



INDONESIA: Recalibrating to meet challenges and opportunities

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12th AIFED

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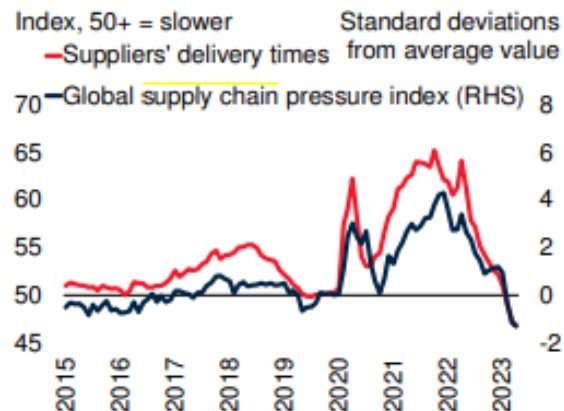


1. CHALLENGES & OPPORTUNITIES

CHALLENGES: GLOBAL SUPPLY CHAIN PRESSURES PRECEDED THE US-CHINA TRADE WAR

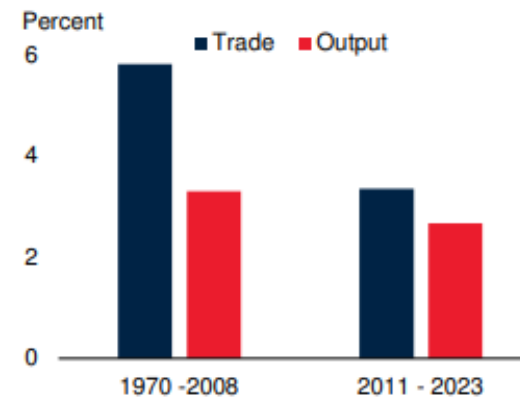
- Pressures on global supply chains have abated as goods demand has weakened and global shipping conditions have improved. The global supply chain pressures index and suppliers' delivery times reached their lowest levels in almost four years in the first half of 2023 and are expected to remain low.

A. Global supply chain pressures

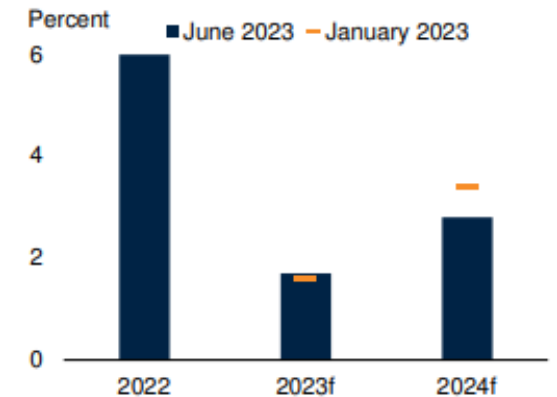


- The responsiveness of global trade to changes in output is predicted to reduce further and global trade growth is forecast to slow from 6 percent in 2022 to 1.7 percent in 2023.

C. Global trade and output growth



D. Global trade forecast

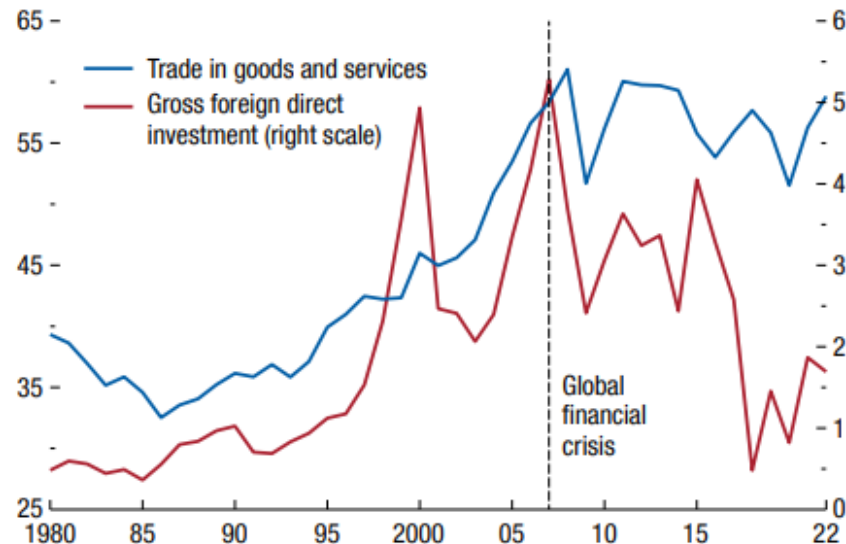


CHALLENGES:AND SLOWBALIZATION

Slowbalization dates to the aftermath of the global financial crisis.

