



The Choice for the Next 5 years:

*5% growth and 0.8 million good jobs a year
or 10% growth and 3 million good jobs*

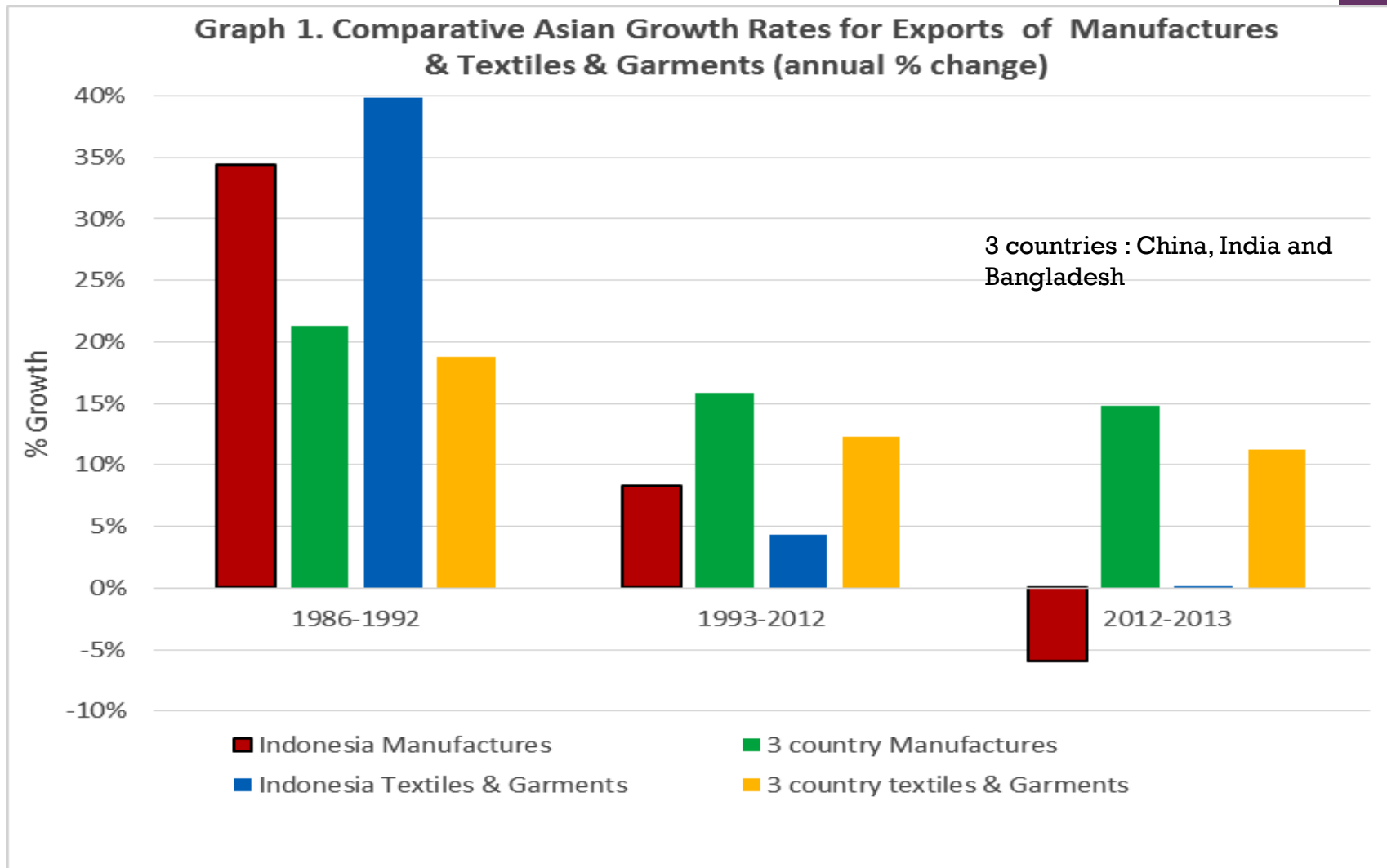
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CORE Public Lecture
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+ Window of opportunity

