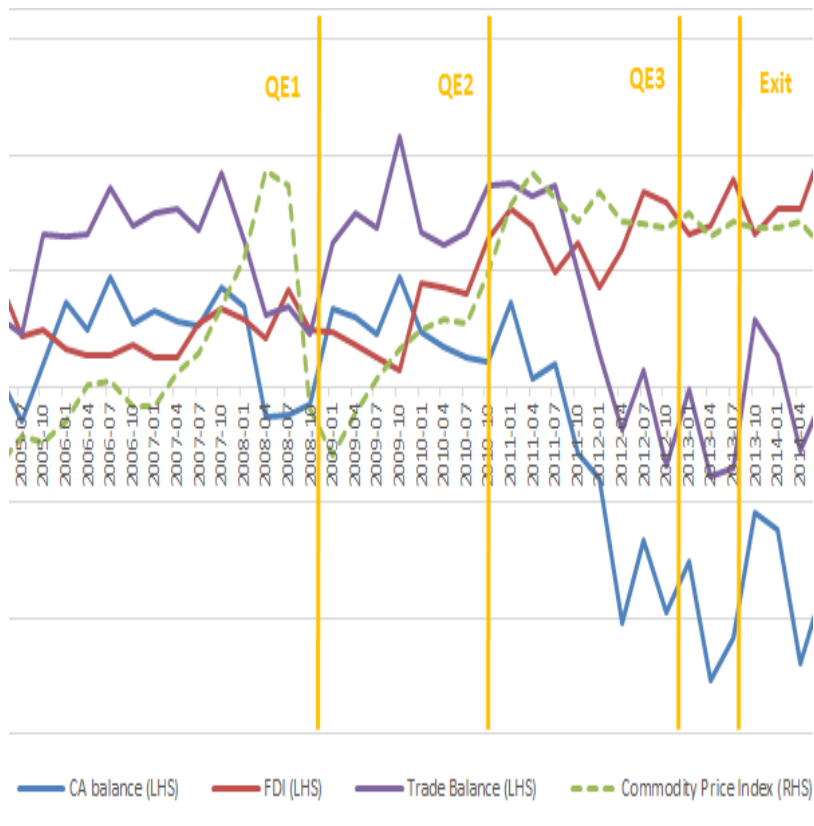
Private Consumptions and investment were important sources of growth



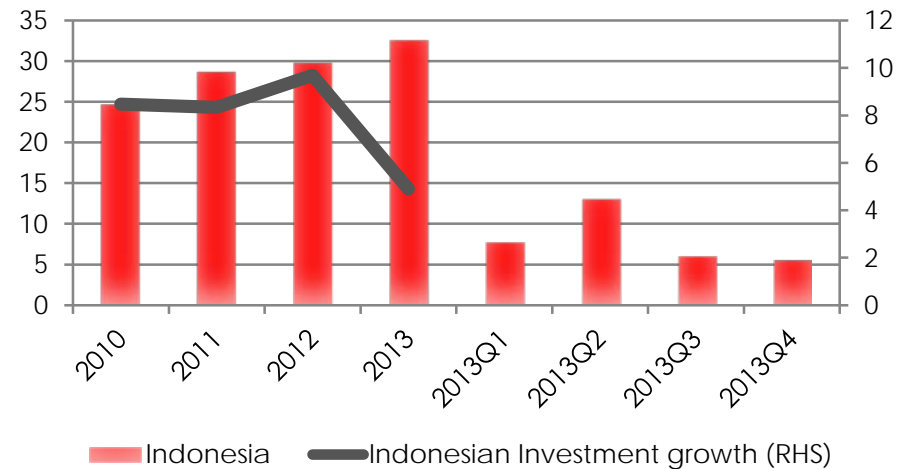
Source of GDP growth:
by expenditures (%)



The song remains the same: commodities and investments boom



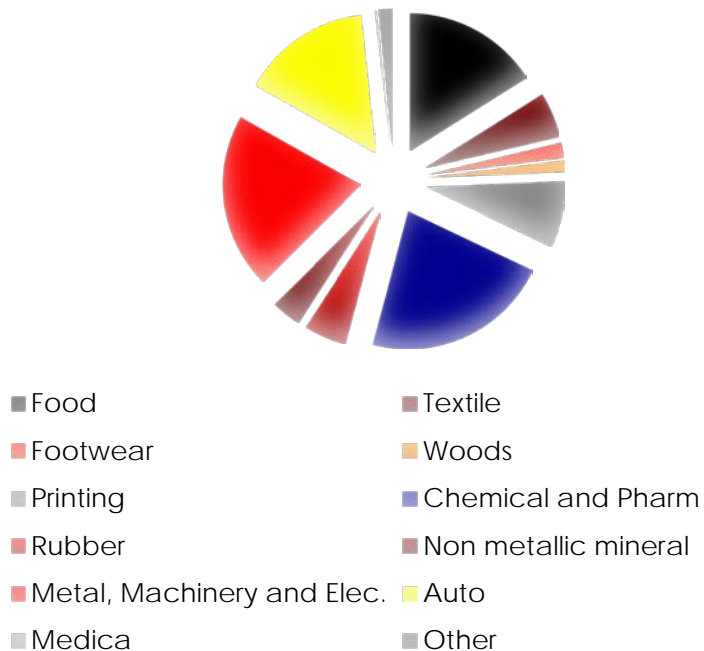
Emerging Market Private External Financing to Indonesia (\$ bn) and Indonesia investment growth (%)



