INDONESIA UPDATE 2015: PROSPECT AND PROGRESS

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Indonesia and its geography

Indonesian Archipelago is the largest archipelago in the world with an area of around 1,919,440 km2 of which is the Indonesian island. As comparison, the second largest archipelago, the Canadian Arctic, is 1,424,500 km^2. Indonesia is also the fourth most populous country after China, India, and the United States.

Located south and east of mainland Asia and north and west of Australia, all of Indonesia's islands are located in the Indian and Pacific oceans. The whole country is stretched across 5,100 km, a distance equivalent to about one-eighth of the Earth's circumference. The country is located in the region of the equator with most of the country is situated in the southern hemisphere and surrounded by the South China Sea, The Sulawesi Sea and the Pacific Ocean to the north, and by the Indian Ocean to the south and west.

About half of the country's 17,504 islands are inhabited. The main islands of Indonesia are Jawa (Java), Sumatera, and Sulawesi. The country shares the island of Kalimantan (Borneo) with Malaysia and Brunei, which up to three quarter of the island is Indonesian. The country also shares the island of New Guinea with Papua New Guniea; Indonesia occupies the western half of the island, known as Papua. Another island which Indonesia shares is Timor, which the eastern part is occupied by Timor Leste. Smaller islands include Bali, Lombok, Sumbawa, Flores, and the Maluku (the Spice Islands).

The new development term of 2015-2019

As Indonesia changed its president, it is also time for the nation to set up a new midterm development plan (*RPJM 2015-2019 or Rencana Pembangunan Jangka Menengah 2015-2019*). The new administration has the opportunity to organize new arrangement to boost things that are lagging and to maintain those that are already

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in moving in the right direction. Some new directions are apparent from the new developmen plan. These include plans: to boost infrastructure development and to reduce regional disparities and inequalities in a broad sense.

Table 1. Some Key Indonesia Economic Indicators

INDICATORS	2008	2009	2010	2011	2012	2013	2014
GDP and Inflation							
Growth (%, y-o-y)	6	4.6	6.2	6.5	6.3	5.8	5.1
GDP Per Capita (USD)	2240	2344	3004	3525	3583	3500	3647
Investment to GDP Ratio (%)	27.7	31.1	32	31.9	32.7	31.7	31.8
Inflation (%, y-o-y)	11.1	2.8	7	3.8	4.3	8.4	8.36
GOVERNMENT BUDGET (APBN), Rp Trilliun							
Revenue	982	849	995	1211	1338	1429	1633
Expenditure	986	937	1295	1295	1491	1639	1877
UNEMPLOYMENT							
Quantity (millions)	9.4	9	8.3	7.7	7.2	7.4	7.2
Percentage of the workforce (%)	8.4	7.9	7.1	6.6	6.1	6.3	5.94
POPULATION BELOW POVERTY LINE							
Quantity (million people)	35	32.5	31	29.9	28.6	28.6	27.7
Percentage of total population (%)	15.4	14.1	13.3	12.4	11.7	11.5	10.96
GINI RATIO	0.35	0.37	0.38	0.41	0.41	0.41	0.41

