Dionisius A. Narjoko and Teguh Y. Wicaksono

ASEAN: perspectives on economic integration: achieving the ASEAN Economic Community agenda: an Indonesian perspective

Report

Achieving the ASEAN Economic Community Agenda: an Indonesian Perspective

By Dr. Dionisius A. Narjoko Economic Research Institute for ASEAN and East Asia
& Dr. Teguh Y. Wicaksono Centre for Strategic and International Studies, Indonesia

INTRODUCTION

Regional integration is a major agenda that ASEAN currently pursues for its ten members. It is the ASEAN Vision 2020 that envisages an integrated Southeast Asian region with equitable economic development and reduced socio-economic disparities. In respect to economic integration, the Hanoi Action Plan in 1998 stated the Vision more clearly by declaring an intention to create a prosperous and highly competitive ASEAN region in which there is free flow of goods, services, and capital. This was further expanded in the 2003 Declaration of ASEAN Concord II, by establishment of the ASEAN Economic Community into "a single market and production base, turning the diversity that characterises the region into opportunities for business complementation making the ASEAN a more dynamic and stronger segment of the global supply chain". The original target for the AEC was 2020, but it has been revised to 2015.

The literature suggests a number of important factors for the process towards an integrated ASEAN economy. According to Soesastro (2005), one of these is the state of development of the ASEAN member countries, which applies not only for the dichotomy between the ASEAN-6 and CLMV (i.e., the newer ASEAN member countries), but also within the ASEAN-6 members. This paper addresses this subject from the perspective of Indonesia. Here, we put a proposition that the AEC agenda, furthering economic integration in the Southeast Asia region – as well as in the wider regional perspective of East Asia – is important not only for the region, but also for any ASEAN member country.

This paper tests this proposition by discussing two economic-development topics that are pertinent to Indonesia, namely industrialisation and income inequality. It also attempts to derive some stylised facts which enable one to – at least – determine the likely answer for the test of the proposition. In doing so, we elaborate on the extent of the gap of development in respect of the two topics mentioned earlier.[1] Thus, the next two sections discuss the challenge faced by Indonesia in terms of industrialisation and income inequality, respectively.

1 This forms the major part of this paper

CHALLENGES FACED BY INDUSTRIALISATION IN INDONESIA

Indonesia has enjoyed rapid industrialisation in the past two decades or so. As noted in Table 1, this is reflected by the rapid increase in the share of the country's manufacturing sector over the period 1985-2004. In the early phases of industrialisation, much of the rapid growth came from the labor-intensive and resource-intensive sectors, such as textiles-garments and wood sector. Over time, however, the importance of this sector declined, and the technology- and capital-intensive sectors started to contribute more to overall manufacturing growth. All these are illustrated in Table 2 where, on the one hand, the share of the wood sector had declined in the past two decades but, on the other hand, the share of heavy processing and metal goods industry increased.

Table 1. Output share of Indonesia and the other ASEAN countries (in%) 1985 - 2004