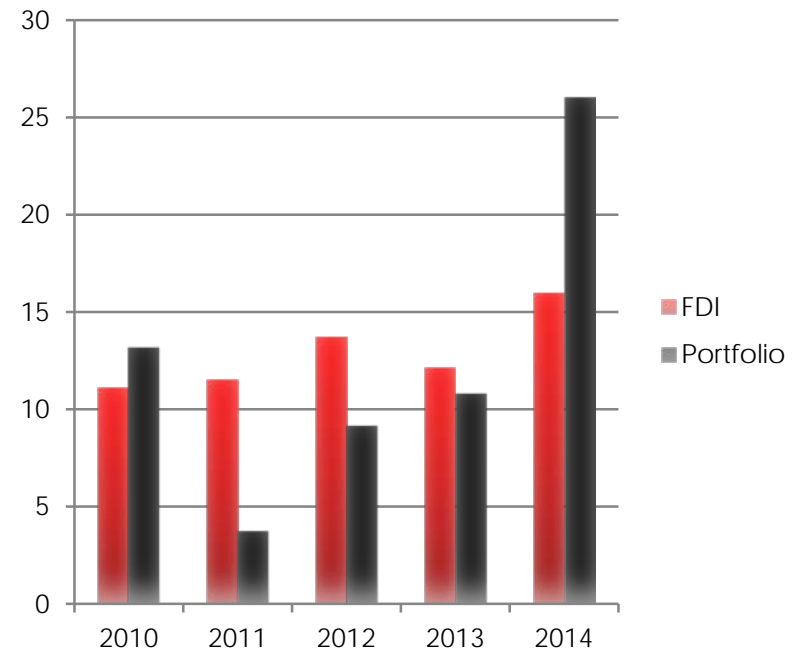
Investment: dominated by domestic market oriented sector...

Portfolio investments remain important

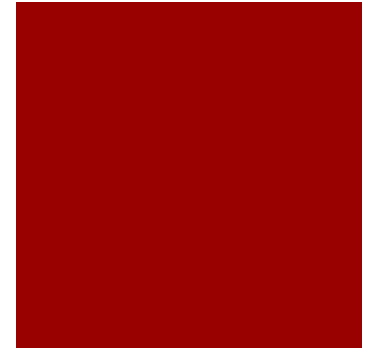
Indonesia: Investment realization, by sectors 2000-2014



FDI and Portfolio investment in Indonesia



Source: CEIC



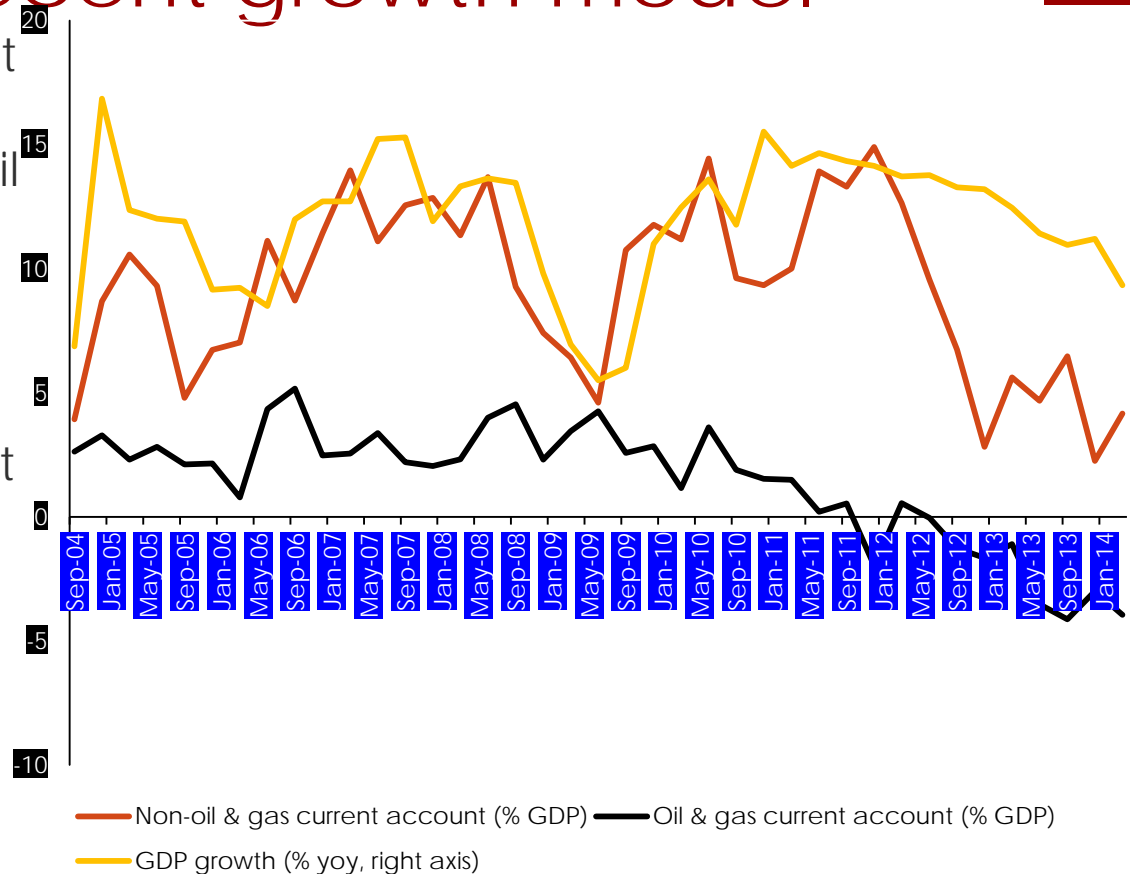
CA deficit/GDP and Private Capital flows

