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### Going beyond the 'new normal' in Indonesia

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AT THE HELM

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# Going Beyond the 'New Normal' in Indonesia



The Republic of Indonesia's former Minister of Trade and former Minister of Tourism and Creative Economy, Professor Mari Pangestu, talks about the country's resilience, and going beyond the 'new normal', in this interview with Philip Zerrillo.

**What are some of the measures that the Indonesian government implemented after the Global Financial Crisis of 2008? Have these measures achieved their goals?**

I believe the Indonesian government has taken the right steps to ensure macroeconomic stability by embarking on a conventional economic policy and choosing stabilisation over growth. To prevent capital outflow, we increased the interest rate and allowed the rupiah to depreciate. For fiscal consolidation we raised the fuel price, and switched expenditure toward infrastructure and social welfare. The main challenge ahead with regard to macroeconomic policy is managing the monetary policy in the face of the U.S. Federal Reserve tapering its quantitative easing policy, and managing the fiscal policy.

But I think we need to go beyond the 'new normal', to find a different way of questioning ourselves and the role of the state and the market. We have to address more fundamental reform issues. For Indonesia, this means reforming infrastructure and increasing our competitiveness across the board. Diversification of our export structure

and our economic structure is the imperative going forward.

We need productivity- and innovation-based growth. And that's the challenge that I think requires structural reforms and addressing issues of competitiveness, such as our high cost of logistics, the issue of human capital and the right quality of investments.

**What are some of the key initiatives that Indonesia needs to take in terms of infrastructure development?**

In the last 10 years or so, we have recognised the need to address the infrastructure bottleneck. So we have been trying to set up a framework to ensure that the political as well as commercial risk issues of infrastructure development are addressed, while also promoting private-public partnership. There has been some success—the building of some power plants, ports, airports and roads—but it still falls short of what is needed.

The main issue with infrastructure boils down to acquiring and developing land, and the certainty about the economic pricing of these projects to make the

private-public partnership attractive. On the land issue, after a lengthy process, an Eminent Domain law was passed in 2012, so that the government can take over private land for public use, of course after a fair process. But it has only recently been implemented. Hopefully in the years ahead it will increase the certainty for land acquisition needed for infrastructure.

**And are there specific infrastructure industries that you think would be prioritised?**

The priority is clearly on power generation. We recognise that area as one of the major bottlenecks for growth and also for development. The target is that the country should be able to produce 35,000 megawatts by 2019. But can we reach that and make it sustainable? A lot of what we are using today is still coal. Can we develop clean coal generated power plants? And what about other sources of energy like hydro or gas or renewable energy? The incentives for these sources are not yet clear. For instance, there seems to be more incentives for coal-fired power plants as compared to gas—yet gas is a cleaner source of energy and Indonesia has gas reserves.

The second priority, I think, pertains to logistics and improving connectivity—because you want to connect more remote regions with the mainland. This would address issues of efficiency and competitiveness, as well as help alleviate poverty. In practice, this means developing ports and airports. The government may focus on integrated ports to begin with, and this is an area where public-private partnerships are likely to develop. Once roads are built and connectivity is established, it will raise the productivity of the agricultural sector, and the ability to get goods in and out of the country will certainly enable more value adding.

### **What are your thoughts on the future megatrends taking place in the medium-to-long term that would impact Indonesia's economy?**

China's impact on Indonesia is significant because the decline in commodity demand is impacting prices and overall consumer demand in Indonesia. But on the positive side, as China restructures and goes to its 'new normal' of rising labour costs, it is shifting away from the large-scale labour intensive manufacturing it has relied on, and that allows room for Indonesia to maintain competitiveness in this area.

So Indonesia needs to capture this opportunity by ensuring that its labour policy does not unnerve investors and exporters. For instance, an increase in minimum wage should not be done in a way that causes uncertainty. Or consider the retrenchment issue. It needs to be carefully managed, as it is difficult and costly to retrench in Indonesia. Incentives need to be provided to labour-intensive, export-oriented investments, and industrial estates should be developed near the supply of labour.

### **What are your views on the ASEAN Economic Community (AEC), and the opportunities and challenges that it would bring to Indonesia?**

I don't see AEC 2015 as a gate that opens up and suddenly causes dramatic change by the end of 2015. This is actually a process that has been ongoing. In general, Indonesia has probably benefitted from the current process of the AEC, because a lot of multinationals chose Indonesia as their regional hub or regional production centre. Moreover, Indonesian producers and exporters already view ASEAN as a domestic market. But are the small- and medium-sized enterprises (SMEs) able to benefit from the ASEAN market? The answer is probably still no. That is the kind of capacity building that SMEs will need to focus on.

