3. STRUCTURAL POLICY COUNTRY NOTES: MEDIUM-TERM POLICY CHALLENGES

INDONESIA

Medium-term economic outlook (forecast)

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth (2012-16 average, percentage change)</td>
<td>6.6</td>
</tr>
<tr>
<td>Current account balance (2012-16 average, % of GDP)</td>
<td>-1.0</td>
</tr>
<tr>
<td>Fiscal balance (2012-16 average, % of GDP)</td>
<td>-1.1</td>
</tr>
</tbody>
</table>

Medium-term plan

<table>
<thead>
<tr>
<th>Period</th>
<th>2010-14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Theme</td>
<td>Prosperous, democratic and just</td>
</tr>
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Basic data (in 2010)

<table>
<thead>
<tr>
<th>Category</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total population</td>
<td>238 million</td>
</tr>
<tr>
<td>Population of Jakarta</td>
<td>9.6 million</td>
</tr>
<tr>
<td>GDP per capita at PPP</td>
<td>4 394 (current USD)</td>
</tr>
</tbody>
</table>

Sources: OECD Development Centre, MPF-SAE 2011/12, national sources and IMF.

Notes: Six ASEAN countries includes Indonesia, Malaysia, the Philippines, Singapore, Thailand and Viet Nam. Emerging Asia includes six countries of ASEAN plus China and India.

GDP growth rates (percentage changes)

<table>
<thead>
<tr>
<th>Country</th>
<th>2003-07 (average)</th>
<th>2012-16 (average)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>6.6</td>
<td>7.8</td>
</tr>
<tr>
<td>Average of six ASEAN countries</td>
<td>4.3</td>
<td>5.1</td>
</tr>
<tr>
<td>Average of Emerging Asia</td>
<td>1.4</td>
<td>3.6</td>
</tr>
</tbody>
</table>

Source: OECD Development Centre, MPF-SAE 2011/12.

GDP per capita (PPP, current USD)

<table>
<thead>
<tr>
<th>Country</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>10 000</td>
</tr>
<tr>
<td>ASEAN 10 Average</td>
<td>20 000</td>
</tr>
<tr>
<td>Emerging Asia Average</td>
<td>30 000</td>
</tr>
<tr>
<td>OECD Average</td>
<td>30 000</td>
</tr>
</tbody>
</table>

Sources: IMF and national sources.

Composition of exports (in 2010) (percentage of total exports)

- Mineral Products: 35%
- Others: 29%
- Textiles: 7%
- Plastics/Rubber: 7%
- Machinery/Electrical: 10%
- Vegetable products: 12%

Source: Trademap.

Composition of imports (in 2010) (percentage of total imports)

- Others: 24%
- Machinery/Electrical: 26%
- Chemicals & Allied Industries: 9%
- Transportation: 10%
- Metals: 19%
- Mineral Products: 21%

Source: TradeMap.

Towards a prosperous, democratic and just economy – Indonesia’s medium-term development plans and master plans

The 2010-14 national medium-term development plan (RPJMN 2010-14) is the second phase of the implementation of the 2005-25 national long-term development plan (RPJPN 2005-25).

In the next five years (2010-14), Indonesia will face a number of challenges on its way to realising a society that is “prosperous, democratic and just”. Economic growth will not only be inclusive but will also reduce inter-regional gaps, be evenly spread within the development sectors and will not damage the natural environment. In addition, economic growth is to include infrastructure development, increased productivity, strengthening of public sector capacity and further consolidation of democracy (Table 3.1.1).
Enhancing regional connectivity and human resources are priorities

The Master Plan for the Acceleration and Expansion of Indonesia’s Economic Development (MP3EI) 2011-2025 was launched in May 2011 and is complementary to the medium-term plan. The implementation strategy of MP3EI will integrate three key elements (and eight main programmes): developing the economic potential of six regional economic corridors; strengthening national connectivity locally and internationally; and strengthening human capital and national science and technology capacities. The economic corridors targeted for expanded development in the Master Plan are Sumatra, Kalimantan, Java, Sulawesi, Bali and Nusa Tenggara, and Papua-Maluku.