percent

Source: IIF

There is something wrong about Indonesia's recent growth model

- Deficit in current account is widening since 2012, mainly due to deficit in oil and gas balance
- But surplus of non-oil and gas exports has also declined, suggesting that exports has not growing



Source CEIC

Managing the macro economy during the taper tantrum



$$CA = (S - I) + (T - G)$$

Stability over growth:

Expenditure reducing policy:

Cut I, and G (fuel subsidy transfer to cash transfer)

Expenditure switching policy

Allow ER to depreciate

Opening import (removed quota for meat), lowering import tariff for soybean

Granger causality test and Cumulative IR (use generalized impulse): on Current Account

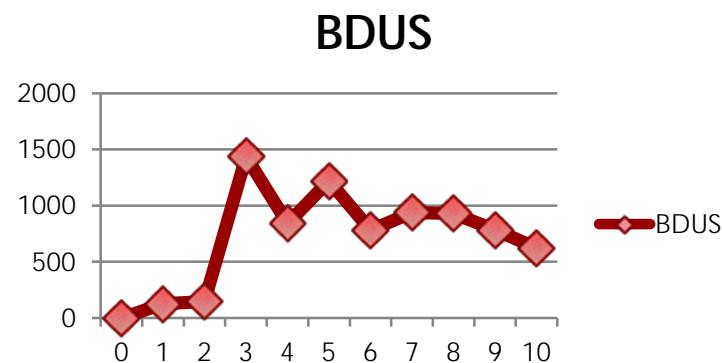
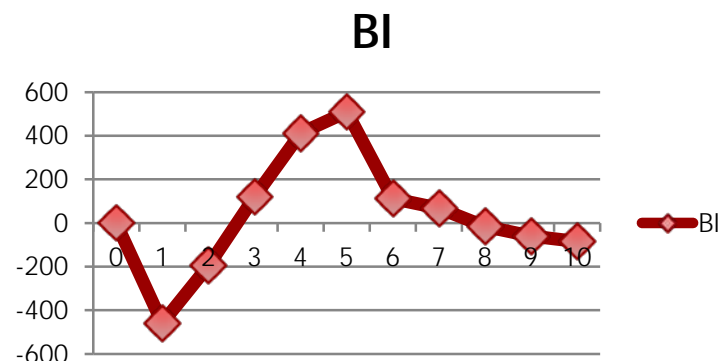
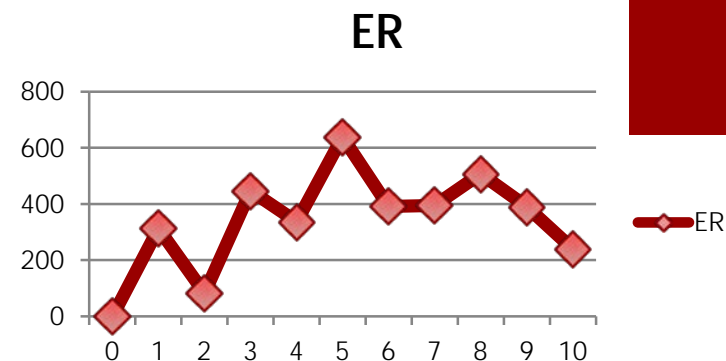
Pairwise Granger Causality Tests

Date: 11/13/15 Time: 00:40

Sample: 2004Q1 2014Q1

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
BI does not Granger Cause BDUS BDUS does not Granger Cause BI	39	0.35817 0.97079	0.7016 0.3890
CA does not Granger Cause BDUS BDUS does not Granger Cause CA	39	0.05292 7.37765	0.9485 0.0022
ER does not Granger Cause BDUS BDUS does not Granger Cause ER	39	0.47168 2.00221	0.6280 0.1506
CA does not Granger Cause BI BI does not Granger Cause CA	39	1.36440 3.58307	0.2692 0.0387
ER does not Granger Cause BI BI does not Granger Cause ER	39	0.25046 0.81128	0.7799 0.4527
ER does not Granger Cause CA CA does not Granger Cause ER	39	7.31257 6.15250	0.0023 0.0052



Lessons learnt from post AFC:
declining competitiveness?