Country	Sector	1985	1990	1995	2000	2004
Indonesia	Agriculture	23.2	19.4	17.1	15.6	14.6
	Manufacturing	35.8	39.1	41.8	45.9	44.0
	Services	40.9	41.5	41.1	38.5	41.4
Brunei Darussalam	Agriculture	2.2	2.4	2.5	2.7	3.6
	Manufacturing	52.3	54.8	43.9	47.8	49.2
	Services	45.5	42.8	53.5	49.5	47.2
Malaysia	Agriculture	20.0	15.0	12.7	8.4	9.1
	Manufacturing	38.5	41.5	40.5	48.4	48.5
	Services	42.7	43.5	46.8	43.1	42.4
Philippines	Agriculture	24.6	21.9	21.6	15.8	15.2
	Manufacturing	35.1	34.5	32.1	32.3	31.9
	Services	40.4	43.6	46.3	52.0	52.9
Singapore	Agriculture	1.0	0.4	0.2	0.1	0.1
	Manufacturing	34.5	32.5	32.9	33.5	32.4
	Services	68.8	67.2	66.9	66.4	67.5
Thailand	Agriculture	15.8	12.5	9.5	9.0	10.1
	Manufacturing	31.8	37.2	40.8	42.0	43.5
	Services	52.3	50.3	49.8	49.0	46.4
Cambodia	Agriculture	44.7	55.6	49.6	37.9	32.9
	Manufacturing	20.3	11.2	14.8	23.0	29.2
	Services	35.0	33.2	35.5	39.1	37.9
Lao PDR	Agriculture	53.9	61.2	55.2	52.6	47.0
	Manufacturing	17.7	14.5	19.1	22.9	27.3
	Services	28.4	24.3	25.7	24.6	25.7
Myanmar	Agriculture	48.2	57.3	60.0	57.2	50.6
	Manufacturing	13.1	10.5	9.9	9.7	14.3
	Services	38.7	32.2	30.1	33.1	35.1
Brunei Darussalam	Agriculture	40.2	38.7	27.2	24.5	21.8
	Manufacturing	27.4	22.7	28.8	36.7	40.2
	Services	32.5	38.6	44.4	38.7	38.0

Source: Compiled from ADB Statistics and CEIC Data base

Table 2. Output share of manufacturing sector by broad industry groups, Indonesia and the other ASEAN countries (in %), 1985-2004

Country	Industry	ISIC*	1990	1995	2000	2004
Indonesia	Food processing	31	27.5	22.3	20.1	na
	Footloose labour intensive	(32+39)	15.1	18.6	18.1	na
	Wood & paper products	(33+34)	15.6	13.0	13.3	na
	Heavy processing	(35+36)	18.1	16.7	20.0	na
	Metal goods	(37+38)	23.8	29.4	28.5	na
Thailand	Food processing	31	21.7	17.1	17.0	19.9
	Footloose labour intensive	(32+39)	27.9	19.6	17.9	16.4
	Wood & paper products	(33+34)	4.5	11.7	10.5	10.9
	Heavy processing	(35+36)	17.5	14.8	17.4	19.5
	Metal goods	(37+38)	28.4	36.9	37.1	33.3
Singapore	Food processing	31	3.7	3.1	2.5	3.1
	Footloose labour intensive	(32+39)	5.1	2.3	1.9	4.2
	Wood & paper products	(33+34)	6.2	6.5	4.9	4.2
	Heavy processing	(35+36)	23.1	19.1	22.6	22.5
	Metal goods	(37+38)	61.9	69.0	68.1	68.2
Malaysia	Food processing	31	13.4	11.3	6.3	8.1
	Footloose labour intensive	(32+39)	7.9	6.4	4.8	3.6
	Wood & paper products	(33+34)	10.2	10.1	7.4	5.5
	Heavy processing	(35+36)	25.3	25.6	26.2	29.8
	Metal goods	(37+38)	43.3	46.7	55.3	53.0
Philippines	Food processing	31	49.4	47.3	49.1	51.6
	Footloose labour intensive	(32+39)	11.7	11.7	10.0	9.1
	Wood & paper products	(33+34)	6.1	5.0	4.2	3.7
	Heavy processing	(35+36)	21.5	21.5	19.4	16.9
	Metal goods	(37+38)	11.3	14.5	17.2	18.7
Cambodia	Food processing	31	na	44.8	19.9	13.6
	Footloose labour intensive	(32+39)	na	30.8	67.3	77.4
	Wood & paper products	(33+34)	na	14.1	5.9	2.9
	Heavy processing	(35+36)	na	8.7	5.8	5.0
	Metal goods	(37+38)	na	1.6	1.1	1.1
Philippines	Food processing	31	na	35.9	33.5	25.8
	Footloose labour intensive	(32+39)	na	16.3	15.7	14.7
	Wood & paper products	(33+34)	na	11.3	9.0	10.7
	Heavy processing	(35+36)	na	19.2	18.9	18.9
	Metal goods	(37+38)	na	17.3	22.9	29.9