I think the big challenge will be on the services side and the movement of professional workers, because, by and large, not just Indonesia, but most ASEAN countries, are still quite closed or restrictive on the opening up of their services sector. And in fact, many may be regressing in trying to protect some of the services sector, such as finance, health and education. So for instance, some of the priority sectors like health should be allowing 70 percent ASEAN ownership—but it's been a slow process trying to get there, and even if these sectors were opened up, the next challenge is managing the domestic regulation issues that would emerge.

I think services is something that we policy makers, or people talking about competitiveness, have not prioritised in Indonesia. Meanwhile, Malaysia and Singapore have already made competitive services a part of their long term development plan, and so has Thailand to some extent. And China is already in that mould. So Indonesia needs to understand that to become competitive,

it must have a competitive services sector, be it logistics or financial services, which would facilitate the competitiveness of other sectors.

And we should want to be competitive in our own right, and think carefully about the movement of professionals. I believe that if you don't have the skills at home, you should be open to getting talent and skills from abroad as long as the idea is that you learn from them, and alongside develop your own set of human capital.

### **Fifty percent of Indonesia's population are 29 years of age and below, and the country needs to grow at 6 percent per year or more to create jobs for them. At a time when most countries are worried about ageing population, does Indonesia see its young demographic as an asset?**

We do have a demographic bonus, but if you cannot create jobs or utilise your productive young labour force in the right way, you instead have a time bomb. So while we would benefit from our young population in the sense that we will be able to continue with labour-intensive export-oriented manufacturing, I think it is something that we should work at, and one of the keys is information and communications technology (ICT) infrastructure.

ICT infrastructure is very important because it means you can work from anywhere. It also opens up a huge opportunity for long-distance learning, or e-learning, which makes sense in a country as spread out as Indonesia. In the 1970s, the launch of the satellite really helped Indonesia to develop because you could watch television, and there was a lot of education through that mode, including Indonesian

language education and propagating family planning. Now it's obviously a different world, but with improved ICT infrastructure—in terms of broadband, accessibility, speed and cost—you could do a lot for young people even before the physical infrastructure gets built.

And we should take advantage of the economic opportunity available on account of the ageing population in North East Asia. There will be increased demand for certain sectors, such as health products. And I think Indonesia has not done much in terms of exporting services, such as health, when compared to Singapore, Malaysia or Thailand. Moreover, Malaysia and Thailand have programmes inviting people to retire in their country. All these initiatives create value, generate foreign exchange and are a service that skilled Indonesian workers can deliver. So I would say there is an opportunity that we need to study.

But the bottom line is that you have to invest in the right type of education, and skill and capacity building for the young people.

### **What, in your view, are the sunrise and sunset industries in Indonesia?**

It is probably not very useful to categorise industries as sunrise or sunset. But industries which are becoming less competitive are typically the low-end, large-scale, and 'sweatshop' type of industries, in say, garments and footwear. Therefore, what needs to be done is to move to the medium and higher-end, as we should be looking to be at the higher value-added part of the global value chain. Similarly, if agriculture does not keep up with the more recent productivity increases, it may not

become a sunset industry, but would be increasingly uncompetitive. For now mining too, has the appearance of a sunset industry, because of low demand and low prices.

The rising industries are the higher value-added portions of manufacturing, and I think we should focus not just on low labour costs advantage, but also think about more skilled labour, the value-added phases like improved materials, research and development (R&D), design, and so on. And there is potential for the services sector to become more efficient and competitive. Given increased purchasing power and the growing middle class, tourism and creative industries such as fashion, lifestyle and consumer-related products will also have potential. Despite a slowdown in property due to slower growth, Indonesia's size allows for continued property development and construction in the second- or third-tier cities.

### **Talking about the second- and third-tier cities, are there any efforts underway to develop talent in these more distant places?**

Yes there is, and creative economy and digital connectivity is an important part of that answer. We have seen talent and industry develop where the local government has been active about developing connectivity in the ICT space, and providing creative public space and opportunities. That is why realising the broadband blueprint by 2019 is crucial.