Source: Bappenas, 2015

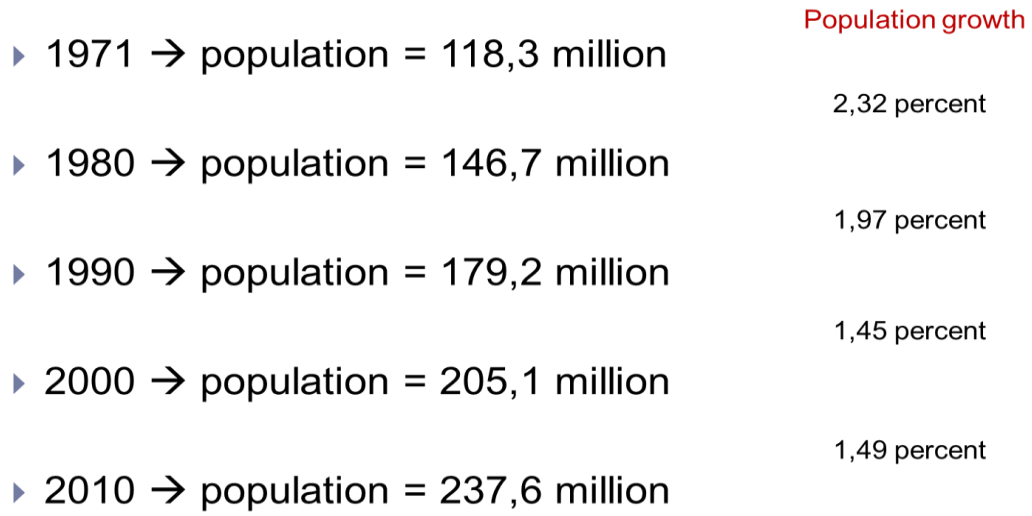
Indonesia economic progress in 2008-2014 can be seen in Table 1. Per capita income had steadily increased during the period, in spite of some bumps dragging economic growth down to below 6 percent in 2013-2014. Impressive success in managing inflation rate in 2009-2012 unfortunately met a strong challenge in 2013-2014, although the rate is still significantly lower than the rate in 2008, when it hit 11 percent. Strong external shocks drove domestic price level to rise such as the hike in international oil price in 2013.

Unemployment had been showing the desired tendency to fall. About two million people found jobs during 2009-2014, lowering the number of unemployment 9.4 million in 2008 to 7.2 million in 2014. Improvement of welfare can also be seen from the continued decrease of poverty incidence which number to less than 11 percent in 2014, well below the 15.4 percent in 2008.

Indonesia is among the leading country regarding management of population growth prior 2000. Between 1971-2000, population growth had been reduced to 1.45

percent in 2000 from 2.3 percent in 1970. However, since 2000 afterwards the figure increased slightly. Political shifts seemed to be the main reason for this. In 2004, regional autonomy was implemented resulting a moment of euphoria in the provinces where new authorities now were being transfered to them. Within such atmosphere and freedom to make decision, less populated regions viewed that family planning program was no longer in their top priorities of development. Previously, under the centralistic approach to implement the program, all regions must comply with directive from Jakarta. With the regional autonomy, this was no longer the case.

Figure 1. Population Growth 1971-2010.