Table 3.1.1. Summary of the 2010-14 Development Plan: key development targets

<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td><strong>Economics</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP growth rate (%)</td>
<td>6.0, per year (2005-08, average)</td>
<td>6.3-6.8, per year (2010-14, average)</td>
</tr>
<tr>
<td>Inflation rate (%)</td>
<td>9.0, per year (2005-09, average)</td>
<td>4-6, per year (2010-14, average)</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>8.4 (7.4 in 2010)</td>
<td>5-6</td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net enrolment rate in junior high school education (%)</td>
<td>72.28</td>
<td>76</td>
</tr>
<tr>
<td>Gross enrolment rate in senior high school education(%)</td>
<td>64.28</td>
<td>85.0</td>
</tr>
<tr>
<td>Gross enrolment rate at universities of those in the 19-23 year age bracket (%)</td>
<td>21.26</td>
<td>30.0</td>
</tr>
<tr>
<td><strong>Health</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Life expectancy (years)</td>
<td>70.7</td>
<td>72.0</td>
</tr>
<tr>
<td>Maternal mortality rate per 100 000 live births</td>
<td>228</td>
<td>118</td>
</tr>
<tr>
<td><strong>Infrastructure</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Highway construction (km)</td>
<td>-</td>
<td>19 370</td>
</tr>
<tr>
<td>Electrification ratio (%)</td>
<td>66</td>
<td>80</td>
</tr>
<tr>
<td><strong>Poverty</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poverty rate (%)</td>
<td>15.4 (13.3 in 2010)</td>
<td>8-10</td>
</tr>
</tbody>
</table>

Source: OECD Development Centre's compilation based on national sources.
Structural policy focus

**Indonesia’s medium-term policy challenges and responses**

- Speed up transport infrastructure development by improving the regulatory environment
- Improve the outcome of higher education and reduce urban-rural disparities in access to educational infrastructure
- Reform labour market regulation to increase employment

**POLICY FOCUS**

*Speed up transport infrastructure development by improving the regulatory environment*

The current state of transport infrastructure in Indonesia is a substantial bottleneck to the economic development of the country. Transport infrastructure is both insufficient in quantity and inadequate in quality, which hampers both the internal economic integration and the international competitiveness of the country. In the last five years, several infrastructure projects have been implemented, including development of the Hasanuddin Makassar Airport, construction of the Suramadu Bridge, and the further development of 11 full container terminals for supporting export and import activities in the harbours. In addition, 11 dams have been constructed.

Additional government-led infrastructure investment will be needed. In May 2011, the Indonesian government launched 17 new infrastructure projects, worth IDR 190 trillion (Indonesian rupiah) (USD 22.3 billion), as part of the 2011-25 Master Plan for the Acceleration and Expansion of Indonesian Economic Development. The projects, mostly industrial construction projects, were launched at numerous locations: Sei Mangke in the province of North Sumatra, Cilegon in Banten, Lombok Timur, East Nusa Tenggara and Timika, Papua.

Though total investment needs for infrastructure development may exceed assigned government funds, there is room to mobilise national savings for infrastructure development further. Together with an effort to enhance sub-regional connectivity, the infrastructure development of Metropolitan Jakarta is also important. Indeed, the transport infrastructure system of Indonesia requires comprehensive actions. The following challenges should be addressed:

- The possibility of additional financing options for infrastructure development should be explored, in particular outside the central government for example, municipal bonds, revenue bounds and infrastructure funds. The general regulatory framework needs to be reformed to provide these “market-based” financing options.

- Private participation in infrastructure investment is limited. Public-private partnerships (PPP) could enhance the feasibility of infrastructure projects. However, further regulatory reform is needed in Indonesia to provide the institutional setting needed to foster PPP (Box 3.1.1).

- Land acquisition is an additional impediment to accelerating transport infrastructure development. Several infrastructure projects have been interrupted because of resistance from small landowners. Reforms of the land acquisition process are needed to speed up further infrastructure development. The new land acquisition bill needs to determine not only the compensation for landowners, but also to construct an effective framework for expeditious payments and appeals.