Indonesia made slow progress in export diversification; appreciation of exchange rate could be one of the reasons

Figure 11 Relatively Slow Progress in Diversifying Export Products

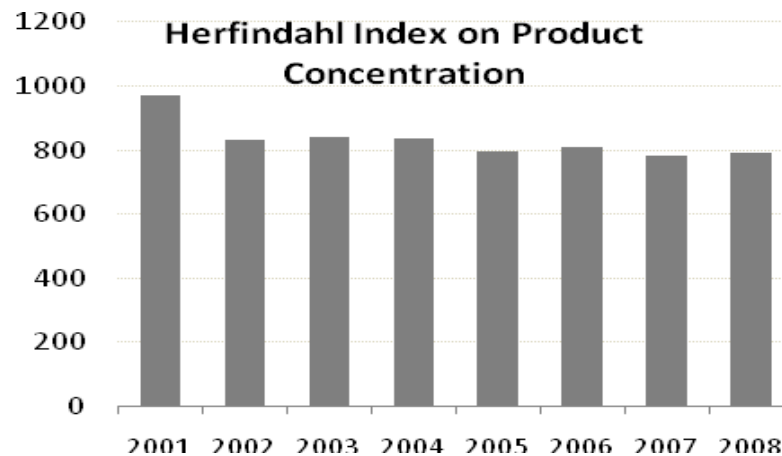
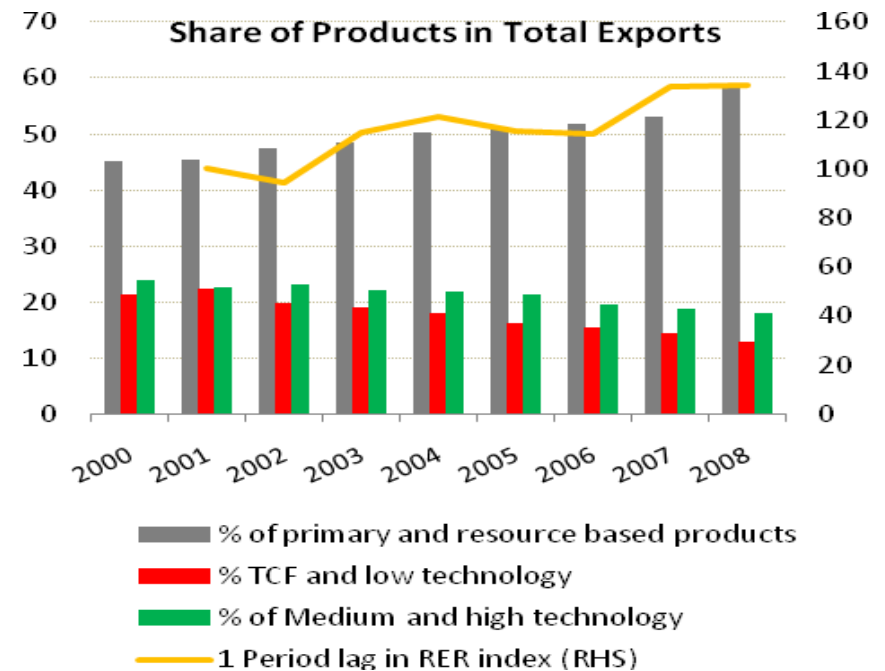