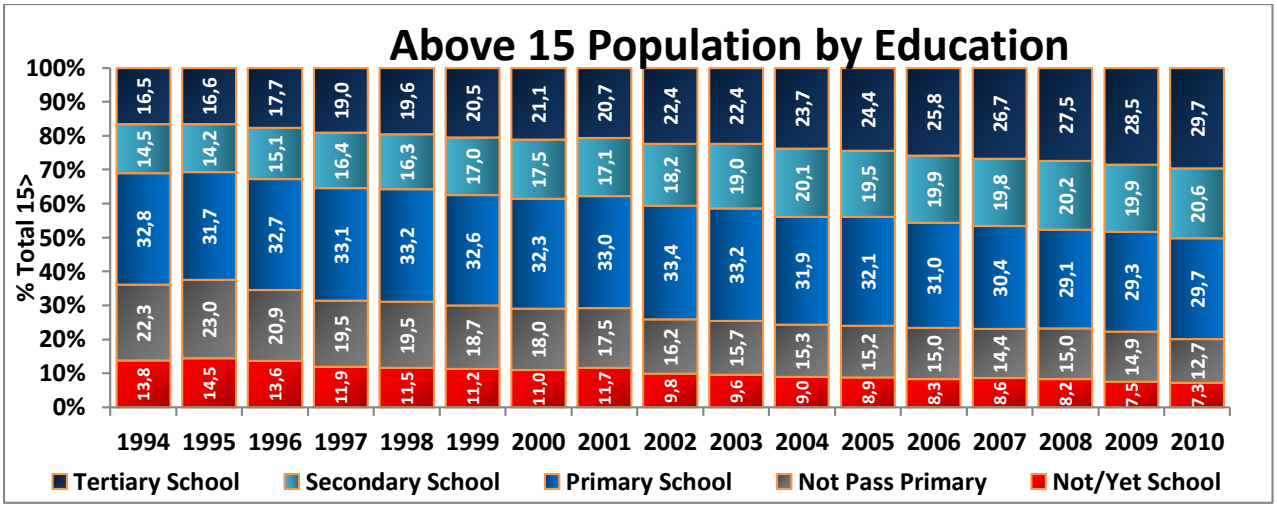


Nevertheless, progress in education sector has always been impressive. Figure 2 shows the steady reduction of less educated working age population since 1994. Domination of productive age population with elementary education is being replaced by more and more people with higher education, that is those with secondary and tertiary educations. At the same time, people enjoying secondary and tertiary educations were increasing until almost 30 percent of the total working age population in 2010. As Indonesia enters the digital era, more and more people of the nation will be better prepared to meet the challenges.

In passing, such development in education will be more strategic as the implementation of ASEAN Economic Community (AEC) becomes effective in 2015. One point of the AEC agreement is free movement of skilled labor within the region. This means that Indonesia is facing a new challenge and opportunity as well. The challenge is regarding the myth which goes with the concern that Indonesia will only

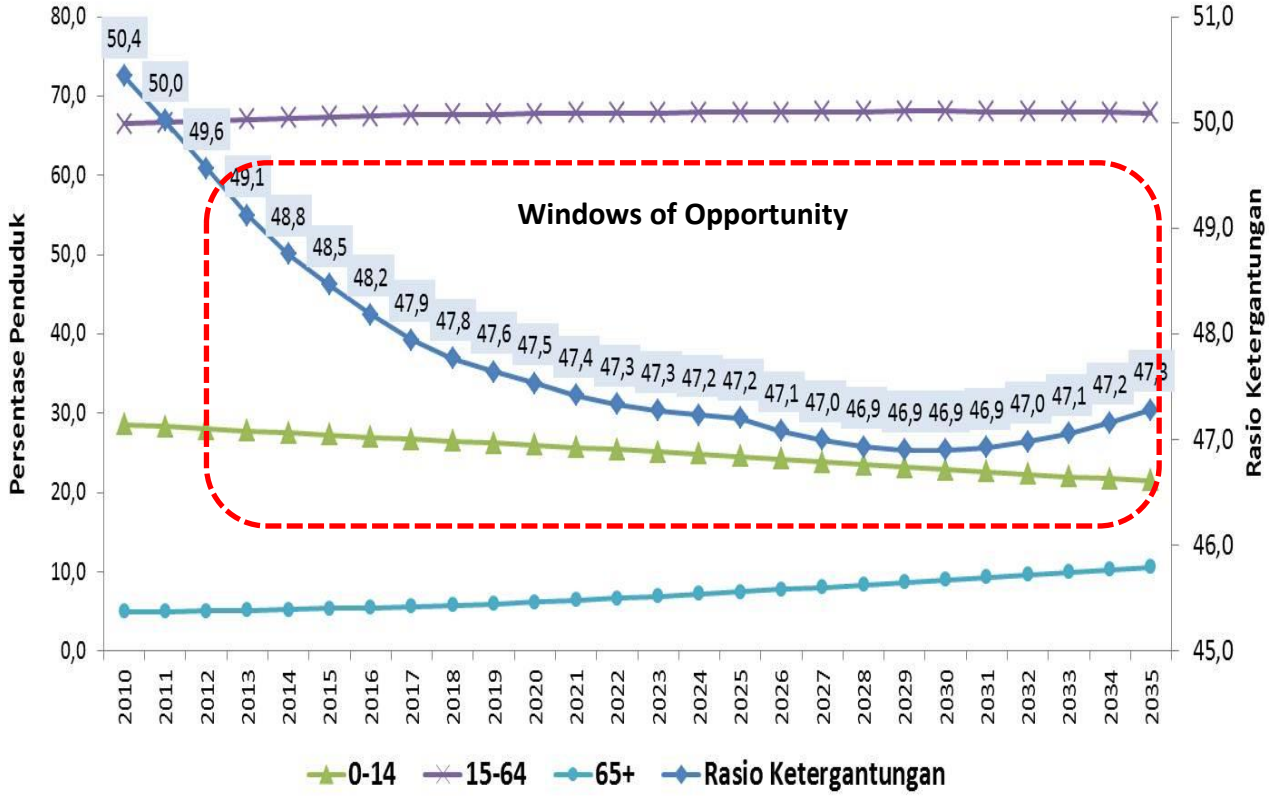
be a mere market of foreign skilled labor. The opportunity, meanwhile, is how to provide the new regional market for Indonesian skilled labor.