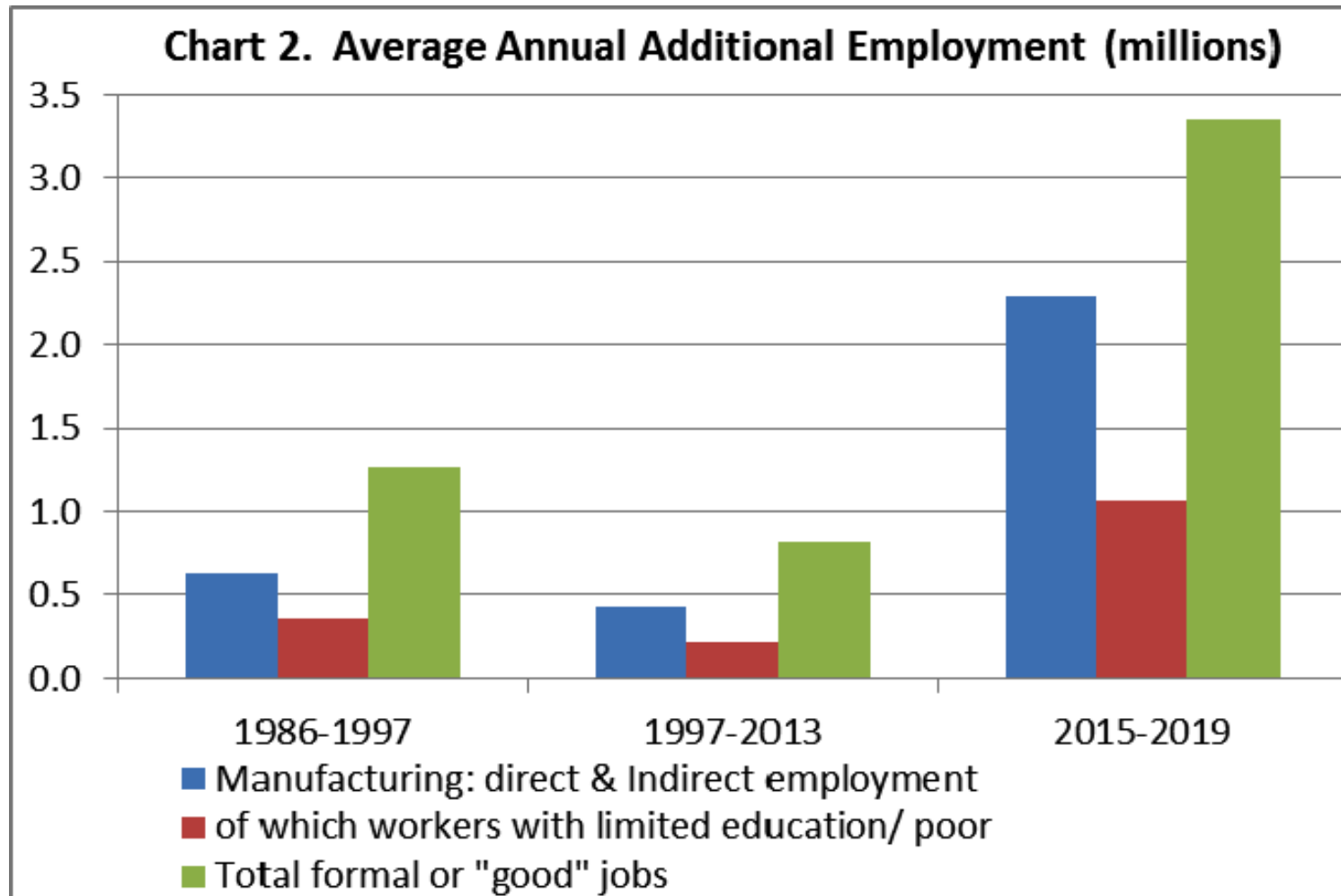
- **In the next 5 years Indonesia has a unique window of opportunity to raise the income of its people and especially of the poorer 40% of the population** because:
 - *It is one of the few countries that has a large pool of additional workers entering the labor force – a “demographic dividend”*
 - *China, which has dominated the world market for labor intensive manufactured goods, is no longer competitive in that market. Its wages are too high, its labor force is getting older & smaller*
- With the right policies Indonesia by 2019 can take over 10% of China's 2012 market for labor intensive manufactures. That would imply a 19% growth rate of manufactured exports. Is this feasible?

