EU-ASIA ECONOMIC GOVERNANCE FORUM

Indonesia: Better infrastructure for more growth

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The phrase "speed it up" often features in Indonesian president Joko Widodo's speeches. Since beginning his five-year term in October 2014, he has very quickly started to implement his new plans for economic policy, advocating speed above all else to overhaul its outdated infrastructure. According to both the government and international organisations, this is a crucial factor in the archipelago's recently sluggish economy regaining momentum. However, a year after his inauguration, Widodo is forced to admit that putting his plans into effect has not been entirely successful.

Difficult adjustment

As recently as 2010, Indonesia experienced an annual increase in economic output of 6.4% in real terms. However, the growth rate has steadily fallen since then, dropping to just 5.0% in 2014 (Statistics Indonesia (BPS), press report, 5th February 2015). In the context of this slowdown, Widodo spoke of rectifying his predecessors' "wrong" priorities when presenting his mid-term economic programme ("Jokowi lays out reform agenda", Jakarta Post, 19th December 2014): He explained that while for many years, Indonesia's developmental model has been based on the sale of commodities such as palm oil, rubber, tin and coal, the impetus for growth should now predominately come from overhauling the outdated infrastructure. He claimed that the Indonesian economy has to contend with extremely high logistics costs and an insufficient power supply, amongst other issues. Additionally, he spoke of plans to establish commodity processing sites inland. Widodo is therefore putting forward a nationalist/protectionist stance, hoping to remove the country's heavy dependency on imports (especially in terms of food and energy supply) with the aim of making Indonesia self-sufficient. "An economy that relies merely on the export of raw commodities will eventually disintegrate", commented Minister of Finance Bambang Brodjonegoro on the new economic policy ("One year on: Jokowinomics: Shifting gear to infrastructure", Jakarta Post, 20th October 2015).

Following the new guidelines, expenditure for infrastructure raised 2015's budget to a historic high, more than doubling the previous record of 290 billion rupiah (Rp) (19.9 billion euros). This corresponds to 2.7% of the gross domestic product (GDP). To raise additional funds, the new government simultaneously reduced the extremely high fuel subsidies by more than three quarters, freeing up around 15 billion U.S. dollars ("2015 state budget approved", Jakarta Post, 14th February 2015).

Although expectations were initially high for Widodo and his new cabinet upon entering office, there is now widespread disillusionment. The original anticipated growth for 2015 of 5.7% in real terms fell significantly short of its target. GDP increased by just 4.7% between January and September 2015 compared to the same time period for the previous year. Growth between July and September 2015 was also slower than that in the previous quarter, dropping from 3.8% to 3.2% (BPS, press report, 5th November 2015). This prompted private institutes and supranational institutions such as the International Monetary Fund and the World Bank to revise their original predictions for the whole of 2015 downwards: Economic researchers across the board are now expecting an increase of 4.7%, which would be the worst result for six years.

One reason for the decrease is unfavourable global economic conditions meaning that Indonesia, like many emerging countries, is facing a myriad of problems: Recovery is still slow in industrialised nations such as Japan and the EU, China is no longer experiencing the rapid growth of the past, prices of commodities have dropped significantly and the financial markets are anything but stable (International Monetary Fund, IMF World Economic Outlook: Adjusting to Lower Commodity Prices, October 2015).

Indonesia was hit especially hard by the fall in commodity prices, which overall make up more than 70% of its exports. For example, the export revenue from mineral fuels and mineral oil products in 2014 was already around 15% lower than the figure for the previous year, a drop of 21 billion U.S. dollars. Rubber saw an even greater decrease at 24.4% (BPS, press report, 5th February 2015). The downward trend has continued in 2015: From January to September, revenue from mineral fuels dropped by 24.8%, rubber by 18.5% and tin by 32.8% (BPS, press report, 15th October 2015).

In addition to those caused by foreign economies, many of Indonesia's problems have originated within its own borders. For example, Widodo lamented in press reports that many of the larger-scale projects will take years to complete, "because there are 'big forces' that consistently hamper the development of government programmes and policies" ("Jokowi worries 'big forces' hampering govt projects, policies," Jakarta Post, 3rd August 2015).