Figure 12 Increasing Share of Primary and Resource Based Products

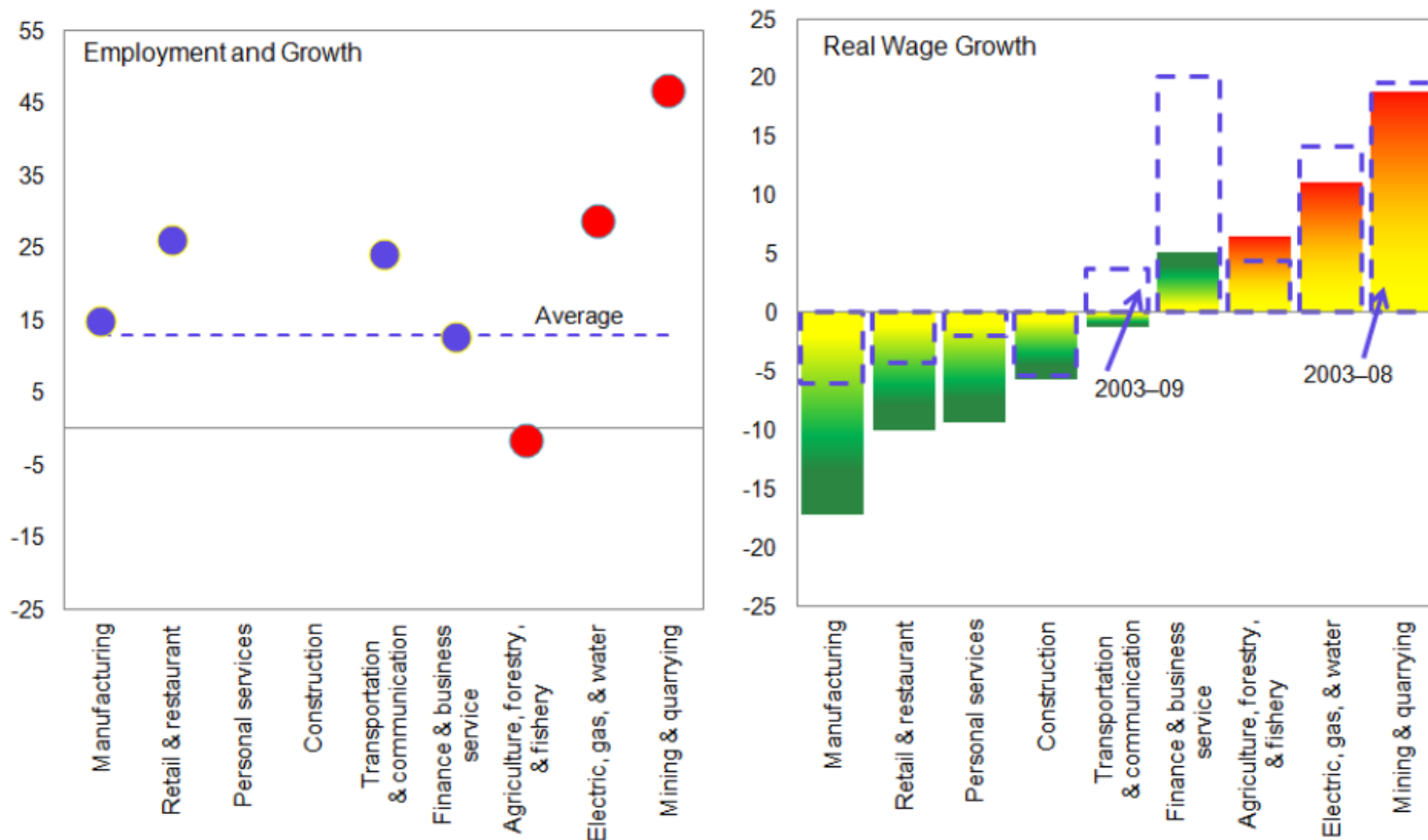


Source: Bank Indonesia and authors' calculation using UN-Comtrade data. Classification based on Lall (2000)

Employment and wage

Figure I.10. Employment and Wage by Sector, 2003–08

(Growth, in percent)



Source: IMF (2010)

Then should Indonesia dump export led growth strategy?

Comovements between Innovations in Private Consumption with Innovations of GDP Components^a

Lags	Components of GDP		
	Government consumption	Gross fixed capital formation	Exports
0	0.12	0.06	0.24
-1	-0.16	-0.04	-0.27
-2	-0.22	-0.01	-0.41
-3	0.26	-0.07	0.29
-4	0.20	-0.13	0.49

Source: Estimated from BPS National Account

^a Comovements between innovations of each component derived from original data that spans from 2000-I to 2008-IV. Here growth is expressed as annual (year-to-year) growth

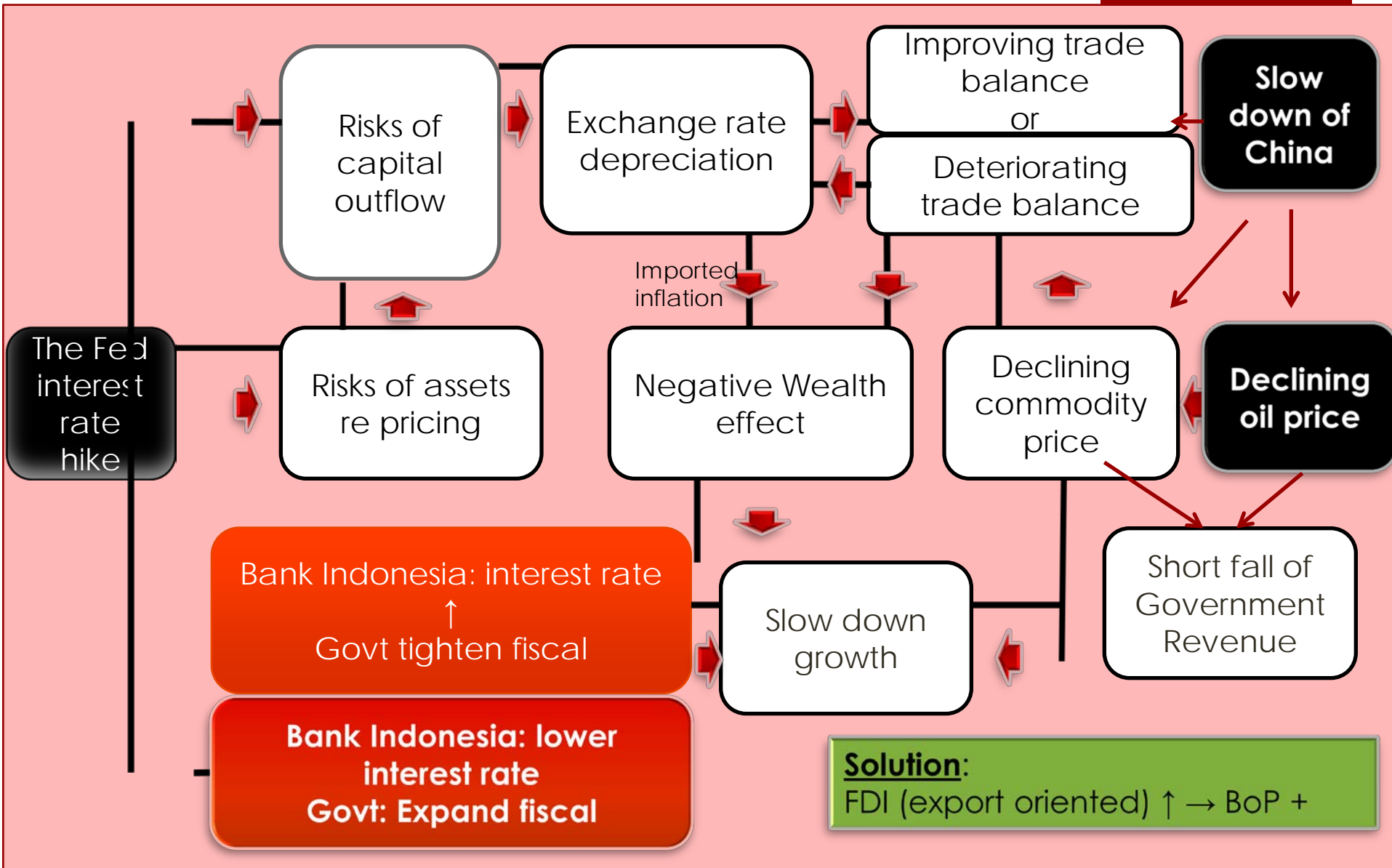
What are the lessons learnt?