Figure 4.1. “Slowbalization”
(Percent of GDP)

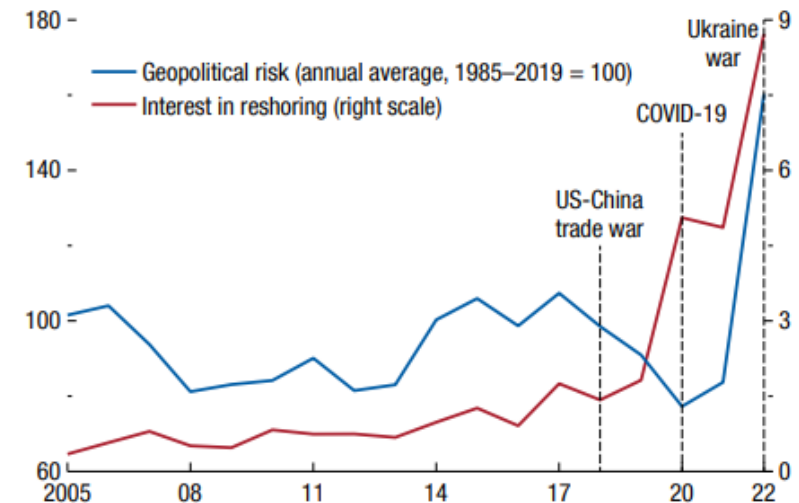
Foreign direct investment sharply declined after the global financial crisis.



A sharp spike in firms' interest in reshoring and friend-shoring occurred at the same time that the average geopolitical distance across country pairs started increasing.

Figure 4.2. Rising Geopolitical Tensions and Foreign Direct Investment Fragmentation
(Index; frequency of mentions of reshoring on right scale)

Recent years have seen increasing geopolitical risk and companies' interest in reshoring and friend-shoring.



CHALLENGES: GEOPOLITICS AND GEO ECONOMICS

INTERTWINING ECONOMICS, SECURITY AND TECHNOLOGY

International trade and governance not priority, TPA lapsed in 2021. Focus of US trade policy: domestic lens, protection of worker's rights, sustainability

US: Realigned US-China trade relations; did not lift Trump tariffs; step up engagement with like minded countries: friend and ally shoring, **IPEF**, the infrastructure initiative with G7 (counter BRI); using global platforms G7

- Decoupling and Derisking strategy (small garden high wall analogy): efficiency – just in time vs security (concentrated supply - China, shocks) – just in case
- US Domestic response: IRA, CHIPS and Science Act and Restrictions on US investments and export controls (reshoring, on shoring) AND diversification/deconcentration with “allies” (friend shoring)

China – self sufficiency, Make in China, circular economy, China slowdown and structural change, Outward investment - diversification