I can give you an old age example and a new age example. The old age, traditional industry example would be batik, which is a technique of wax-resist dyeing applied to cloth. About 10 years back, batik was dying

and none of the young people wanted to go into batik or even weaving, because people were not interested in wearing batik or woven products. But in the last 10 years, with the push to promote the creative economy and interest in developing heritage-based products, there has been a boom in batik and a number of batik centres have become alive again. And now there are schools that are teaching batik-making, there is use of computer-aided design, and there appears to be a revival of the industry with incomes increasing for batik makers.

A new-age example is digital connectivity. All over Indonesia, you have pockets of offshoring and outsourcing work for all kinds, be it animation, graphic design or online selling. And a lot of them are working from homes in their villages.

Let me give you one such example. There are around 250 people working in a village about one hour away from Jogja. They're providing logo designs for websites. So thousands of small companies will put in their requests to make a logo, and these people compete to develop the logo. Whoever wins will get US\$200 to US\$400 for each logo, and as a result, their income can go up more than 20 times. But during the day, they continue to work as farmers and stone construction workers. They create logos at night, and they can do so because they are connected digitally. They taught themselves graphic design, and as they don't speak English, they use Google Translate to communicate with their clients. It is an amazing story, and brings with it an added advantage that as the young people are busy at night, the village is safer then.



**“Trade” is not always popular, and as Minister of Trade, how did you deal with that, particularly in a country where there is considerable domestic demand for employment?**

I think there is a lot of misunderstanding about trade. And especially after the Asian Financial Crisis in 1997-98, as well as the more recent global crisis, there is a tendency, not just in Indonesia but around the world, to blame trade and liberalisation—to say we have a crisis because we are too exposed to globalisation.

And so a kind of anti-foreign, anti-import mentality emerges, and when you see small companies go under or comparisons being made with cheap goods from China, the debate always arises that we should stop imports. It then becomes difficult to explain that to export and produce goods competitively for the domestic market, you need to access internationally priced inputs, including imports. More importantly, if you don't have the goods in your country, importing is going to help the consumers and even the poor. For instance, food imports will benefit the poor, because otherwise the food prices would be higher.

So what I have found is that the words “free trade”, “liberalisation”, “opening up” are not words that you would use if you were a smart Minister of Trade. We need to be better at explaining how opening up benefits the national interest, such as, by creating jobs, keeping prices stable for consumers and the poor, and so on.

For example, we have to make sure that there is enough rice in the country because rice makes up about 25 percent of what the poor consume. So we have to ensure that prices are stable, and when we don't have enough stock domestically,

we import. But we will see to it that we import only the amount that is necessary, so that it will not hurt the price that our farmers would receive and that the government continues to buy rice at the minimum floor price.

**To conclude, what are some of the key measures that Indonesia should take to address the key social and economic challenges that it faces? And are you optimistic about its future economic growth?**

Well, I think the major challenge for Indonesia is how to have sustainable growth, with new sources of growth coming from more productivity-based growth. That means it has to come from new investments in physical infrastructure and initiatives which would increase productivity. Therefore paying attention to R&D and innovation is going to be important in the way we diversify the structure of our economy.

And I would submit that developing more efficient, more modern and more competitive services has to be an important part of the strategy. Just like many other countries, we are also dealing with an increase in inequity in Indonesia, which has to be addressed primarily through physical infrastructure as well as accessibility to health and education, so that we have the human capital capacity to compete and become part of the growing economy.

If the new government can succeed on infrastructure and ensure that we have stable macroeconomic conditions, I think everything else will fall into place. Subsequently, we will have the luxury to fine-tune things a bit more. We already have universal health and universal education programmes in place, and I think we have to be mindful

to continue these programmes in an effective way.

I think Indonesia has shown a lot of resilience. It has gone through many crises and a number of changes. I am reasonably optimistic about its future economic growth because I believe that democracies are always noisy, and in general, we complain a lot domestically. But we are consolidating the process of democracy, and while the institutions are not there yet, we are going in the right direction. It's a little bit of trial and error, but the new government should be practical and brave to make changes when they need to. If what they're trying to do is not quite effective or the targeting is not quite right, they should have the political will, as well as the ability and the flexibility to change directions and make it work.

**Professor Mari Pangestu**

*served as Indonesia's Minister of Trade from 2004 to 2011, and as Minister of Tourism and Creative Economy from 2011 until October 2014. She is currently Professor of International Economics at the Faculty of Economics, University of Indonesia and is on the Board of Directors of the Centre for Strategic and International Studies, Indonesia's leading thinking tank*

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