Figure 2. Change of Education Structure of the people, 1994-2010.



Indonesia entered a unique period in terms of its demography when in 2012 the dependency ratio declined and stayed below 50 percent. This period of low dependency ratio is a potential which may provide Indonesia with demographic dividend. Demographic dividend is a bridging concept between demographics and economics. In this period Indonesia has an opportunity to boost economic growth since the population now is dominated by productive age group. This means that there is now a huge humber of labor force available in the country.

Figure 3. Indonesia Demographic Dividend



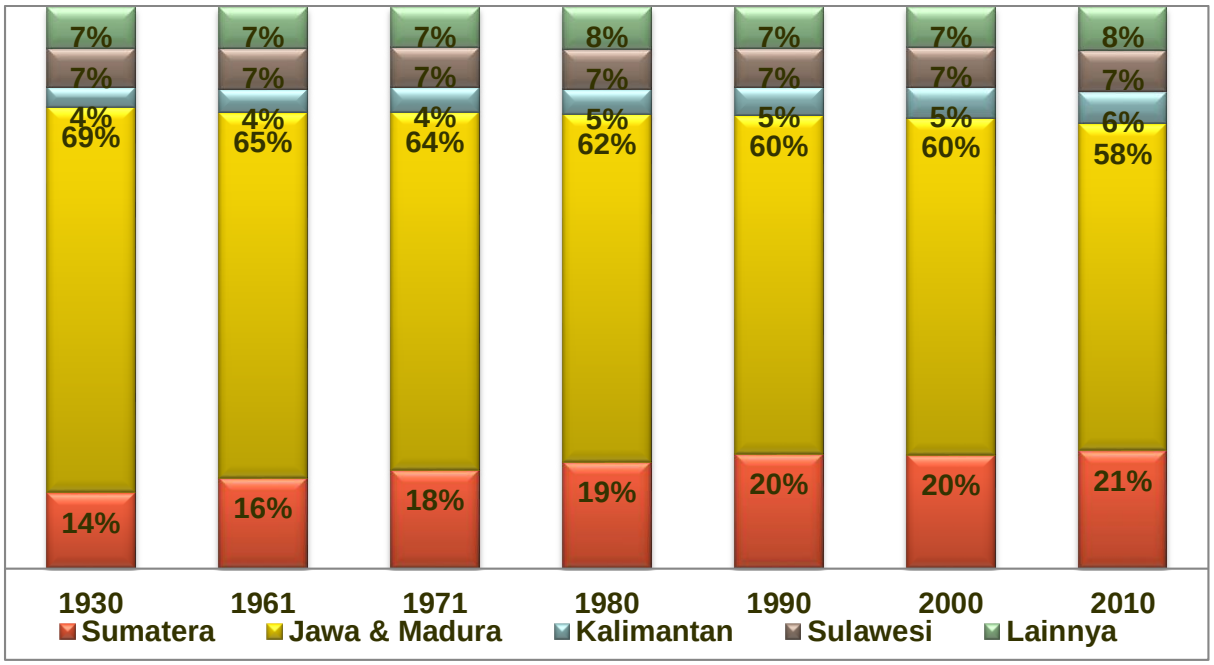
Demographic dividend is a window of opportunity, not a windfall profit. Only with proper policies this chance can be capitalized. Such policies would be: to improve the quality of human capital (preparing skills and competencies of the workforce), to maintain fertility rate to decline (an effective family planning program), provision of jobs with emphasize on the quality of jobs, increased access to savings, provision of infrastructure, as well as to improve work environment where no discrimation is applied towards female workers. Fail to manage demographic dividend would lead to problems such as unemployment, which may result in social conflicts, environmental degradation, and health burden.