+ Look at the record: Earlier reform increased manufactured exports 34% a year



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- Policies which provide incentives to export will also increase the competitiveness of industries competing with imports. *Import substitution*
 - *Only manufacturing can provide the millions of jobs Indonesia needs to turn 10 million “surplus”, low productivity workers into fully productive ones.*
 - *If workers produce little they are not a “demographic dividend” but a “demographic curse”*

+ The importance of manufacturing in providing jobs



+ The next administration, with right policies can provide

- **3 million good jobs a year on average–**
 - 2 million full time, regular jobs to employ the workers that are added to the labor-force each year;
 - another 1 million jobs to move workers out of low productivity, poorly paid jobs with irregular income and no benefits;
 - and to employ some of those who now go abroad to jobs where far too many are mistreated.
- **An economy that is growing at 10% a year, which means that the income will double in 7 years.**
- **Move 10 million families from poverty to middle class.**
- **Put to productive work some 2 million workers with limited education, virtually all of them among the poorest 40%, and one million more educated ones including educated unemployed.**

+ Reforms are politically painful. Why not Business as usual? 6% growth is quite OK

- **But Indonesia will miss the unique opportunity to take over some of China's world market. Other countries will move in & this opportunity will be forever lost**
- **Income growth will fall to 5% or less:**
 - **6% was due to Commodity boom which is over; before the boom growth was 4%**
 - **Manufacturing has become less competitive because of "Dutch Disease"**
- **Less than 1 million good productive jobs a year will be created & more than 1 million workers will be added to the "surplus"**

Why can Indonesia not grow more rapidly by expanding domestic demand?

If income increases people will want more imports also; not everything can be produced in the country. [Of every Rp billion on increased consumption roughly Rp 220 million is spent on imports]. Can not pay for the increased imports unless have more export earnings.

- + Policies and programs to get DDG & 3 million good jobs a year

Part I. To regain Indonesia's competitiveness in labor-intensive manufactures requires attacking high costs everywhere in the economy.

Reducing the cost of infrastructure: Currently logistic cost 26.5% of GDP while Malaysia 13.% & Japan 10.6%

Develop industrial clusters outside Jakarta where land and labor are cheaper but infrastructure is poor. Give priority to infrastructure for areas that have attracted industrial production & employment, especially for export.



The central government spends less than 1 % on infrastructure, need to increase to about 5%.

To overcome limited government implementation capacity allow private firms to discharge tax obligations by building infrastructure. Provide a small subsidy. Especially useful for less developed areas.

Convert **commercial vehicles to run on local natural gas** at no initial cost to the owner. This would use a low cost ample domestic resource instead of a high cost imported resource. Price of gas can be kept low thus reducing high transport cost, with no possibility of low-cost fuel being sold to private vehicles or smuggled abroad. [Perfectly segmented market].

+ Lowering cost of Labor, Increasing Income of Workers

- **Training program** to enhance skills, increase productivity & incomes. Government programs tend to be ineffective; private firms are reluctant to train workers who may leave for competitors once trained. Combination: government pays for training by the industry.
- **Exchange rate policy** can be a powerful economic tool to increase the competitiveness of Indonesian products. Bank Indonesia should behave like other Asian central banks: not push up the value of the Rupiah but push it down if needed to keep exports competitive.