Even disputes within state bureaucracy are delaying reform plans ("Jokowi urged to resolve political turmoil to speed up economic recovery", Jakarta Post, 4th October 2015). With the aim of significantly speeding up large infrastructure projects, the president has combined several public authorities: A new Coordinating Ministry for Maritime Affairs, for example, is aimed at coordinating the work of the former Ministries for Transport, Maritime Affairs and Fishing Industry, Energy and Mineral Resources, as well as Tourism, and at promoting the long-neglected maritime economy and construction of new ports ("One year on: President Jokowi's first year: Sailing into the storms", Jakarta Post, 21st October 2015). Another new ministry will combine public works and the construction of state housing, with a focus on building new dams, bridges and roads. However, organisational merges of this type take time – one of the main reasons why only around 30% of 2015's budgetary resources for infrastructure had been requested by late August of that year ("One year on: Cautious optimism after slow start on infrastructure", Jakarta Post, 21st October 2015).

To set the slow processes back in motion, the government launched six reform packages in autumn 2015. The first list of measures aims to revive private investments, simplifying or completely abolishing regulations, awarding more tax incentives to companies for investments in priority industrial sectors, accelerating "strategic" projects and allowing foreigners to buy expensive property (Asian Development Bank, Asian Development Outlook 2015 Update: Indonesia, September 2015, p. 164). Other reform packages deal with accelerating approvals for investments in industrial parks, reducing fuel prices and deregulating and simplifying land acquisition (Jakarta Post, various articles, key word: Economic packages).

Even if not everything is running smoothly at present, there is a general consensus that Widodo's reforms will gradually take effect and that a growth of over 5% will be possible again in 2016. The IMF and the World Bank predict an increase of 5.1 and 5.3% in the new year, with the government estimating an increase of 5.5% in their draft budget.

However, all of Indonesia's developmental goals could become meaningless if the world economy fails to emerge from its fragile state in 2016. In fact, there are plenty of question marks over Jakarta: It is assumed that the USA will raise interest rates before 2015 is over, which would probably cause further cash outflows from Indonesia despite the currently high domestic base rate of 7.5%, putting even more pressure on the rupiah's exchange rate. The national currency depreciated almost 12% relative to the U.S. dollar between January and December 2015. A further blow is that commodity prices do not show any signs of increasing. Ultimately, the switch from the Chinese model for development to a more island-orientated strategy will influence the Indonesian economy in one way or another ("RI economy predicted to continue cooling", Jakarta Post, Business, 6th November 2015).

Minister of Finance Bambang Brodjonegoro agrees that 2016 will be a year of insecurity for the island state. It would therefore be better not to set ambitious development goals, but to prepare a "realistic" budget which is based on the actual conditions ("2016 budget will be more realistic: Minister", Jakarta Post, 8th September 2015).

High potential

Despite all this, Widodo and his government are confident that Indonesia will regain the rapid growth rate of the past in the medium-term. Upon assuming office in autumn 2014, the President promised that the GDP would increase annually by around 7% in real terms until 2017, and that annual growth in the region of 8% would be achievable by 2019 ("Jokowi lays out reform agenda", ibid.). In principle, all the conditions needed for high growth are present. Indonesia has the largest economy in South-East Asia and boasts vast national resources (Germany Trade and Invest, Economic structure and opportunities: Indonesia, September 2015). The country has a very large domestic market, with private consumption making up a large share of the GDP at over 56%. In addition, Indonesia has a very young population (with an average age of 28) which is constantly growing, while other Asian countries need to deal with the problem of an ageing and shrinking population (Germany Trade and Invest, Economic trends at the turn of the year 2015/2016 - Indonesia, November 2015).

However, there are also many negative factors. For example, the manufacturing industry has become increasingly weak in recent years: In 2014, it was contributing 21% to the GDP, down from 22% in 2010. Services are also failing to sufficiently develop, with a share of 42.2% in the economic output (Germany Trade and Invest, Economic structure, ibid., p. 3). However, it is Indonesia's most important asset – its very young population – in particular that is experiencing real problems. Whilst the unemployment rate amongst all adults of working age was officially recorded as just below 6.2% in August 2015 (according to the most recent data), this figure is probably much higher in reality as the huge informal sector was not adequately sampled – with around a fifth of young men and a third of young women between the ages of 15 and 24 not working or not in education (Indonesia Investments: Slowing Economy of Indonesia: Rising Youth Unemployment, www.indonesia-investments.com, 22nd June 2015).