Note: n.a = not available * Based on ISIC Revision 2
Source: CEIC Database

According to Hill (1996), the pattern shown by Table 2 reflects both changes in industrial policy in Indonesia over the period and the natural stages of industrialisation. In the early export-promotion phase, countries tend to promote manufacturing products that they have some comparative advantage in,[2] but as these countries acquired more advanced technology, production activities move towards a higher level of product sophistication. Meanwhile, the rapid industrialisation in Indonesia was triggered by bold trade and industrial policy reforms put in place from the mid-1980s through to the first half of the 1990s.

The rapid industrialisation that occurred in Indonesia, however, does not seem so exceptional if one compares the Indonesian experience with the experience of other ASEAN countries. Examining Table 1 more carefully, there seems to have been some 'catching-up' of industrialisation in Vietnam, Cambodia, and Lao PDR. In addition to this, and perhaps more importantly, Indonesia seems to have lagged behind the other older ASEAN member countries, particularly Thailand and Malaysia, in developing technology intensive industries. The share of output of metal goods industries in the total manufacturing output is much lower for Indonesia, compared to Malaysia and Thailand. The gap is particularly large between Indonesia and Malaysia where the share of the industry in Malaysian manufacturing was almost twice that of Indonesian manufacturing.

2 See, for example, Ng and Yeats (2003), Kimura and Ando (2005a; 2005b), Ando (2006), and Athukorala and Yamashita (2006) for empirical studies highlighting the increasingly importance of IPNs in East Asia. All these studies employed international-trade data or firm-level data to derive some findings of the occurrence of IPN.

One possible reason for the lag experienced by Indonesian manufacturing is the inability of the country's manufacturing sector to adjust to the increased importance of international production networks in the East Asian region. It is a stylised fact that production of final-products of some technology and capital-intensive products has been facilitated by cross-border production networks.

Tables 3 and 4 provide some support for the reasoning. Table 3 produces a key point that the industrialisation in Indonesia still relies much on labour- and resource-intensive sectors, despite their declining importance within the country's manufacturing output, and this is compared to the general situation in the other ASEAN countries. The table, which reports the share of manufacturing exports by factor intensity in Indonesia and some other ASEAN countries, shows the share of unskilled labour intensive (ULI) group in Indonesia's export is still rather large compared to its share in the other ASEAN countries. Although this has been declining, the share of ULI group for Indonesian exports was only slightly below 50 per cent of the total Indonesian manufacturing exports in 2005. Meanwhile, the share for the other ASEAN countries was much less than 50 per cent, although it varies from country to country (i.e. about 20 per cent or below). The data also supports the proposition by showing the slow rate of the reduction in the share of ULI group. This is clearly illustrated when one compares the trend of the ULI share of Indonesia with the Philippines or Thailand. The share of exports in the ULI group in these countries declined substantially from about 50 per cent in 1990 to slightly above 20 per cent in 2005.

Table 3. Share of manufacturing exports of Indonesia and the other ASEAN countries (in%), 1990 - 2005

