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JAPAN SHOULD TURN ITS ATTENTION TO HIGHER ADDED-VALUE INVESTMENT IN INDONESIA

Yuri Sato

Indonesia's trade protectionism has come under criticism. Import restrictions on finished industrial goods were introduced in 2010 to control illegal imports. In 2012, imports of horticultural crops such as fruits and vegetables were restricted to registered importers at designated ports (which exclude the country's largest port at Jakarta). Anti-dumping tariffs went into effect in March 2013 on cold rolled coils/sheets made in Japan, China, South Korea, Taiwan and Vietnam. With respect to exports, the Mineral and Coal Mining Law of 2009 will ban exports of unrefined nickel, copper and other ore from 2014.

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With the aim of requiring domestic refining, rules were put in place in 2012 that only companies with refining plans were permitted to export raw ore, and a 20% export tax was imposed. Exports of unprocessed rattan, used in the making of furniture, were also banned.

Indonesia's trading partners have strongly objected to these trade restrictions. The US has filed an action with the WTO against the restriction on horticultural imports. Japan, which relies on Indonesia for 54% of its nickel ore imports, has on numerous occasions in intergovernmental talks asked that the export restrictions and taxes on ore be lifted.

Economists both inside and outside Indonesia have also expressed concerns. They warn that inward-looking protectionism would exacerbate a slowing economy. In 2012 Indonesia posted a $1.6 billion trade deficit (using the CIF value of imports; the country had an $8.4 billion surplus using a balance of payments table with FOB values for both imports and exports) because of increased imports, especially of capital goods, even as conditions in international commodity markets weakened and exports declined. Given Indonesia's worsening balance of payments, its currency has been dropping and its economic growth rate has slowed to 6.2%from previous year's 6.5%. The prevailing view is that the government, facing the external unbalance, rushed into imposing short-term import restrictions. It is also pointed out that the Yudhoyono administration, whose term of office expires in 2014, is hurrying to generate tangible results from its push for domestic production.

A more long-term viewpoint is needed to understand Indonesia's policy. Indonesia's export structure has become considerably vulnerable throughout the 2000s, after it achieved a dramatic switch from petroleum exports to manufactured exports in the 1980s and 1990s. Manufactured products had accounted for 59% of total exports in 2000, but fell to 41% in 2010. By contrast, natural resource exports such as coal, minerals, and palm oil surged. This was due in part to Indonesia's laissez-faire attitude after being freed from the Soeharto regime's "top-down industrialization," and in part to the emergence of China, a ravenous consumer of resources and an exporter of a full range of low-priced products. Indonesia became a classic case of "the Dutch disease," reverting to the status of resource-exporting country as its industrialization receded in the face of a resource boom. The slowdown in the Chinese economy has clearly exposed this structural vulnerability.

World's fourth largest population of 240 million and abundant resources are a double-edged sword for Indonesia. Unless employment is created for this vast population and the Dutch disease symptomatic of the "Resource Curse" is overcome, the country will fall into poverty and unemployment. Over the next two decades, Indonesia can enjoy a demographic bonus with the percentage of its productive-age population reaching a peak, giving Indonesia a chance to become a major economic power. The period is also a crucial phase, given that Indonesia should revitalize its industry, expand its exports of industrial products, process resources to create added value and jobs, and make its industrial structure more robust before the demographic bonus is over. Policymakers in Indonesia well recognize the seriousness of this challenge. Even a change of government is unlikely to diminish the sentiment that a certain degree of policy intervention is needed to realize these objectives.

Japan must take a long-term perspective on where markets will arise. Production should be located near markets. Japan has long imported unprocessed resources from Indonesia and exported industrial goods, but this asymmetric bilateral trade structure must inevitably change. Underlying the import restrictions imposed on steel sheets for automotive applications, for instance, is Indonesia's will to produce them domestically. The key solution will be direct investment. Japan should turn its attention to investment for higher added-value production in Indonesia. Indonesia needs to make active use of foreign investment to revive its industry, create added-value in resources and foodstuffs, and strengthen its export structure. The February 2013 easing of restrictions on foreign capital participation was a move in the right direction. The world is eagerly watching to see if Indonesia will adopt a wise policy balance.

Yuri Sato is Director-General, Area Studies Center, Institute of Developing Economies, Japan External Trade Organization (IDE-JETRO). Her research focus is economy, industry and business in Indonesia.