- Co-ordination with local governments needs to be improved. While local governments’ participation in provision of infrastructure services (except for some areas such as water and sanitation) is limited, there are several local regulations which can hamper the flow of goods and labour. Relevant local and national laws, regulations affecting infrastructure investment and capacity of local government need to be further harmonised over time.
Box 3.1.1. Enhancing the use of public-private partnerships: examples from OECD countries

There are several elements for the success of PPP. Two important elements are appropriate risk-sharing between private and public parties to a PPP contract and supporting regulatory and institutional frameworks. There are three key issues to be addressed for enhancing the regulatory framework of PPP based on OECD experiences:

- **The public sector comparator**
  In order to carry out an ex-ante comparison of the potential benefits of PPP, many OECD countries have used the public sector comparator (PSC). The PSC involves an estimate of the benefits from a hypothetical PPP (reference PPP) and is used by governments to decide whether a traditional procurement process or a public-private partnership is the better option to provide a service. However, there are different methods governments use to assess value for money. Countries such as **Germany** use a complete cost-benefit analysis. Other OECD countries such as **Japan** and the **Netherlands** use the public sector comparator prior to the bidding process. In this case, the project can only proceed to the bidding phase if the reference PPP demonstrates that a PPP can bring about better value for money than traditional procurement. The third most complex assessment method involves the use of the PSC after the bidding process. This method, which is applied in **Australia**, compares the PSC to the actual PPP bids. The competitive bidding process, the fourth method, is mainly used in **France** and the **United States**.

- **PPP units**
  In addition to the PSC, PPP units have also contributed to the success of PPP in OECD countries. The PPP Knowledge Centre in the **Netherlands**, which was created within the Ministry of Finance in 1999, the Partnerships Victoria, a PPP unit in **Australia**, and the PPP units in the **United Kingdom** are successful examples. Efficient PPP units have gone hand in hand with the creation of effective institutional capacity to create, manage and evaluate PPP. PPP units have several advantages: the PPP unit guarantees an adequate spending of budgets; avoids "free riding" by government departments; provides a knowledge centre; regulates the creation of PPPs; and permits a separation between PPP practice and policy.

- **Political support and engagement of all stakeholders**
  Due to the long-term nature of PPP contracts, political support and consensus building are fundamental to make sure a PPP is successful, particularly when key public services (such as transport or access to water) are provided.

**Source:** OECD (2008a).

### POLICY FOCUS

**Improve the outcome of higher education and reduce urban-rural disparities in access to educational infrastructure**

Tertiary education in Indonesia needs to be enhanced as both access to and the quality of university education is insufficient. Although the gross enrolment rate at the tertiary level has been increasing, it was still only 24% in 2009 while the government's target for 2014 as set out by the medium-term development plan is 30%. Public spending on university education ought to be increased as well. Public expenditure per student at the tertiary level as a percentage of gross domestic product (GDP) per capita decreased from 18.7% to 16.2% between 2007 and 2008. This is noticeably below the comparable rates for Thailand and Malaysia, which were 22% and 33.9%, respectively. Expenditure in tertiary education as a percentage of total educational expenditure in Indonesia was 11% in 2008, with expenditures on primary and secondary education accounting for 51% and 36% of total educational expenditures, respectively. There is room to reallocate resources to tertiary education within education sector.

The quality of tertiary education in Indonesia is lagging behind. Although the medium-term development plan sets a goal of having at least 11 Indonesian universities in the Top 500 Times Higher Education Ranking (THE) by 2014, Indonesian universities find it hard to get international recognition. Meanwhile, Indonesia was ranked 66th out of 139 countries in global competitiveness in higher education and training according to the **Global Competitiveness Report 2010-2011** (WEF, 2010). As a result, university graduates often lack
the necessary skills employers need. Higher education also fails to provide the necessary research needed to support innovation. There are gaps in thinking, technical, and behavioural skills for tertiary graduates as perceived by employers and a significant proportion of professionals (i.e. about 20-25%) need retraining (World Bank, 2011). Moreover, as their research output indicates, Indonesian universities do not provide sufficient support for innovation. In 2009, only 31 patent applications of Indonesian origin were registered at the World Intellectual Property Organization (WIPO); while in 2007 the number of scientific and technical journal articles published by Indonesian authors (198) was the second lowest among the ASEAN-6 countries.