Product Group and Country	Description	1990	1995	2000	2005	
Indonesia						
ARI	Agriculture Resource Intensive		34.3	22.1	11.0	8.1
MRI	Mineral Resource Intensive		1.9	0.8	1.5	1.4
ULI	Unskilled Labour Intensive		49.7	54.1	50.8	47.5
HCI	Human Capital Intensive		9.1	14.1	20.5	22.4
TI	Technology Intensive		5.1	8.6	16.1	20.7
TOTAL			100	100	100	100
Malaysia						
ARI	Agriculture Resource Intensive		4.0	5.2	3.3	2.9
MRI	Mineral Resource Intensive		2.4	1.5	0.7	0.6
ULI	Unskilled Labour Intensive		25.6	21.0	19.8	18.2
HCI	Human Capital Intensive		20.6	19.8	20.6	22.2
TI	Technology Intensive		47.5	52.5	55.5	56.0
TOTAL			100	100	100	100
Philippines						
ARI	Agriculture Resource Intensive		6.5	2.4	0.8	0.6
MRI	Mineral Resource Intensive		1.6	0.6	0.3	0.4
ULI	Unskilled Labour Intensive		52.8	42.1	18.2	23.5
HCI	Human Capital Intensive		12.9	16.7	8.5	11.8
TI	Technology Intensive		26.2	38.2	72.2	63.7
TOTAL			100	100	100	100
Singapore						
ARI	Agriculture Resource Intensive		1.4	0.6	0.3	0.2
MRI	Mineral Resource Intensive		0.8	0.6	0.3	1.3
ULI	Unskilled Labour Intensive		24.6	16.6	13.8	11.4
HCI	Human Capital Intensive		26.7	25.3	16.4	19.0
TI	Technology Intensive		46.5	57.0	69.2	68.2
TOTAL			100	100	100	100
Thailand						
ARI	Agriculture Resource Intensive		3.3	2.4	2.1	1.4
MRI	Mineral Resource Intensive		7.9	4.6	3.0	3.0
ULI	Unskilled Labour Intensive		54.3	47.4	31.7	25.8
HCI	Human Capital Intensive		20.0	21.4	26.3	34.7
TI	Technology Intensive		14.4	24.2	36.9	35.2
TOTAL			100	100	100	100

Source: UN Comtrade data base

Table 4. Trade in parts and components of some ASEAN countries, 1992-2003

EXPORT

Country	Value of parts & components exports (US$ billion)			Share of parts and components exports in total manufacturing exports (%)			Growth of parts and components exports (%)	Growth of manufacturing exports (%)	Contribution of parts and components in growth of manufacturing exports (%)
	1992	1996	2003	1992	1996	2003	1992-2003	1992-2003	1992-2003
Indonesia	0.6	1.7	4.3	3.7	7.4	13.9	8.3	2.7	24.5
Malaysia	10.0	23.5	33.9	38.7	42.6	42.7	4.9	4.5	44.6
Philippines	0.8	8.8	20.7	19.8	52.5	63.8	13.7	8.6	70.0
Singapore	13.0	39.4	56.5	27.0	39.7	46.7	6.0	3.7	59.8
Thailand	4.1	9.5	15.8	19.1	23.4	26.7	5.4	4.1	31.0

IMPORT

Country	Value of parts & components exports (US$ billion)			Share of parts and components exports in total manufacturing exports (%)			Growth of parts and components exports (%)	Growth of manufacturing exports (%)	Contribution of parts and components in growth of manufacturing exports (%)
	1992	1996	2003	1992	1996	2003	1992-2003	1992-2003	1992-2003
Indonesia	3.6	6.7	3.1	18.5	23.8	18.5	-0.5	-0.5	18.5
Malaysia	11.0	27.1	36.5	35.2	47.5	55.7	4.9	3.0	74.4
Philippines	1.9	10.9	19.1	24.8	43.6	63.1	9.4	5.5	76.5
Singapore	16.0	50.3	49.6	30.0	42.8	49.2	4.6	2.6	70.8
Thailand	6.8	20.9	17.2	24.7	32.9	32.5	3.7	2.6	41.0

Source: UN Comtrade Database, taken from Athukorala and Yamashita (2005)

Another set of evidence is provided by Table 4, which shows a wide gap in the importance of parts and components trade between Indonesia and the other ASEAN countries. The table shows that the share of the parts and components trade is substantially lower for Indonesia compared to that of the other ASEAN countries. Here, the growth of imports, for example, was negative for Indonesia over the period 1992-2003, and a similar picture can also be drawn for the export side. These statistics indicate that compared to the other ASEAN countries Indonesia has not been developing its parts and components industry.