Table 1. The Exchange Rate and the Cost of Indonesian Labor

| | | Nominal | Real | | US\$ | Workers | Exporters |
|--------------|--------|---------|-------|---------------|------|---------|-----------|
| | CPI | wage | wage | Exchange rate | wage | wage | wage |
| | | (000) | (000) | (approx) | | gain % | loss % |
| 2008.I | 105.3 | 1,093 | 1,038 | 9,400 | 116 | | |
| 2011.II | 126.5 | 1,327 | 1,049 | 9,000 | 147 | 1.0% | -26.7% |
| 2012.III | 134.45 | 1,654 | 1,231 | 9,800 | 169 | 17.3% | -14.5% |
| 2008 to 2013 | | | | | | 18.5% | -45.1% |

From 2008 to 2011 workers “real wage”, their purchasing power stayed the same but the cost of labor for exporters increased 27% because of the exchange rate. Exchange rate management that seems to ignore impact on domestic production and employment.

But this increases the prices of imported goods and contributes to inflation. Stabilize the price of foods important for lower income people by reducing import duties or subsidizing the price of lower quality imports

| Garment Workers' Wages in Asian Countries (US\$ per month in 2013) | | | Rp wage is 1.7 million. | Exchange rate |
|--|----------|--|-------------------------|---------------|
| Indonesia | 148-182 | | \$ wage is | |
| China | 237-460 | | \$189 | 9,000 |
| Bangladesh | 38 - 68 | | \$170 | 10,000 |
| Cambodia | 61 - 95 | | \$155 | 11,000 |
| Vietnam | 80 - 113 | | \$142 | 12,000 |
| India | 90-117 | | \$131 | 13,000 |
| | | | | |
| Average wage in Indonesia in 2013 III = Rp 1.7 million | | | | |



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- Reestablish drawback program that Indonesia once had that provided an incentive for domestic production of inputs into exports
 - **Lower the cost of government regulation and corruption.** Establishing a culture of honesty and of service to the public is difficult & can take time. But the cost of regulation & corruption can be reduced almost instantly. If rules are vague, unpublished and left to interpretation then honesty depends on having civil servants who are saints. If rules & decisions are clear, published and leave little discretion then sinners will behave like saints.
 - Strengthen the incentives for export/ import substitution by subsidies that indirectly enhance export performance: for training; management, technology, R&D, product development (Fiscal incentives), privileged financial access for SMEs , **cheap rents and one-stop services in industrial estates** support (Fiscal incentive), trade-related information, surveys, seminars, enterprise consultation



Main Fiscal Policy program

- Many of these steps require more funds. The combination of enhancing tax revenue collection and reducing energy subsidy will unlock substantial resources that can be spent on crucial programs [energy subsidy focused on buses & trucks]
- Social protection program, including health care, active labor program, food (main staples) price stabilization program to make sure that poorest 40% benefit from reduction of energy subsidy.
- Infrastructure
- Matching grants to get local governments to spend on health education, development not just own salaries and own benefits
- Tax reform has to be well designed so benefits available only in second year, while cuts in fuel subsidy best in the first year (spending political capital in the honey moon period)

+ Fiscal Projection with New Initiatives [all as % of GDP]



| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2022 | 2025 |
|--|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Tax Revenue | 12 | 12 | 12.5 | 13.0 | 13.5 | 14.0 | 14.0 | 14.5 | 15 |
| Non Tax Rev | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 |
| Total rev | 16 | 16 | 16.5 | 17.0 | 17.5 | 18 | 18 | 18.5 | 19 |
| Energy Subsidy | 3.3 | 1.5 | 1.0 | 1.0 | 1.0 | 0.5 | 0.5 | 0.5 | 0.5 |
| Extra money To allocate | 0 | 1.8 | 1.0 | 0.5 | 0.5 | 1.0 | 0 | 0.5 | 0.5 |
| Education (20%) | 3.2 | 3.2 | 3.3 | 3.4 | 3.5 | 3.6 | 3.6 | 3.7 | 3.8 |
| New Social protection /Food stabilization/ Matching grants | 0.3 | 0.6 | 0.7 | 0.8 | 0.9 | 1.0 | 1.0 | 1.1 | 1.2 |
| Infrastruc- ture | 0.4 | 1.9 | 2.8 | 3.1 | 3.4 | 4.2 | 4.2 | 4.5 | 4.8 |