Other important characteristics of indonesian population is its skewed distribution to the western part of the country. This condition has been prevailing for many decades if not centuries. Significant distinction relevant here is that the eastern provinces are rich in natural resources, but are lacking in both the quantity and quality. This regional population disparity may be both cause and consequence of lacking of development in the eastern provinces. And the current government seems to be more willing to tackle this problem as can be seen from the current RPJM. Figure 4 shows the population distribution by island from 1930 to 2010. This figure also tells

that the inter-regional population imbalance has persisted for more than five decades.

In terms of migration, such regional disparity mentioned above may also be seen as a factor which hamper population movement into the eastern Indonesia. Meanwhile, the western part faces its own population-distribution related problem namely urbanization. At national level, urban areas in Indonesia is 1.7 percent of total area in 2011, with urban population accounted for 49.7 percent of total population. It is projected that Java will become an island city and many other islands in the western Indonesia will follow suit, such as in the Riau Kepulauan province.

Figure 4. Population Distribution by Island



One serious problem regarding the urbanization relates to the goal of the current administration to develop food security. Up to now, Java is still the main food (especially rice) producer of the country. But, such progress of urbanization poses alarming threat to Indonesia food security. Another major issue with current pattern of urbanization comes from the tendency of de-industrialization plaguing the manufacturing sector. Since 2006, contribution of the non-oil manufacturing output has been slowly decreasing. Lack of new investment is suggested as the main cause.

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One major issue hampering acceleration of investment is the lack of infrastructure to support new investments. It is estimated that Indonesia at the moment needs 2,6500 kilometers of new road; 1,000 kilometers toll road; more than 10,000 kilometers of railroad; 24 new seaports; and so on. The amount of fund needed in 5 year development term for infrastructure alone is about 469 billion USD or around 94 billion USD a year. Obviously the government cannot fulfill the needed fund on its own, since it can only provide, at the most, for 16 billion USD a year. Participation from other parties such as SOEs, regional governments, and private sector are open.

The willingness of the central government to focus on infrastructure development is also seen from the reallocation of government budget from previously heavy towards financing subsidies, especially oil fuel price subsidy.

The Need for Infrastructure

However, demand for more and better infrastructure also comes from the necessity to avoid, or perhaps even to escape from, what is called as the middle income trap (MIT). MIT is a notion where a country has already reached middle level of per capita income but having difficulty to upgrade to higher level of income status (Todaro and Smith, 2012). The term was introduced by Gill and Kharas in their book “An East Asian Renaissance: Ideas for Economic Growth” (2007). The idea was inspired after observing the sudden economic performance slowdown of East Asian countries which previously were seen as miraculous (Robertson and Longfeng, 2013). Apparently, such symptom is also plaguing other countries in different continent. Some South American countries are still unable to promote themselves to higher income class, staying for quite some times in the middle income class level. These countries have difficulties to promote themselves and their products to compete in international markets. One important reason is because these countries’ exports still rely on labor-intensive products, while domestic wage have significantly risen. Their products, then, are no longer competitive because at the same time low income countries have already entered industrialization and also export labor intensive, low wage products.