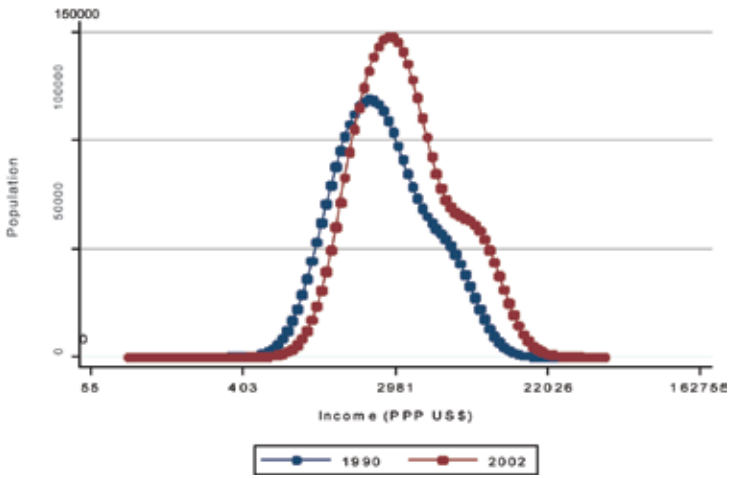
INCOME INEQUALITY IN INDONESIA

There is a consensus among economists that poverty reduction is strongly associated with economic growth. However, several studies on poverty in East Asia or Southeast Asia show rather mixed conclusions – although some key points remain regarding the link between significant poverty reduction and sustained economic growth (e.g. Warr 2006; Jomo 2006). One of the key issues in this subject is the trade-off between inequality and economic development. Rapid economic development, although it improves country-level development in general, does not always go hand-in-hand with improvement in income equality.

As for Indonesia, however, the trade-off between inequality and economic development does not seem to be a major one. This is illustrated in Figure 1, which compares the income distribution in Indonesia between 1994 and 2002. A striking feature of the figure is that income growth which occurred between 1994 and 2002 was not marked by significant inequality. Nonetheless by 2002, the income of the rich group grew faster than other income groups and it led to rather unequal income distribution in 2002. This may be caused by the impact of the 1998 economic crisis whose consequence ran into the 2000s. The message of this figure is straightforward: while the economy experienced stagnation in 2000-2002, only the rich

reaped the benefit of economic development. Cameron found that the 1998 economic crisis resulted in less inequality as urban people were hard hit by economic crisis and this narrowed the income gap between urban and rural. However, Cameron concluded that the evolution of income distribution in Indonesia has marked the success of equitable economic development. One reason is that industrial centres happened to be close to rural Java where many poorest families live (Cameron 2002) and industrialisation grew rapidly due to strong policy of openness.

Figure 1. Income Distribution, Indonesia, 1994 and 2002



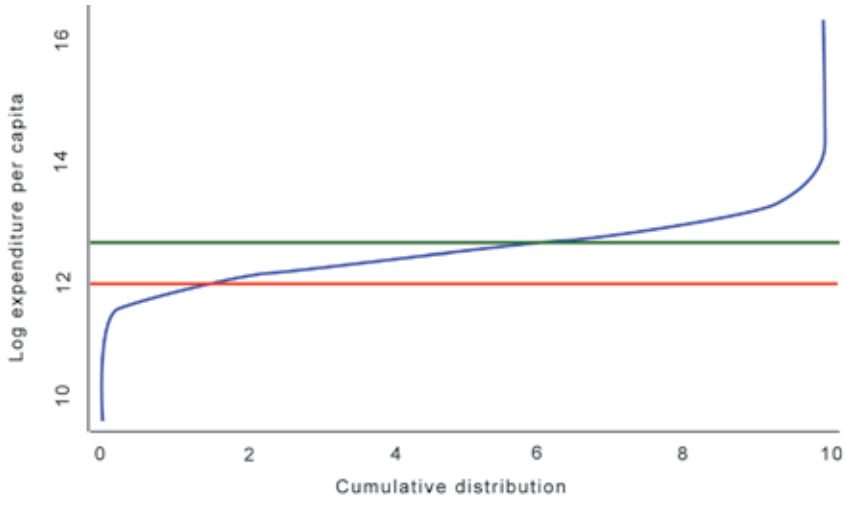
According to a recent estimate, the poverty rate in 2007 was 16.6 percent, down from around 17.5 percent in 1996.[3] In 2007 the level of absolute poverty, measured by those living below PPP $1 a day was 10.4 percent, or around 23.4 million.

