Indonesia’s economy

Spicing up growth

Bad policy as much as bad infrastructure is holding Indonesia back

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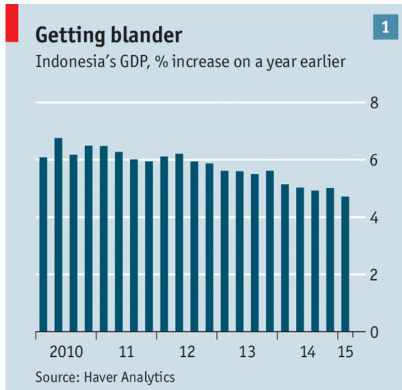
IN LATE April Indonesia’s president, Joko Widodo, better known as Jokowi, wooed foreign moneymen at a big international conference. Investing in Indonesia will bring “incredible profits”, he promised. “And if you have any problems, call me.” Two days later, at a summit of Asian and African dignitaries, Jokowi struck a different note. He called for “a new global economic order that is open to new emerging economic powers” to avoid the “domination of certain groups and countries”.

That is not necessarily a contradiction: you can pursue foreign cash while also arguing that international financial institutions grant developing countries too little power. But the change in tone was striking: from open, affable and welcoming of foreign money to prickly and suspicious of it. In his first seven months as president, Jokowi has tended to present the first face to the world, particularly to potential investors. But Indonesia’s policies still show too much of the second. That has grave implications for the country’s future.

Jokowi (pictured) says he wants Indonesia to return to 7% annual growth—a rate unseen since the Asian financial crisis of the late 1990s, but not unusual before it. In fact, the economy is slowing. In the first quarter of this year it grew by 4.7% year on year, down from 5% in the previous quarter (see chart 1). On a quarterly basis, it has been shrinking for six months now.

The problem is commodities. Ever since the ancient Romans acquired a taste for cloves, commodities have played a big part in Indonesia’s economy. The country is the world’s leading exporter of palm oil and tin, the second-biggest rubber exporter and the fourth-largest coal producer. The Grasberg mine in Papua, Indonesia’s biggest and easternmost province, is the world’s biggest gold mine and its third-largest copper mine. When China's hunger for commodities was growing and prices were high, Indonesia boomed. But since 2011 its growth rate has declined, reflecting China's weakening appetite for raw materials and the dramatic fall in prices this has precipitated.

South-East Asia



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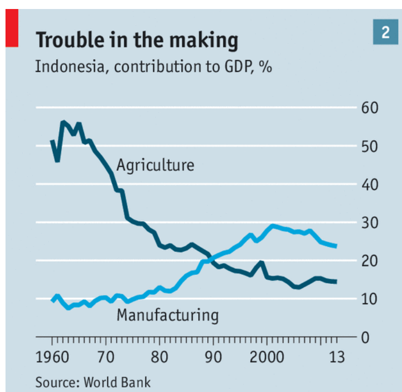
Jokowi's plan is to rebalance Indonesia's economy away from commodities and towards manufacturing. The country managed a similar shift once before: in the late 1970s and 1980s, as the price for Indonesia's then-abundant oil fell, the government tried to attract foreign investment in industries like food processing and carmaking instead.

By 1990 manufacturing's share of GDP exceeded that of agriculture for the first time, thanks to a winning combination of low wages, decent infrastructure, a stable investment climate and abundant natural resources (see chart 2). That boom ended with the Asian financial crisis and the chaotic fall of Suharto, Indonesia's long-serving strongman, in the late 1990s.

Indonesia today should be even more attractive as a manufacturing hub. It is the fourth-most-populous country in the world, with a huge, fast-urbanising domestic market and a rising consumer class. Workers are cheap: the average manufacturing job pays a base salary of $253 per month, compared with $369 in Thailand and $403 in China. Demography is in its favour: its median age, 29.2, is well below those of Thailand (36.2) and China (36.7).



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But Indonesia's bureaucracy is impenetrable and its infrastructure, much neglected since Suharto's day, woeful. Companies spend 50% more on logistics than those in Thailand and twice as much as those in Malaysia. No wonder that foreign investment has stagnated in recent years. Manufacturing's share of GDP, meanwhile, fell from 29% in 2001 to 24% in 2013.

Jokowi has taken some steps to reverse this slide. He launched a one-stop shop for investment approvals in January that has helped speed progress through Indonesia's Kafkaesque bureaucracy (though when dealing with Indonesian bureaucracy, "speed" is a relative concept: according to Wellian Wiranto of OCBC, a Singaporean bank, the one-stop shop has reduced the number of days required to obtain a permit to build a power plant from 923 to 256).

Using savings from the welcome cutting of fuel subsidies late last year, Jokowi has boosted the budget for infrastructure by 53%—the biggest year-on-year increase in Indonesia's history. Better roads and ports should drive down logistics costs. Some of the money is for much-needed power plants: Indonesia has five times Britain's population, but just half of its generating capacity. He has also sought out foreign investment for infrastructure projects.

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But many businesspeople worry that the results will not match the rhetoric. Much of Jokowi’s infrastructure money will go to inefficient, state-owned enterprises. Indonesia has inflexible labour laws and minimum wages have shot up (albeit from a low base). Moreover, a morass of protectionist rules persists. The number of industries barred to foreign investors, for instance, has grown steadily. Last year the “negative-investment list” expanded to include onshore oil extraction and e-commerce. In 2014 the government banned the export of some raw minerals in a disastrous effort to ramp up domestic smelting; exports of bauxite collapsed from 55m to 500,000 tonnes within a year, without any concomitant rise in alumina or aluminium exports.

Local-content laws abound, covering energy, retailing and carmaking, among other sectors. A long-mulled, much-criticised draft law may soon require companies that sell tablets and smartphones to produce up to 40% of their components in Indonesia. The aim is to boost domestic tech manufacturing; instead, it will probably create a flourishing black market for iPhones and scare off potential investors. Tight immigration rules have cut the number of foreign workers in Indonesia by 16% in three years, to just 64,000 in 2014. Foreign doctors are banned; foreign oil-and-gas workers must be below the age of 55.

Much of this is not Jokowi’s doing. Economic liberalism has never really taken hold in Indonesia. Its parliament is always ready to embrace protectionist policies, driven by the widespread belief that foreigners have long plundered Indonesia’s resources and left locals none the wealthier. The Asian financial crisis left Indonesia deeply suspicious of foreign capital.

Nor is Jokowi blameless. A decree published without consultation in January unexpectedly banned the sale of beer in minimarts and other small shops across the country, depriving brewers of perhaps half their revenues and startling investors who now fear more surprise regulations. He promised to increase government revenues by bringing more Indonesians into the tax system, but many foreign firms whisper that tax officials are squeezing them harder instead.

Carmaking, led by Japanese firms, is humming along: production is now rising in Indonesia and falling in Thailand. For the past two years more cars have been sold in Indonesia than in any other country in South-East Asia. But Jokowi has lately promoted the potential for a national-car scheme in partnership with Proton, the money-pit that is Malaysia’s national carmaker. Jokowi’s supporters say he has the right ideas, and stress that he faces strong opposition. But whether bad policies are enacted with Jokowi’s support or because he is powerless to stop them matters little: either way, they hinder investment that Indonesia sorely needs.

Geography already puts Indonesia at a disadvantage: it sprawls across more than 13,000 islands, which means that getting goods from one place to another will always be more complicated (and expensive) than just putting them on a lorry. But that makes good policy all the more crucial. When commodities were in demand, Indonesia’s business environment mattered less: companies that wanted tin and copper had to go wherever they could be found. Manufacturers can be choosier.

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