2-2015

Indonesia’s challenges

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INDONESIA’S CHALLENGES

Published:
25 Feb 2015

Supply side constraints will be key to how South East Asia’s largest country maintains the six percent growth it needs to tackle the poverty rate and grow

In 2013 when the U.S. economy started showing signs of recovery, the “hot money” that flowed from the U.S. Federal Reserve’s Quantitative Easing programme into emerging markets started moving in the opposite direction. At the same time, the global economy slowed significantly, due in large part to slowing growth in China that led to softer demand for commodities.

“Because 65 percent of Indonesia’s exports is commodity-based,” explains **Mari Pangestu**, Indonesia’s Minister of Trade from 2004 to 2011, “we felt the pain of low commodity prices on top of all the hot money leaving Indonesia. As a result, we had a current account deficit and the weakening of the rupiah, so much so that we became part of the ‘Fragile Five’.”

Six percent: Indonesia’s magic number

That group of “Fragile Five” countries – Brazil, South Africa, India, Turkey, and Indonesia – are characterised by a high current account deficit and/or a high fiscal deficit. To address its economic challenges, Indonesia embarked on a conventional economic policy: choosing stabilisation over growth.

“To prevent capital outflow, we increased the interest rate,” Pangestu recalls at the recent SMU Presidential Distinguished Lecturer Series event, “*Indonesia: Resilience and Going Beyond the ‘New Normal’*”. “We allowed the rupiah to move in line with fundamentals. The rupiah depreciated by 17 percent in 2013, and it depreciated another two to four percent in 2014.”

“For fiscal consolidation we raised the fuel price; switched expenditure to infrastructure and social welfare; and we did some structural reforms. All this is Reform 101. Crisis leads to good policies. We streamlined permit applications and removed import restrictions. As a result, we grew by 5.8 percent (in 2014), and things stabilised.”

"50 percent of Indonesia’s 250 million people are less than 29 years old – is that a demographic dividend or a time bomb?"

However, Indonesia is expected to grow less quickly in 2015. The World Bank projects a 5.2 percent growth, lower than a previous estimate of 5.6 percent. Pangestu pins the slowdown on supply side constraints – inadequate infrastructure, low productivity, lack of cutting edge technology – but points out the pressing need for her country to maintain a growth rate of six percent.

“50 percent of Indonesia’s 250 million people are less than 29 years old – is that a demographic dividend or a time bomb? It’s the latter if you cannot offer them employment,” Pangestu warns. “Open unemployment is down from seven to just over six percent, but underemployment – that means people who work less than 35 hours per week – is about 40 percent, so it’s still a big challenge.”

On the significance of growing at six percent, she adds, “We want to reduce the poverty rate from 11 percent to about seven to eight percent. Here’s the challenge: the number of near poor (those who are just above the poverty line) is about 40 percent. The moment the economy fails to grow at least six percent, the poverty rate goes up.”

Coping with inequality

There is also the issue of inequality in Indonesia, which has risen like it has in many countries. Poverty, according to Pangestu, has fallen to 10.9 percent from 16 in the past decade, but the GINI coefficient has spiked from 0.33 to 0.41. There is also the urban and rural divide.

“Those who say they have poor access to healthcare in rural areas is 40 percent; in urban areas, eight percent,” Pangestu says. “For education, it’s 41 percent versus 7 percent. For transport, it’s 50 percent in rural. So getting your infrastructure right is not just about efficiency and competitiveness – it’s about reducing the inequity that is happening in Indonesia.”

While the challenges appear daunting, Pangestu, who was also the Minister of Tourism and Creative Economy from 2011 to 2014, highlighted Indonesia’s membership in the Regional Comprehensive Economic Partnership (RCEP) as a reason for optimism. Consisting of the 10 countries in the Association of Southeast Asian Nations (ASEAN) and Australia, China, India, New Zealand, Japan, and South Korea, it accounts for nearly 50 percent of the world’s population.

“It generates 28.8 percent of world output, and 27.9 percent of world trade,” says Pangestu. “Compare it to TPP-12 (Trans-Pacific Partnership), where the population is 800 million people or 11 percent of world population; GDP is 37.6 percent of world GDP; trade, 26 percent.

“What I am saying is: Indonesia and those in ASEAN are in a good neighbourhood. And it’s a growing neighbourhood.”

So how will the Indonesian economy do in 2015? What about the ongoing drama involving the Indonesian Corruption Eradication Commission (KPK) and President Joko Widodo’s candidate for national police chief, General Budi Gunawan?

“I don’t expect exports to grow a lot this year because of external demand and soft prices,” predicts Pangestu. “Investment numbers look good last year, and it continues to look good this year. Investors – foreign direct investors – look medium term, and they continue to come into Indonesia. There might be a lot of protests in Indonesia, but they are not protesting about policies.

“They are protesting about political appointments and personalities,” she adds, before quipping to laughter from the audience, “It’s noisy but that’s democracy.”