However, when measured by those living under $2 a day, the number jumps significantly to 133.6 million or around 59.3 percent of the total population (Figure 2 is drawn from Susenas data in 2007, a period of robust economic growth after sluggish growth between 2000 and 2004). We witness that a doubling in the poverty line results in an almost five-fold increase in the proportion of poor people. These figures suggest that a large number of Indonesians are living at or near the poverty line and are highly susceptible to adverse economic shocks.

Most of the poor in Indonesia live in the rural area where one in every two households is poor. They are likely to be peasants, i.e., those who engage in low-paid agricultural sector jobs or small land holders. In addition, there are the urban poor whose number is smaller than the rural poor but, because of migration, is rapidly increasing. They are likely to be working in the informal sector or doing low-paid, menial jobs in the formal sector. An adverse economic shock is likely to affect different economic sectors differently. The 1997/98 economic crisis, for example, had a greater adverse impact on the manufacturing, construction and financial sectors than on the agricultural sector. As a result, poverty incidence tended to increase more in the urban area than in the rural area. Nevertheless, the crisis might also have caused reverse migration from the urban area to the rural area. PPP US$ 1/dayPPP US$ 2/day 59.3% below PPP US$ 2/day10.4% below PPP US$ 1/day.

3 Coordinating Ministry of Economic Affairs, "Evaluasi Ekonomi 2008 dan Prospek 2009", January 2009

Figure 2. Cumulative distribution of expenditure per capita, Indonesia



Source: Atje, Soesastro and Wicaksono 2009

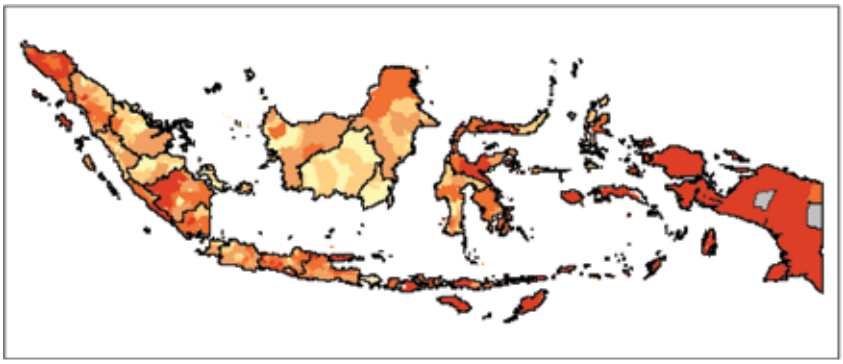
GEOGRAPHIC DISTRIBUTION OF THE POOR

Poverty in Indonesia has a very strong geographical characteristic. Some of the remote regions such Papua, Maluku, East Nusatenggara, Gorontalo and Aceh have higher poverty rates than the rest of the country. In these regions the poor households ranged between 20 and 41 percent of total households. The fact that these are remote regions suggests that their problem may be associated with the lack of access to markets, resources and various services.