Head of the IMF, Christine Largarde, urged the Indonesian government to do more to improve this situation: "Surely no economy can thrive while so much talent remains underutilised", she said in Jakarta in early September 2015. She also explained that many more women needed to be integrated into the job market as currently only half of them are working. If this figure was raised to 64% by 2030, the national working population would increase by 20 million. "This is an economic game-changer", added Lagarde (C. Lagarde, Poised for Take-off – Unleashing Indonesia's Economic Potential, speech, Universitas Indonesia, Jakarta, 1st September 2015).

The issue of reducing poverty is closely connected with this. Although a wealthy middle class has emerged in Indonesia, there are still many people closed off from economic progress. According to the World Bank, 80% of the population – or over 200 million Indonesians – have not profited from the economic growth of the past ten years. The level of inequality, already high, is increasing at a faster rate than in most neighbouring countries ("Indonesia's Rising Divide", World Bank article, 8th December 2015). Head of the IMF Lagarde also demanded "an inclusive growth policy" from the government in Jakarta, in which all sections of society would benefit from the economic and financial opportunities (Lagarde, Poised for Take-off).

But none of these problems can be solved without a "new way of thinking". Excellent results can no longer be achieved by simply exporting commodities and having a large domestic market according to Lagarde, who supported the measures introduced by Widodo, commenting "These steps are in the right direction". This must all be complemented by a foreign trade strategy, with Indonesia integrating more strongly into the global market than before. Of utmost importance for the island state is to make use of the advantages of progressive trade liberalisation and integration with the ASEAN community.

Great deal of insecurity concerning the ASEAN Economic Community and the Trans-Pacific Partnership

The new ASEAN Economic Community (AEC) was launched on 1st January 2016 by members of the Association of South-East Asian Nations (ASEAN) with the aim of transforming their region into a large free-trade area with 620 million people: It was established with the intention, amongst other things, of abolishing customs and other barriers, harmonising standards, increasing investments and mobility, thereby strengthening the economic power of the member nations, and of offering foreign companies an attractive business location (P. Bessler, "Asean Economic Community: The beginning, not the end", guest article, EU-Asia Economic Governance Forum, KAS, Social and Economic Governance Programme Asia/Japan Office, October 2015).

Indonesia's economy is responding to the new AEC with approval as well as apprehension ("SE Asia creates Economic Community, but challenges remain", Jakarta Post, 22nd November 2015). For example, there is major concern that many Indonesian companies are not adequately prepared for the new responsibility, as they are settling for serving the large domestic market rather than surrendering their products and services to the uncertainties of the global market. Only just under 24%

of GDP expenditure in 2014 came from exports. Other countries in the region form a much stronger part of the global economy (World Bank, BPS).

The AEC is providing the opportunity to change this position. For example, Rizal Affandi Lukman, Deputy Minister of the Coordinating Ministry for Economic Affairs, suggested that Indonesia should produce higher value-added products rather than relying on commodities, since around half of its current export structure mirrors Vietnam's ("Domestic industries should expand to regional markets: Ministry", Jakarta Post, 2nd December 2015). The government has introduced measures aimed at strengthening domestic production capacities, whereby companies from the manufacturing sector will receive tax incentives for projects linked to agriculture, forestry, the fishing industry, sea transport or infrastructure, and also for projects located in special economic zones ("RI needs to boost services, high-end manufacturing sectors", Jakarta Post, 1st December 2015).

These types of measures would also strengthen Indonesia's case for joining the Trans-Pacific Partnership (TPP), a free trade agreement concluded in early October 2015 by twelve countries in the Asian-Pacific region, including the USA, Japan and Australia. President Widodo is currently contemplating joining the partnership, although it is hotly debated if his country is sufficiently competitive on an international level to fulfil the TPP's many demands (Competitiveness must improve before joining TPP, Jakarta Post, 11th November 2015). However, as Minister of Trade Thomas Lembong explained, Indonesia's economic partnership with the EU (EU-Indonesia Comprehensive Economic Partnership) could also be helpful for the TPP, as 60 to 70% of its member countries, which was already negotiated with the EU, is also a part of the Trans-Pacific Partnership. The partnership with the EU is planned to come into effect in about two years (RI-EU CEPA paves way for TPP, Jakarta Post, 25th November 2015).

Widodo's saying "speed it up" also applies to Indonesia's integration into the global economy. Only if the country quickly adapts to global changes will it also be able to play an important role in the world economy. However, whether Indonesia's "fractious and noisy democracy" ("Too mild", Economist, 5th September 2015, p. 31) will see it this way remains to be seen.

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