

Research Focus

Post-crisis export performance: The Indonesian experience in regional perspective

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The pre-financial crisis economic boom in Indonesia (late 1980s – 1996) was underpinned by rapid export growth, accompanied by a dramatic shift in the commodity composition of exports away from crude oil towards non-oil primary products and manufacturing. Export success was instrumental in maintaining international creditworthiness and macroeconomic stability following the end of the oil boom in the mid-1980s. Expansion of manufacturing exports played a key role in rapid employment growth; between 1985 and 1995 real manufacturing output tripled and total manufacturing employment (direct + indirect) recorded a ten-fold increase, from 1.1 million to over 10 million.

At the end of the oil boom in the early 1980s, petroleum and petroleum products accounted for almost three-quarters of Indonesia's total merchandise exports. The collapse of oil prices caused a massive decline in total export earnings. In the trough of 1986, total exports amounted to US\$15 billion (18 per cent of GDP, compared with a peak level of US\$22 billion (31 per cent of GDP) in 1982.

Indonesia's economy regained export dynamism from about 1987 by shifting to non-oil exports of both primary products and manufactures. During 1987–96, total export earnings grew by 13 per cent annually, with all years except 1993 and 1994 (when the growth rates were slightly below 10 per cent) recording double-digit growth. The onset of the financial crisis in mid-1997 interrupted this impressive export performance.

During the period (1988–96), export earnings growth across all major non-oil commodity categories was more closely associated with growth of export volume than with changes in unit values. By contrast, during 2000–05, growth in the export earnings of virtually all products came predominantly from favourable world prices, which more than compensated for sluggish volume expansion. This suggests that the relatively slow export growth during

the post-crisis era was predominantly supply, rather than demand, driven. This inference is further supported by the following discussion.

Has Indonesia's relatively poor performance come from its failure to diversify into product lines that have shown greater dynamism in world trade, or from its inability to maintain market share in traditional products, or both? What are the products and product categories in which Indonesia's performance has lagged behind that of its ASEAN neighbours?

Oil exports have recorded a significant contraction, notwithstanding Indonesia's considerable petroleum and gas resources and recent increases in world oil prices. Since 2000, Indonesia's oil and gas exports have clearly lagged behind those of Malaysia.

Despite rapid growth of manufacturing exports from the late 1980s, non-oil primary products – both agricultural products and minerals – still account for a larger share of non-oil exports from Indonesia (31 per cent) compared with Thailand (21 per cent), Malaysia (13 per cent) and the Philippines (9 per cent). Processed food has emerged a dynamic line in the export structures of Indonesia, but Indonesia's world market share of (0.91 per cent) is only one-third of that of neighbouring Thailand (2.93 per cent). This difference goes beyond contrasts in their respective agricultural resource endowments.

Within manufacturing, miscellaneous manufacturing (predominantly wearing apparel and footwear) and resource-based manufacturing (mostly mineral products) continued to account for over two-thirds of Indonesia's manufacturing exports. By contrast, in Thailand, Malaysia and the Philippines, exports of machinery and transport equipment have expanded rapidly, dwarfing these 'traditional' export products. Exports from these three countries of *parts and components* associated with production *fragmentation within vertically integrated global production systems*

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The Treasurer, the Hon Peter Costello will launch the East Asian Forum and the East Asian Bureau of Economic Research (EABER) at the ANU on 17 October and deliver a major address on Australia's East Asian economics interests.

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24 October, Quentin Grafton, Sydney water: Pricing for sustainability

(recorded under the machinery and transport equipment category) have also expanded rapidly.

However, Indonesia has not so far been able to catch up with its regional neighbours in benefiting from rapidly unfolding market opportunities arising from this new mode of international specialisation. For instance, in 2003/04 parts and components accounted for a mere 9.1 per cent of exports from Indonesia, compared with 59.6 per cent in the Philippines, 45.2 per cent in Singapore, 36.3 per cent in Malaysia, and 20.5 per cent in Thailand.

It is interesting to compare the export specialisation patterns of Thailand and Indonesia given close similarities between the two countries in terms of both resource endowment and the stage of economic development. The revealed comparative advantage (RCA) index is derived from the ratio of a country's exports of a good to the world exports of that good divided by the ratio of the country's total exports in total world exports.