Even though the idea of MIT has been addressed many times in many occasions, unfortunately, until now there is no consensus on its definition. Jesus Felipe and his associates (2012) from the Asian Development Bank did a literature study on this

issue. One obstacle to reach consensus in this matter is the lack of theoretical ground. For example, the income classification used by the World Bank to put countries into income groups has always changed from time to time. In 2010, a country belonged in the low income class if its per capita income, measured with gross national income (GNI), is less than 1,050 USD; lower middle-income if its GNI per capita lies between 1,006 and 3,975 USD; upper middle-income if its GNI per capita lies between 3,976 and 12,275 USD; and high-income if GNI per capita is above 12,275 USD. However for 2015, the income groups has been altered as: low-income if GNI per capita is less than 1,045 USD; lower middle-income if it lies above 1,045 and below 4,125 USD; upper middle-income if its GNI per capita is between 4,126 and 12,745 USD; and high-income for countries with per capita income more than 12,745. Without clear definition, there is no exact line to determine when a country belongs in the middle-income group and when it should be already in the high-income class.

Indonesia and MIT

Regarding Indonesia, Ohno (2009) studied, using the US per capita real-income to measure relative real per capita income of selected East Asian countries, that since 1950 Indonesian per capita income has not caught up. Meanwhile, countries like Taiwan and South Korea, beginning in the late 1960s managed to take off to close their income gap with the US. When in 1950 their incomes were about 20 percent of the US, in 2005 they were already about 60 percent.

Another study by Felipe and his associates (2009) tried to set out income groups over 60-year period from 1950-2010 for 124 countries. In addition, they also determined the time limits for a country to move up to higher income level. This time limit becomes the reference whether a country is stuck in a certain income level trap. The research divided the middle-income group into two sub-groups of lower middle and upper middle. For a country to be caught in the lower middle-income trap it must stay within this group for more than 28 years; while for the upper middle-income trap, the time limit is 14 years.

Felipe, *et al*. (2009) found that Indonesia had already been in the lower middle-income level since 1985. This means that if Indonesia did not move up to at least the upper middle-income in 2014, the country was caught in the MIT. More explicit result

stating that Indonesia is already caught in the MIT since 1990s is found in Robertson and Longfeng (2013).

The Role of Infrastructure

Infrastructure is important for economic growth because it facilitates the flow of goods, people, information and ideas. To escape from MIT, Indonesia needs a high rate of economic growth. An estimation by Bappenas suggests that for every additional 85 trillion rupiahs (6.7 billion USD) infrastructure expenditure will create economic growth as much as 1 percent in 2015. A study by Shekhar Aiyar (2013) showed that lack of transportation and communication infrastructure in Indonesia became the major obstacle to boost economic growth. However, Indonesia is in urgent needs for infrastructure to bring logistics cost to a competitive level. In addition, regarding the large regional inequalities, infrastructure is also needed to mitigate these disparities.

Most of infrastructure expenditure is for east Indonesia and the periphery regions. The government wants infrastructure developments create development with quality. Development with quality means: development for the people, inclusive and broad-based, and must not widen interclass and interregional inequalities; development activities must not damage or lower environmental sustainability and ecosystem equilibrium. In short, it must produce growth while maintaining sustainable welfare.

Regional inequality which is reflected in per capita income disparities also show variation of types of infrastructure needed. Regions with low income per capita needs larger portion of infrastructure development for irrigation, electricity and water; while more advance regions generally need infrastructure for transportation, electricity and communication. In other words, the focus of infrastructure development among regions varies according to local necessities. It is important, however, to look after coordination among regions. Lack of coordination will lead to wasteful spending.

For 2015, for the first time in the history of Indonesian budget, capital (infrastructure) expenditure is larger than spending on subsidy. With the budget reallocation, expenditure quality of the budget becomes better off. Acceleration of infrastructure development is the theme of government work plan of 2016. For 2016 government

work plan Infastructure expenditure is raised 20 percent from 139 trillion rupiahs in 2015 to 167 trillion rupiahs in 2016.

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