G2 TRADE TENSIONS: NOT LIKELY RESOLVED ANY TIME SOON

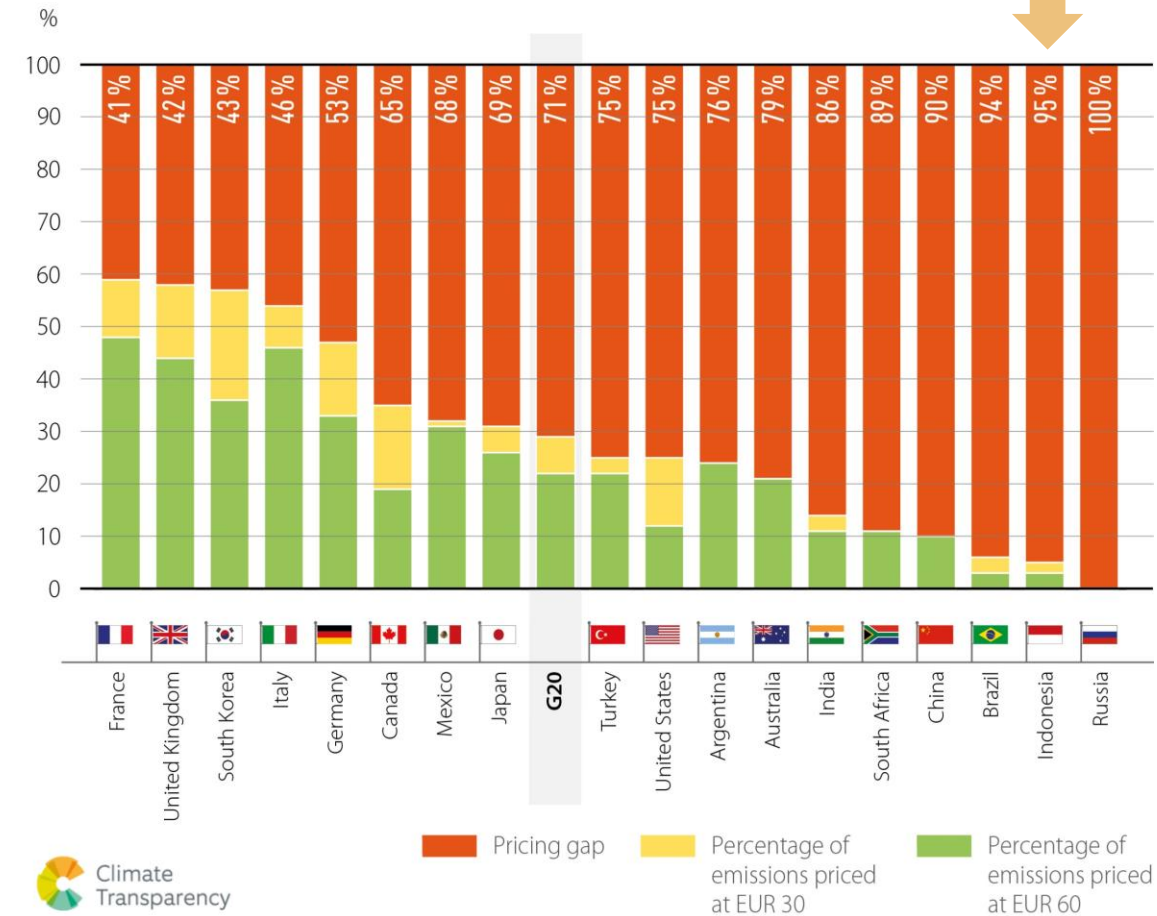
It is here for the long term and complex:

- **Unfair Trade:** trade deficit in goods and currency manipulation (export subsidy) to justify use of tariffs
- **National Security:** limit intermediate imports (steel and aluminium), use of technology, semi conductors, EV, Critical Minerals
- **Complex:** overlapping US economic, business, technology and security interests in a multipolar world.
- **Issues:** IPR infringement, transparency, market distorting policies (SOEs/domestic vs foreign), technology transfer, industrial subsidies, & technology competition (Huawei)

ANOTHER CHALLENGE: SANCTIONS TO CARBON-INTENSIVE ECONOMY.....

- Major trading countries are starting to place restrictions on carbon-intensive commodities
- CBAM is a technical regulation that aims to shift production inward (onshoring) and prevent carbon leakage; encourage the integration of carbon emission calculations in trade
- Sustainability becomes more acceptable and prerequisite standards - **sustainable supply chain key to competitiveness**
- Trade agreements started to include environmental provisions
- 25% of the Indonesian economy has high carbon intensity; such as mining (14.07%), agriculture (9.22%), fisheries (2.58%), and forestry (0.6%)