- Capital inflow → real ER appreciation → CA deficit → increase vulnerability; rupiah should have been depreciated earlier; however sterilization cost was very expensive
- High current account deficit makes economy become vulnerable, especially if it is financed by portfolio or FDI on domestic market oriented
- Bank Indonesia should have raised the interest rate earlier; government should have tightened the fiscal even once QE started) → politically difficult
- Structural reform (labour, investment, trade policies) should have been done earlier, but politically was difficult (no crisis) (bad times make good policy)

**What are the future
challenges?**



The macroeconomic impact of the global volatility



Shifting into high gear?



Export volatility and concentration

Figure 8: Export volatility and concentration in medium & high tech manufacturing

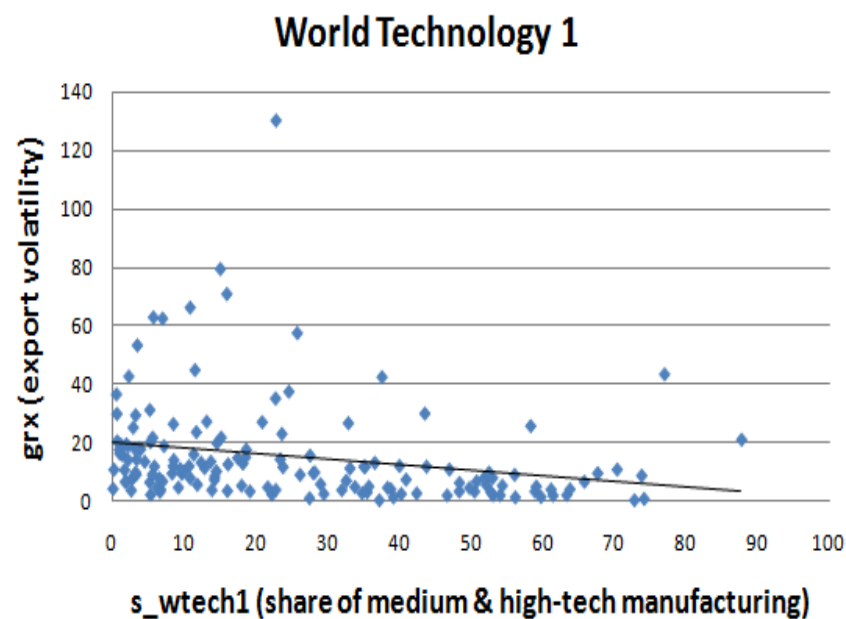
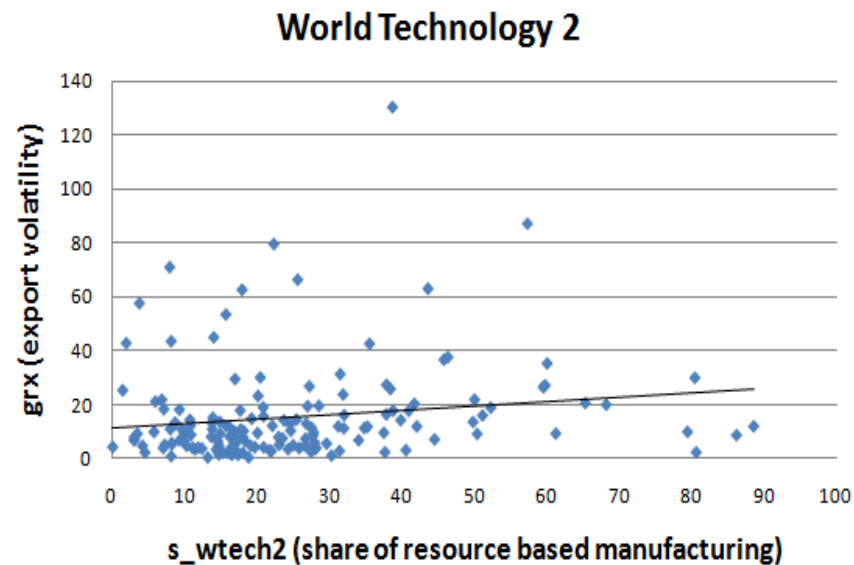
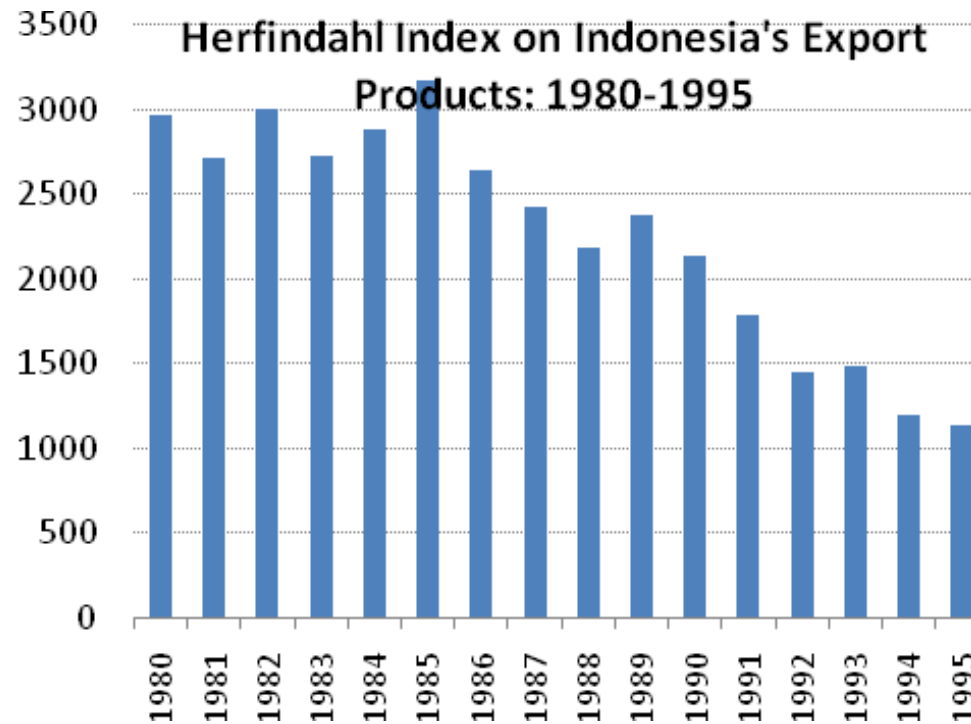