■ Problems to solve :

■ Financing – mostly addressed

- Local government → property tax + (competition) incentive
- Bank Infrastructure and special bond guarantee
- Central government budget restructuring (tax reform + subsidy reform)
- Private sector initiatives (with government incentive)

■ Land

- Land bank (local and central government)
- Flexible compensation and pooling readjustment and reconstruction

+ Other sources of income & jobs

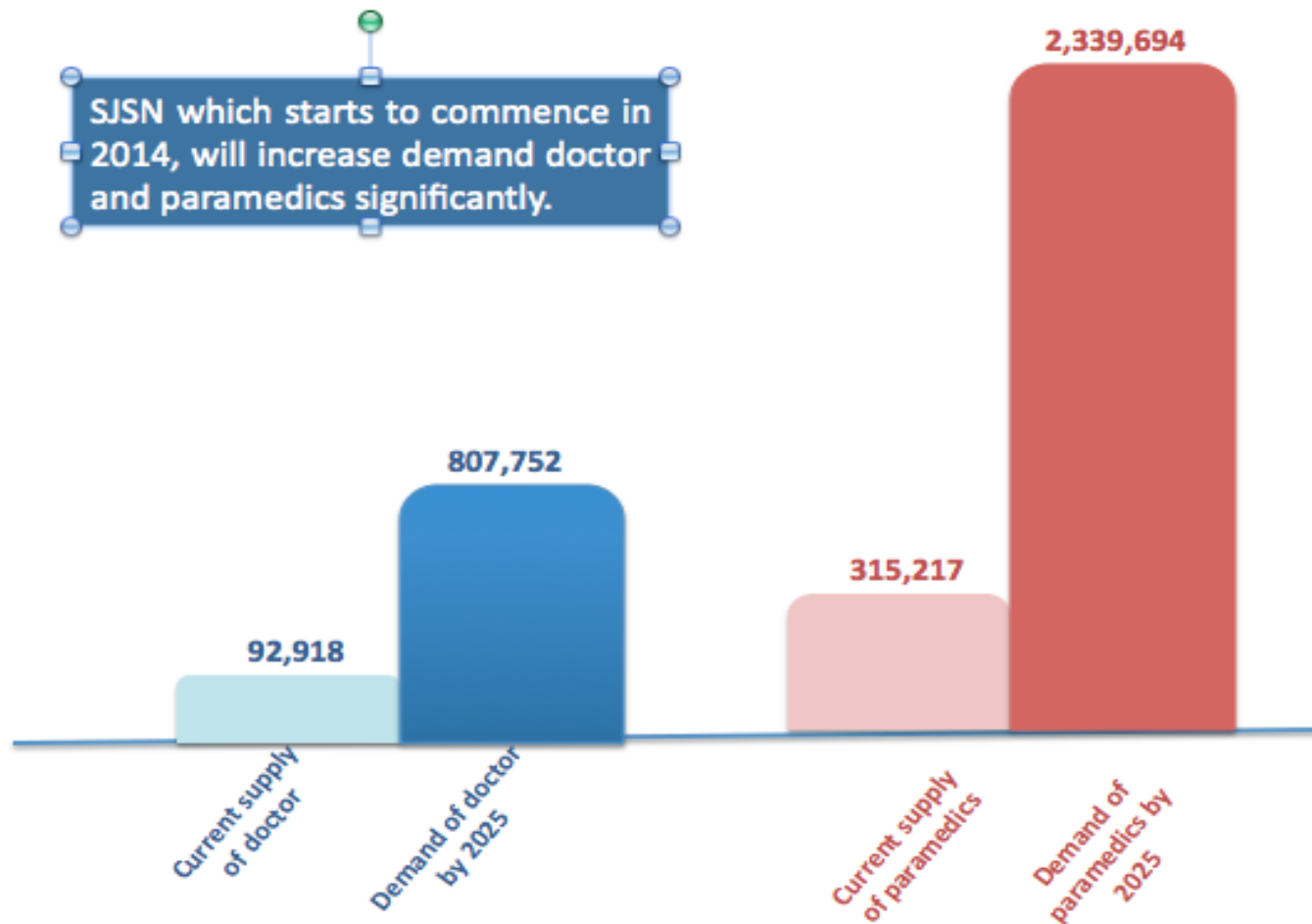
High Productivity Agriculture with food value chain (4 million Jobs 10 years). **Role of** ADM, CARGILL, Dreyfus, WILMAR, Fontera NZ system