Although access to basic education has been steadily improving (highlighted by the increasing enrolment rates), several important challenges remain in Indonesia. Disparities in school infrastructure aggravate rural-urban disparities. The sub-optimal performance of higher education is an important factor behind the inadequate supply of skilled workers and the overall supply-demand gap in the labour market. The effects of the urban-rural disparity in education infrastructure can be observed in both enrolment and literacy rates. For instance, while the school enrolment rate of children 7-12 years old in Jakarta was 99% in 2010, the comparable rate in Papua was only 76%. The same disparities can be observed for literacy: the rate of illiteracy among the population of 15-year-olds or over varies between 0.7 and 31.7% across the country.

Higher education, in particular at the university level, needs to be upgraded (Figure 3.1.1). The current outcomes of higher education highlight the need for a more skilled workforce and the mismatch between the graduates’ skills and industry’s needs. Although the overall demand for skilled workers is increasing, Indonesia’s share of workers with higher education degrees still lags behind other countries. For instance, in 2008, more than one-third of civil servants (37%) had only a general high school education. Educational programmes need to be raised to international standards and the quality of teachers needs to be enhanced if these limitations are to be remedied.

The quality of education needs to be addressed as well. For instance, Indonesia fares poorly on the OECD’s International Student Assessment (PISA), ranking 57th in 2009 among the 65 participating countries in reading, 61st in mathematics and 60th in science (Figure 3.1.2).

![Figure 3.1.1. Enrolment rates by level of education from 1995-2010 (percentage)](image1)

![Figure 3.1.2. OECD PISA results in 2009 (score)](image2)

*Note: The PISA scale was set such that approximately two-thirds of students across OECD countries score between 400 and 600 points. Gaps of 72, 62 and 75 points in reading, mathematics, and science scores, respectively, are equivalent to one proficiency level.*

*Sources: national sources and OECD.*

Another serious problem is the inefficiency in labour markets created by the mismatch between the skills acquired at school and the needs of businesses. The unemployment rate among workers with higher education has been increasing for years. Given that the demand for skilled workers is likely to remain high, efforts to expand formal education, especially at the higher education level, need to be strengthened through additional public investment. Job market mismatches can be narrowed by fostering a deeper partnership between academia and industry and also by facilitating mobility of job-seekers through better access to information on job opportunities.
There is also room to increase public spending on education aimed at reducing urban-rural disparities, with a special focus on rural school infrastructure development. It is also essential to step up the involvement of regional governments in infrastructure development planning, management and maintenance.

**POLICY FOCUS**

Reform labour market regulation to increase employment

The Indonesian labour market is characterised by the large portion of the workforce that is employed in the informal sector. In fact, almost two-thirds (*i.e.* 61%) of the active labour force belonged to the informal sector in 2007 (World Bank, 2010). However, as a survey of two provinces (Yogyakarta and Banten) by the Asian Development Bank and BPS-Statistics Indonesia (2011) shows, both the contribution of the informal sector to Indonesia’s total gross value added (GVA) and its labour productivity are quite low (Figures 3.1.3 and 3.1.4).

**Figure 3.1.3. Nature of employment**
(percentage of total employment)

![Diagram showing nature of employment in Yogyakarta and Banten]

**Source:** ADB (2011) and BPS-statistics, Indonesia.

**Figure 3.1.4. Contributions to GDP of formal and informal sectors**
(percentage of total gross value added)

![Diagram showing contributions to GDP in Yogyakarta and Banten]

**Source:** ADB (2011) and BPS-statistics, Indonesia.
The large informal sector distorts the labour market in Indonesia. There have not been enough opportunities for poor workers to move up to better jobs in the formal non-agricultural sectors. Better integration of the informal sectors with the formal economy is necessary for the creation of a more active labour market.