In Indonesia, primary products (food, beverages and tobacco, agricultural raw materials and minerals) have continued to occupy a relatively important position among products with revealed comparative advantage. By contrast, in Thailand the number of RCA products in the primary products category increased between 1990–95 and 2000–05 (from 10 out of 20 to 11 out of 25), as did their share in total exports (from 31 per cent to 22 per cent). Thailand's RCA products are heavily concentrated in food and beverages, reflecting the country's well-known success in the world processed food trade. By contrast, Indonesia's RCA in primary exports is predominantly in agricultural raw materials and minerals.

Within manufacturing, Indonesia's comparative advantage continues to be confined largely to traditional labour-intensive manufactures – textiles, furniture, various categories of clothing, footwear and a few domestic resource-based products – fertiliser, rubber goods, cork and wood manufactures (predominantly plywood), paper and paper products, and non-metallic mineral products. By contrast, Thailand's RCA in manufacturing has become increasingly broad-based, with the number of products belonging to

the machinery and transport equipment category accounting for an increasing share of total exports. This is evident from the trade overlap with China and changes in market share in the three key markets: the United States, the EU, and Japan.

Competition from China is having considerable impact on the trading environment faced by Indonesia and other developing countries in the region. However, competition from China does not necessarily imply a proportionate loss in market share for all developing countries. Rather, the emergence of China as an economic powerhouse offers lucrative new market opportunities for the other countries in the region. However, Indonesia has not been able to profit from the new market opportunities in China to the same extent as its neighbours. Among the ASEAN-5 countries, Indonesia is unique for the persistent decline in the share of manufacturing in its exports to China (from 88.0 per cent in 1989/90 to 53.7 per cent in 2003/04). This decline seems to reflect its poor performance in machinery and transport equipment exports, and in particular in the parts and components sub-category.

The experience in world trade in clothing and textiles in the first year (2005) following the abolition of the Multi-Fibre Agreement (MFA) contradicts the widely held prediction that Indonesia and other ASEAN countries would suffer significant contraction in textile and clothing exports under the new competitive market conditions. These findings are also consistent with the view that Indonesia's recent poor export performance is largely *supply driven*.

In sum, Indonesia's export performance in the post-crisis era has lagged behind not only its own performance record during the pre-crisis economic boom, but also the contemporary export performance of its ASEAN-5 neighbours (except the Philippines). Poor export performance has been reinforced by a failure to maintain growth dynamism in existing product lines or to benefit from emerging new opportunities for international production. This includes the rapid expansion in imports by China that has opened up new market opportunities for countries like

Indonesia. Finally, there is no evidence of catastrophic loss of market opportunities in textiles and clothing for Indonesia under the new competitive market conditions following the abolition of the MFA.

What are then the supply-side problems constraining export growth? What should be the reform priorities for addressing these problems? To answer these questions, it is essential to revisit the policy context and the business environment that underpinned the impressive export performance of the pre-crisis economic boom of 1987–96.

During the 1987–96 period, sound and credible macroeconomic management in Indonesia played a pivotal role in ensuring international competitiveness in domestic tradeable production. But, the rapid expansion of non-oil exports during the ensuing decade did not result from sound macroeconomic policy alone; microeconomic reforms were an integral part of the story. In the post-crisis period, good progress was achieved in restoring order to the macroeconomic house shattered by the 1997/98 financial crisis, but little progress has been made in microeconomic reform.

Confusion and uncertainty generated by ongoing political and institutional changes, and the government's failure to produce a definitive agenda of economic reform, has created a state of uncertainty in the business environment. Perhaps the most important manifestation of this is Indonesia's dismal record in attracting FDI, particularly into export-oriented industries. Net annual FDI inflow in Indonesia has been persistently negative since 1998.

Thus, there is a strong case for reversal of recent backsliding in microeconomic policy reform, and for speedy implementation of Indonesia's unfinished reform agenda. Prudent macroeconomic management, while necessary, is not sufficient to achieve rapid and sustained export growth in an era of rapid economic globalisation.

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This article is a summary of a recent seminar presentation at the Crawford School of Economics and Government. A longer version appeared in the *Bulletin of Indonesian Economic Studies* August 2006.

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