Tourism and Hospitality (3 millions jobs over 10 years) with focus on International Tourist

Both labor –intensive. Tourism employs workers with full range of education. Both substantial potential but less than manufacturing. Government to provide for externalities: Infrastructure a big problem, but also special needs [cold chain, artificial reefs, garbage collection, health facilities]

+Health Care Industries (services)

Employment opportunities (3 millions over ten years)



Oil, Gas and Mining Industrh

Oil/ gas have slowed down the economy, not helped it to grow.

Can thst be reversed at acceptable costs?

- Some ways to maintain productivity of the mining sector:
 - ✓ ***Good governance, transparency and participation*** are essentially *prerequisites*
 - ✓ Extractive industries can be an engine of development
- It will require
 - Capacity to monitor companies and enforce laws
 - Rights of assembly
 - Freedom of information
 - Other basic civil and political liberties

- We have seen successes
 - Norway
 - Chile
 - Botswana
 - Trinidad

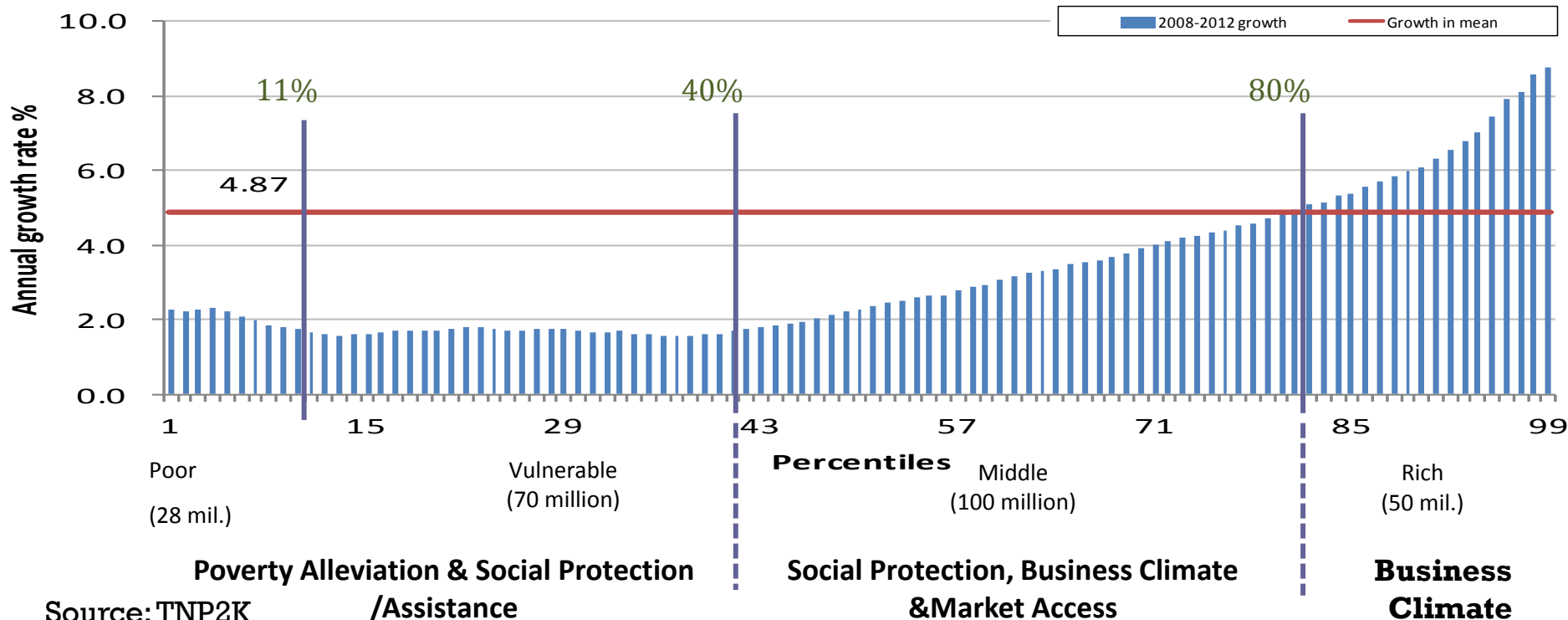
Four household groups: POOR, VULNERABLE, MIDDLE, and RICH Classes