Carbon-pricing gap in G20 countries, 2015



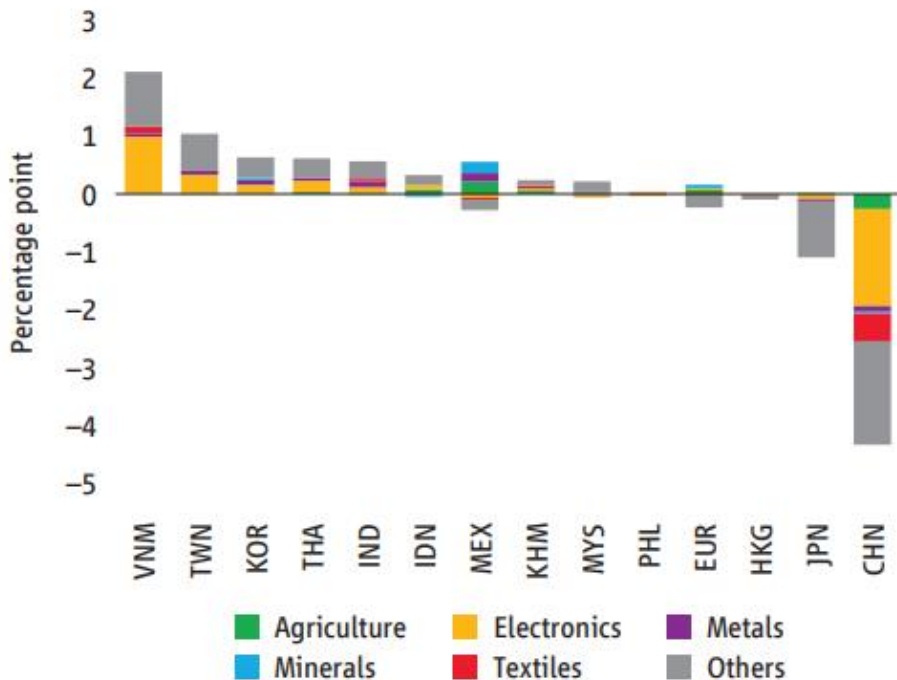
* No data exists for the European Union and Saudi Arabia.

Source: OECD 2018

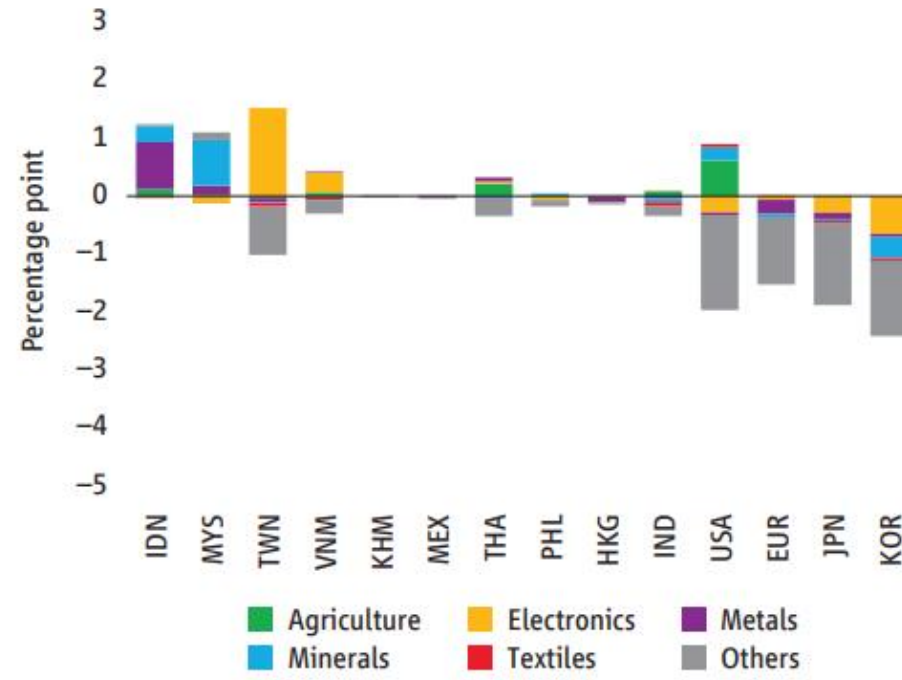
OPPORTUNITIES: RELOCATION AND TRADE DIVERSION

Figure 44. Exports of some EAP economies to the US and China increased after they imposed trade restrictions on each other

A. Changes in share of US imports, 2018–2022)



B. Changes in share of China imports, 2018–2022)



Source: Customs data from the US and China.

Note: Sectoral decomposition of changes in the economy's share of respective imports during 2018–2022.

Economies such as Vietnam, Thailand, and Indonesia exhibited an increase in their share of US imports, also particularly in the electronics industry, suggesting US trade diversion from China.