Figure 9: Export Volatility and concentration in resource based manufacturing



Take the benefit of low commodity price:
Low oil price in the 80s, devaluations, deregulations
helped Indonesia to diversify its exports products
from 1980-1995



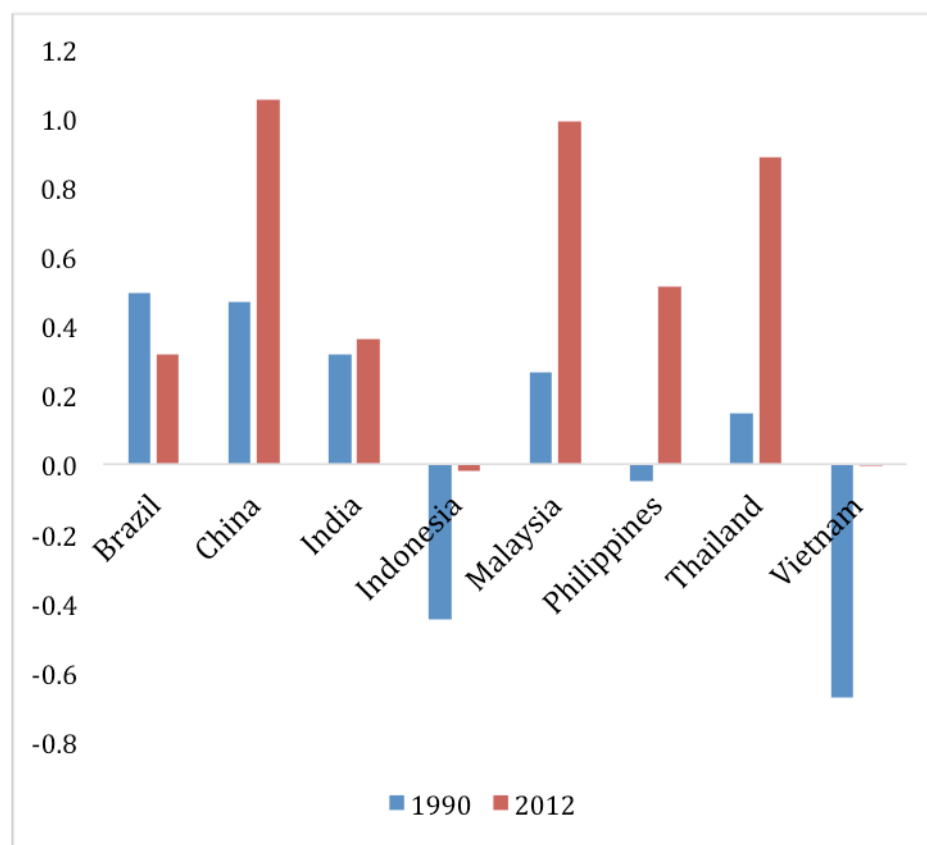
Source: authors' calculation using UN-Comtrade data

Capability to undertake complex task is still behind other middle income countries