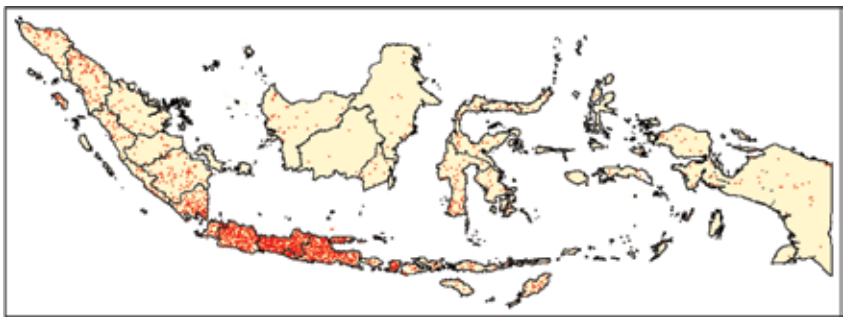
Yet, the concentration of poor people in Java and Madura, where most of the Indonesians live, is much higher. The majority of poor people live on these two islands. A closer look at the concentration of poor people in Java and Madura shows that some of the districts in these two islands have average numbers of poor people similar to those of the remote areas mentioned above. It should be noted that the geographical characteristic of poverty in Indonesia has not changed significantly over the decades. That is, while the number of poor people has dropped significantly, their geographical dispersion remains the same.

Map 1 illustrates that poverty rates are high in lagging areas, (i.e. Eastern part of Indonesia and Aceh) which are sparsely populated, particularly in Papua. However, from Map 2, one can clearly visualize that the poor are mainly concentrated in Java and Madura - two islands with high population density. These geographical and demographic differences, moreover, suggest that different poverty reduction strategies may be necessary to cope with the challenges. The overall policy should be to connect lagging areas in the Eastern part of Indonesia to the Western part of Indonesia. This can be achieved through improving hubs and transportation modes that allow people and goods to move freely between these regions.

Map 1. Poverty rate is high in Eastern Part of Indonesia and Acheh



Map 2. But the poor is concentrated in Java and Sumatera



Source: Atje, Soesastro and Wicaksono 2009 - 12

WHAT HAS BEEN INDONESIA'S RESPONSE SO FAR?

This brief description of two development topics highlights the point that Indonesia, despite its rapid economic development in the past two or three decades, still lags behind other neighbouring countries in its economic development. This creates a credible justification of having an integrated relationship of the Indonesian economy with the regional economy that surrounds it, and this can arguably be achieved by fulfilling the AEC agenda. In terms of industrialisation, it is clear that through meeting the AEC objective, Indonesia would likely benefit substantially by integrating its industrial sectors with the existing international production networks in the region.

Meanwhile, in terms of reducing poverty, the AEC agenda could help make income distribution more equally distributed in Indonesia. As for this, the reasoning is also clear that economic integration and openness policies should help the poor to more effectively utilise the fruits of economic development. This is because most of the poor were born into poverty from which they have difficulty escaping, and they remain poor because they are unable to participate in productive economic activities. There are a number of factors that may prevent them from engaging in such activities. First, they lack access to markets and basic infrastructure, such as roads, which is one reason why remote regions have a high percentage of poor households. Second, they lack

access to resources, including financial resources. This prevents them from starting their own business. Third, they lack necessary education to enable them to participate in relatively high paid jobs in the formal sector.

What has been the response of Indonesia, so far, in its attempt to reach the objective of AEC? While it is clear that more needs to be done, there are some credible signals of a seriousness of the Indonesian government to meet the AEC objective. This is illustrated, for example, by the inclusion of some AEC commitments in a formal government policy (i.e., one of the most recent presidential instructions – the Indonesian Presidential Instruction No. 5/2008). The Presidential Instruction outlines, for example, many detailed plans of domestic policy objectives for removing trade barriers, both in terms of tariff and non-tariff barriers, and simplifying the AFTA's CEPT Rule of Origins. In addition to these, the Indonesian government launched, at the end of 2008, the National Logistics Blueprint, which aims to improve the logistics sector in the country. It is well noted that the country's logistics infrastructure and services also lag behind the other ASEAN countries, and this constrains Indonesian economic development and poverty alleviation. The Blueprint is consistent with the AEC agenda because, among other things, it plans to improve the services of the Indonesian logistics services providers (LSPs) industries. ■

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