Appropriate reform of labour regulations will also enhance the movement of workers from the informal sector to the formal economy. Reducing the rigidity of labour regulations is also necessary to increase employment. Rigid labour regulations have inhibited job creation while failing to provide protection for the most vulnerable workers. Though Indonesia’s Manpower Law in 2003 was intended to improve workers’ protection, it actually increased the rigidity of the labour market by tightening regulations on hiring and firing without improving the situation of the most vulnerable workers. The law, which increased severance rates for workers with three or more years of employment, resulted in one of the highest firing costs in the region (Figure 3.1.5). In addition, the regulation concerning fixed-term contracts has also been tightened: contracts under the revised regulation cannot be renewed after three years and jobs eligible for temporary contracts have been restricted. These policies not only hamper job creation (as the high cost of downsizing in economic downturns deters new investments); they also fail to protect employees and have a disproportionately large effect on the most vulnerable workers.

The government has recognised the need to reform the current employment regulations, in particular those relating to hiring and firing. Introduction of “appropriate” unemployment benefits would be an option to help improve labour market flexibility. Active labour market programmes (ALMPs) also need to be strengthened in the context of regulatory reform in the labour market.

Both the use and level of minimum wages need to be reconsidered. Indonesia seems to use minimum wage policy for “wage-setting” rather than as a safety net for low-wage workers. The level of minimum wages is relatively high, compared with the average wage (Figure 3.1.6). While the objective of minimum wages is to support the safety net, their level needs to be adequately determined and monitored, not least to ensure compliance and enforcement of minimum wage regulation.

**Figure 3.1.5. Severance payment for redundancy dismissal**
(average for workers with one, five and ten years of tenure, in salary weeks)

**Figure 3.1.6. Minimum and average wage in Indonesia**
(average monthly in IDR)


*Source: OECD Development Centre’s calculation based on CEIC.*
Notes

2. Total estimated investment needs of Indonesia for the period of 2010-20 are USD 450 billion.
3. According to the Times Higher Education Ranking 2011/12, there is no Indonesian university among the top 400 universities in the world. Among the top 700 universities considered by the QS World University Rankings 2011/12, there are 3 universities from Indonesia (University of Indonesia, 217th; Universitas Gadjah Mada, 342nd; Bandung Institute of Technology in the 451-500 range).
4. On the same ranking, Singapore was ranked 5th, Malaysia 49th, Thailand 59th, and the Philippines 73rd.
5. Among the six countries of ASEAN, only the number of patent applications of Vietnamese origin was less (six) than the number of patents of Indonesian origin registered at WIPO.
6. The OECD Programme for International Student Assessment (PISA) covers students who are aged between 15 years 3 months and 16 years 2 months at the time of assessment and who have completed at least six years of formal schooling. In the PISA survey, reading, mathematics and science tasks are ranked by difficulty and are associated with each of the seven proficiency levels from 1b (easiest) to 6 (hardest). A student reaches a given proficiency level if the test results show that he or she has at least a 50% chance of performing a task at that level.
7. The percentage of unemployed with university degree increased from 3.4% in 2004 to 8.5% in August 2010.
8. Data show that the informal sector has been shrinking since 2009.
9. In 2009, 89% of total employment was informal in Yogyakarta while in Banten the equivalent figure was 76%.
10. In Yogyakarta, the estimated contribution of the informal sector to its total gross value added (GVA) in 2009 was 37%. In Banten, approximately 27% of its GVA can be attributed to the informal sector.
11. While labour productivity in Yogyakarta’s informal sector is approximately IDR 7.0 million per job, with productivity of IDR 76.55 million per job in the formal sector, Banten’s labour productivity in the informal sector is estimated at IDR 12.7 million per job, about six times less than the IDR 85.12 million contribution of an average job in the formal sector in 2009.