TRADE DIVERSION OPPORTUNITIES: CAVEATS

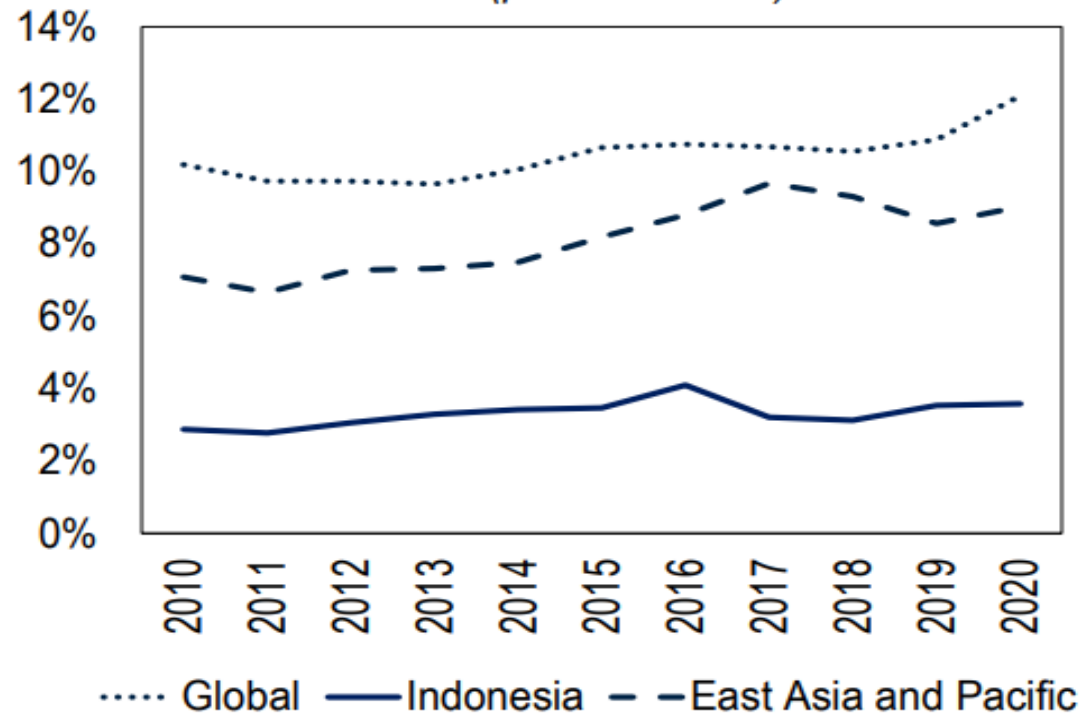
- ❖ Not driven by economic fundamentals: leads to great uncertainty and affects investment decisions
- ❖ Divergent standards across locations (e.g. different approaches to data flows, telecommunications technology) lead to segmentation of markets and reduces benefit from economies of scale
- ❖ Export restrictions on ultimate destination (export of high end SC Chips to China) and import restrictions on ultimate source (IRA and batteries/critical minerals, SC): disrupts GVCs and third country relocation decisions
- ❖ Bilateral restrictions on technology flows and collaboration between large countries: will reduce availability and diffusion of knowledge. Critical minerals and EV and SC.

POTENTIAL : GREEN COMPETITIVENESS AND GREEN TRADE

Potential in exports of green goods and technologies.

Green Goods Exports

(percent of total)