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- ▶ If products could not be made in Indonesia, where else can they be made?
- ▶ From observed trade data, Indonesia made progress in improving capability to export products requiring more complex task (but so does Vietnam)
- ▶ Why matters? It reflects institutional capacity and ability to accumulate and channel knowledge into productive activities

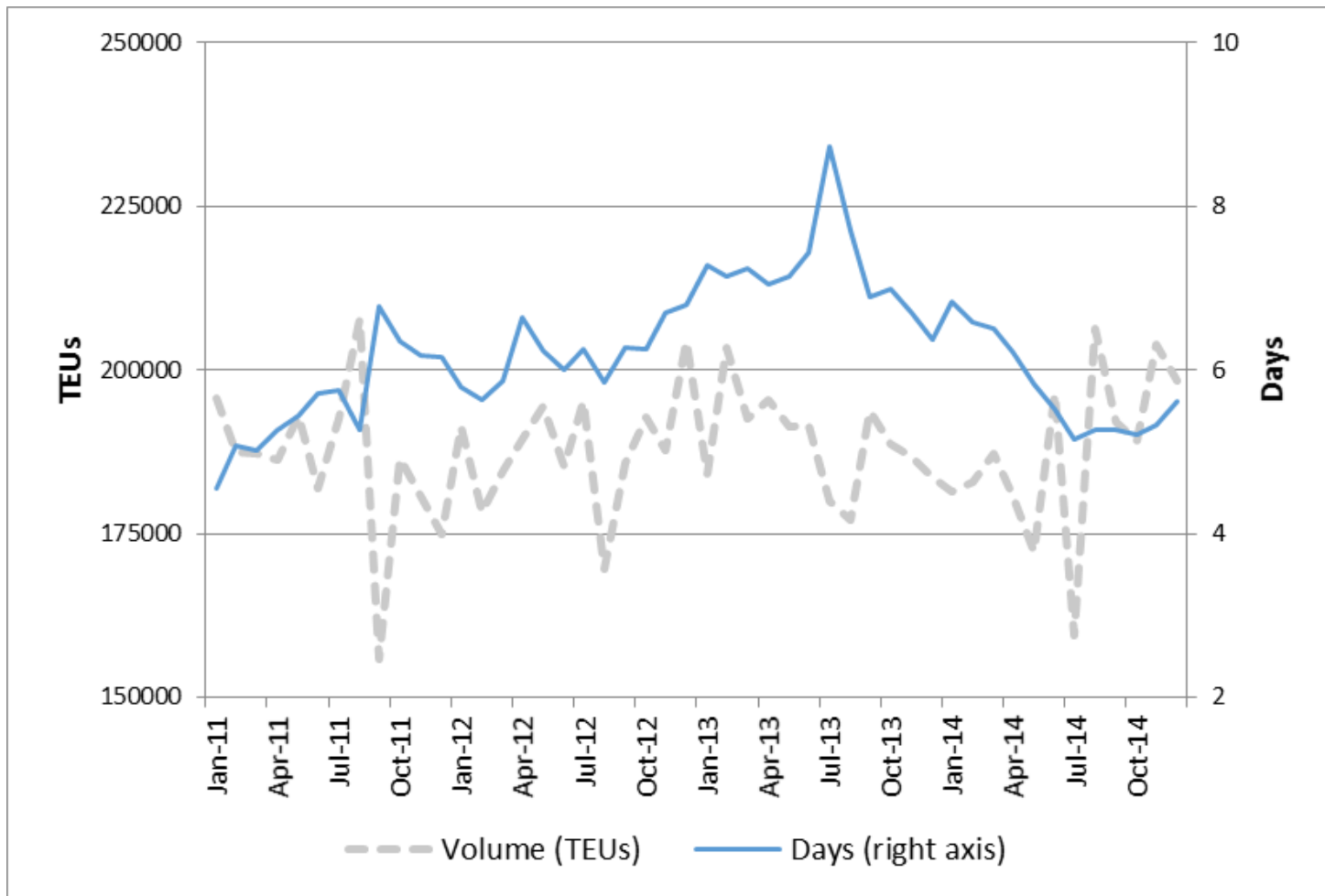
Not yet able to manage complex tasks?



Source: Atlas of Economic Complexity (Hausmann and Hidalgo et.al)

Dwell time and volume at Tanjung Priok (largest port in Indonesia): improved but not enough

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Source: Sandee (forthcoming)

“Industrial policy?”

- Attracting FDI into export oriented sector is the key
- A better connectivity to reduce trade cost
 - Connecting globally and producing locally
- Primary products and real exchange rate
 - Addressing real ER appreciation
- The role of R&D and improvement of products' quality
 - Implement model for public-private R& D that works
- The development of the services sector
 - Efficient services for competitiveness and productivity
- Promotion and marketing
 - Incentives for discovering new products or new markets

Looking forward

- Shifting towards high growth cannot happen instantly without jeopardizing macro-stability. It has to go through the supply side (improving productivity)
- Investing in human capital is a must (Woo and Hong, 2010).
 - But need to be accompanied by steady improvement in governance and infrastructure (logistics, ICT)
 - Environment for knowledge exchange: labor market, creativity, openness to FDI
- Managing political process

Thank you