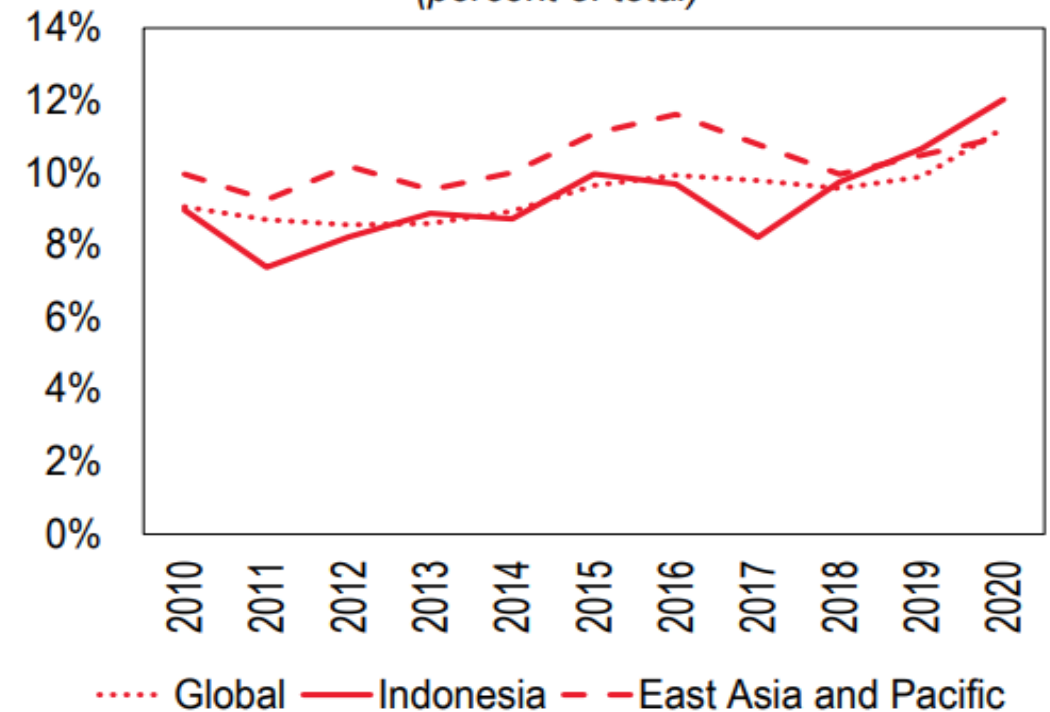


Source: World Bank staff calculations based on BPS data.

Imports: access advanced & cheaper technologies

Green Goods Imports

(percent of total)



Source: World Bank staff calculations based on BPS data.

Note: Green goods as defined here are based on a compilation of the APEC, OECD and WTO green goods classifications and add up to a list totaling 543 products classified at the 6-digit level. Green goods are defined based on the environmental benefits they provide rather than their carbon content and include 19 different categories (e.g., air pollution control; energy efficiency; renewable energy; resource and pollution management etc.)

OPPORTUNITIES: TRADE IN SERVICES

Digital technologies boosted during pandemic and enabling services to become tradeable: digital platforms for retail, finance, transportation and tourism has increased productivity and tradability of services

Trade in services (except transportation and tourism) recovered quickly and experienced high growth during/after pandemic: countries which have competitive advantage benefited

Need: reducing restriction in trade in services, regional and global cooperation for interoperability,



2. INDONESIA: Recalibrating to realize opportunities

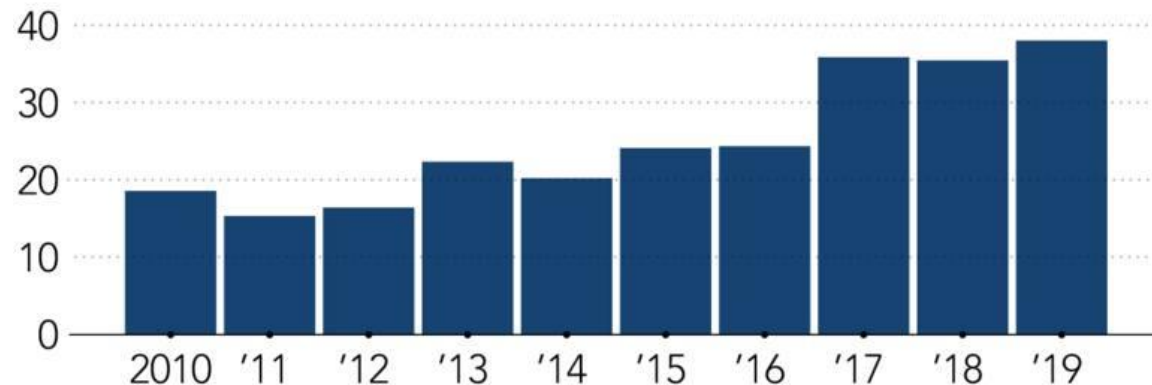
THOSE CREATE OPPORTUNITIES...

Indonesia indeed has strategically tried to take advantage from the current situation

Indonesia has not been main beneficiary to take advantage from spillover effects of US-China trade war

But Indonesia still wants to take the momentum for industrial development

Foreign direct investment in Vietnam shows rising trend *(in billions of dollars)*



Data from 2016 includes M&A deals

Source: Foreign Investment Agency, General Statistics Office of Vietnam

This Week in Asia / Economics

Jokowi tells ministers to take advantage of US-China trade war, as investors bypass Indonesia

- Research by the World Bank revealed that Chinese companies seeking to shift operations due to the trade war with the US had gone to Vietnam, Malaysia, Thailand and Cambodia
- President Joko Widodo said ministers must do more to improve competitiveness and attract foreign direct investment

THE REASON FOR NOT BENEFITING...

Indonesia did not benefit as much from spillover effects of US-China trade war

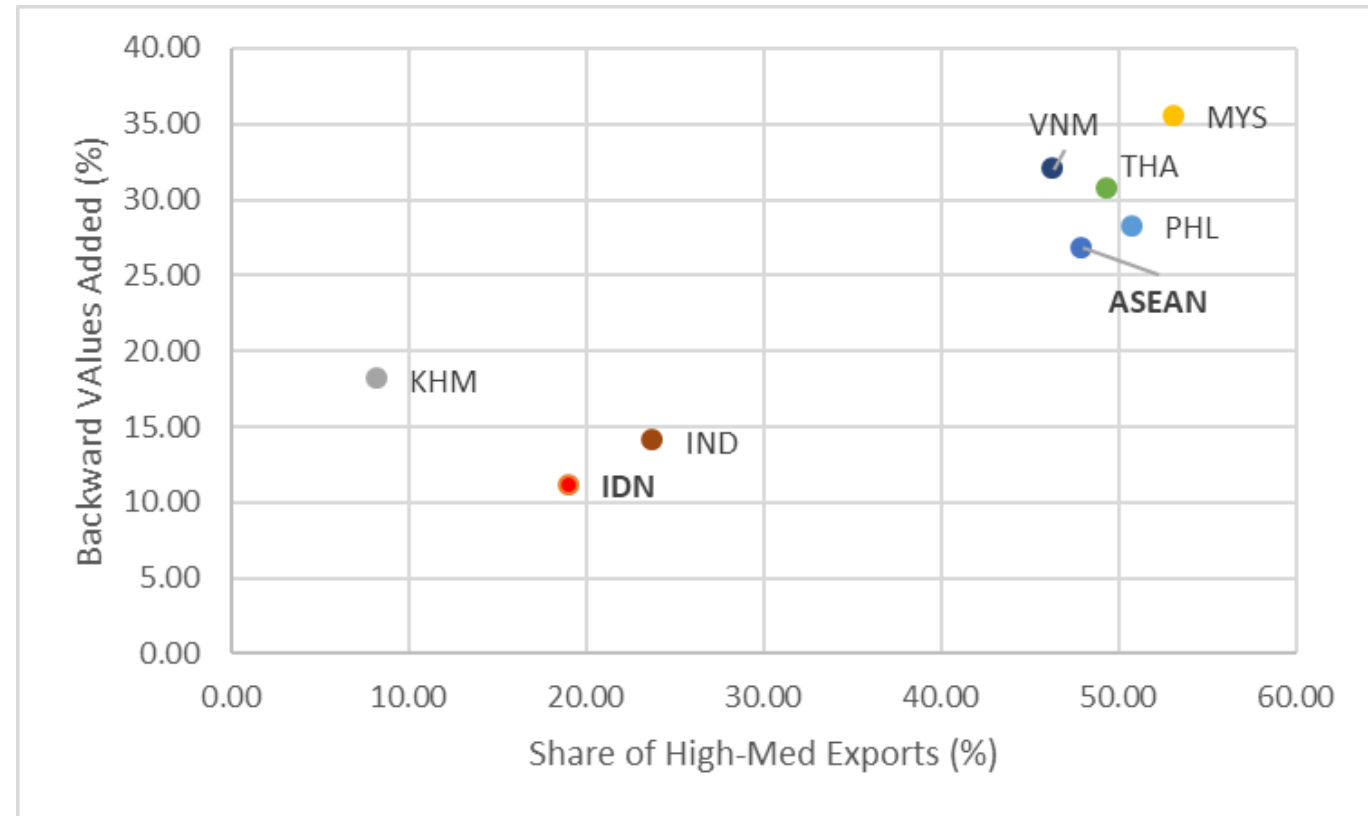
Due to unsuitable production structure, low integration into global supply chain, and highly uncertain business environment (trade and investment)

Other challenges: low productivity (human capital, technology adoption)

Need to recalibrate: opportunity of the shift toward green economy, and rearrangement of global supply chain due to geopolitical dynamics

Response (Main Message): deeper structural reforms and international cooperation to navigate G2 tensions.

Structure of Production and Supply Chain Integration for Selected Developing Countries in Asia



Damuri, 2023 (Forthcoming)

INDONESIA'S TRADE POLICY UNDER THE CURRENT ADMINISTRATION

2014-2019

- Appreciation of rupiah and the end of commodity boom lowers Indonesia's competitiveness.
- Global trend of protectionism and beggar-thy-neighbor exchange rate policies.
- Jokowi administration kept tariffs low, but used protectionist non-tariff measures heavily through Ministry of Trade, Ministry of Agriculture, Ministry of Industry.
 - The acceptance of the WTO TFA in 2017.
- The launching of the Authorized Economic Operator (AEO) programme and of a Post-Border Import Supervision Policy.
- Participation in the ASEAN Single Window (ASW); and the integration of the Indonesia Single Risk Management (ISRM) system within the Indonesia National Single Window (INSW) platform.



2019-2023

- Trade to GDP ratio fell from 72% in 2000 to 33% in 2020 and is also the lowest among regional peers.
- The contribution of manufacturing to Indonesia's GDP also fell significantly, from its peak at 31% in 2002 to 19% in 2021.
- NTMs adding up to an average tariff equivalent of 30 percent, more than in other countries in the region.
- Regulatory consolidation led to a decline in the number of NTM regulations, from 147 in 2020 to 116 in 2021 for import-related NTMs, and from 30 in 2020 to 18 in 2021 for export-related NTMs.
 - Deployment of INSW and INAPORTNET.
- The launch of National Logistics Ecosystem (NLE).

Source: Patunru, A. A., Pangestu, M. E., & Basri, M. C. (2018). Challenges for Indonesia in the new world. Indonesia in the New World: Globalisation, Nationalism and Sovereignty, 1-13;

World Trade Organization. (2020). Trade policy review for Indonesia;

World Bank. (2022). Indonesia Economic Prospects December 2022: Trade for Growth and Economic Transformation

TRADE POLICIES FOR THE NEW GEOPOLITICAL LANDSCAPE

+ INTEGRATING CLIMATE WITH DEVELOPMENT



Trade agreements can reduce trade costs and promote trade, especially if they lower both tariff and non-tariff barriers and generate momentum for further domestic reforms—including reforms that foster private sector development and domestic competition.



Trade costs are still often inflated by **costly administrative border and customs procedures** (Moisé and Le Bris 2013).



Policy-related nontariff barriers that can be standardized include sanitary, phytosanitary, and other standards (often aimed at protecting consumer health and safety), pre-shipment inspections, licensing requirements, and quotas.



Trade costs can be lowered significantly by **streamlining trade and customs compliance procedures and processes** (Staboulis et al. 2020). In addition, end-to-end supply chain digitalization would allow EMDEs to shorten port delays (Arvis et al. 2023).



Finally, **regulatory restrictions on services trade** can add to trade costs. This reflects to a large extent regulations that create market entry barriers—especially with respect to the entry of foreign firms in EMDEs (Ohnsorge and Quaglietti 2023).

3. THE WAY AHEAD: CONSTRUCTIVE INCREMENTALISM.AND ROLE OF REGIONAL AGREEMENTS



SHARED INTERESTS AND AGENTS FOR CONSTRUCTIVE INCREMENTALISM: OUTSIDE OF G2

1. Managing and **navigating the economic-security-technology nexus** from G2 bifurcation: limiting to “valid” security concerns - garden remains small, high wall clearly defined, minimize distortions
2. Continue to **growth through trade and investment**: no massive deglobalization, reshaping of globalization - increase in trade in services, role of digital technology, sustainable supply chain
3. **Manage greater fragmentation – resilient supply chains** and effect on firm decisions,
4. **Relevance of various platforms in various emerging issues** that do not have a clear institutional home. How not become unilateral, fragmented and developing countries left out.
5. **Non G2 conduits**: role of middle powers, regional and other groupings

INDONESIA TURNS TO RESTRICTIVE MEASURES...

Local Contents Requirements

Indonesia turns to protectionist industrial policy as leverages to take advantage from the trend

The idea that Indonesia can increase investment in manufacturing by using natural resources and sizeable market as leverages

Export Ban of Critical Minerals (Downstreaming)

It is expected that business will come and invest in Indonesia instead of just selling their products or sourcing raw materials from abroad

Commodity Balance

But the risks of policy failures are high, just as the history already told us

ANOTHER OPTION FOR INDONESIA: STRENGTHENING COOPERATION AND ACCELERATING REFORM

Indonesia has another option by supporting cooperation with other countries

Developing regional supply chain on various new industries, e.g. EV

To develop regional supply chain, should become trustworthy

Indonesia needs to accelerate reforms on business environment

Provide incentives rather than restrictions