Growth-led employment

- Sectoral growth for employment creation
- Employment as derived demand of growth

Growth-led employment

- Employment is the lead, rather than the lag, variable determining growth
- Employment proceeds income creation
- Public policy enhance employment through direct intervention



The poor and the vulnerable + (i.e., the lowest 40% in the distribution) do not have favorable condition in the world of work

- The poor and the vulnerable dominates three employment statuses: self-employed assisted by unpaid/family workers, casual workers, and the unpaid workers. → high degree of informality.
- By sectors: Agricultural works dominated by the lower and middle income (93.4% of total employment). Financial services dominated by the middle and rich class (90.6% of total employment). The rich group also quite few in construction (14% of total employment), lower 40% group is relatively low in public services.
- The poor and vulnerable are of low quality of human capital & low ownership of (transportation) assets

There is a need for active employment creation policy

- budget allocation to create jobs directly for the unemployed or the poor.
- Short-term employment. Typical activities: infrastructure development, but also different other socio-economic activities.
- PNPM is a good candidate for the active employment creation policy

+ Employment-friendly Village Development (1)

- Village Development (VD) should **be targeting** for employment creation, **prioritizing the poor and the vulnerable as workers.**
 - The unified database & social mapping
 - E.g., prioritize the lowest 20%. VD projects prioritize the lowest 20% households as project labor.
- VD apply the **guaranteed employment principle.**
 - Certain number of days (e.g., 30 days per year) for the targeted group (e.g., the lowest 20% of the distribution).
 - Works may include rural infrastructure maintenance (education and health facilities), poverty alleviation or social protection program services, assisting the education and health services, etc.
 - Role of local government is very important.

+ Employment-friendly Village Development (2)

- VD have a **wage setting mechanism resulting in the self-targeting** among households and individuals in the priority groups.
 - Offer the minimum wage, or prevailing agricultural wage, for unskilled labors → ensuring beneficiaries are low income workers who need the additional income during the off-season in agriculture.
 - Offering wages above the minimum wage would result in: (i) attracting workers around the minimum wage to shift to the PNPM projects, (ii) PNPM would be very hard to attract the unemployed, and the intensive employment creation would be jeopardized.

+ Employment-friendly Village Development (3)

- VD should **include skill training**, providing extra capability
 - Linked with incentives of asset transfers, e.g. working tools or other equipment, upon completing of the training.
- VD applies **local resource base (LRB) principle**.
 - ‘local solution to local problem’ principle, for the employment creation and the overall project design.
 - The rural infrastructure development should be designed in such as way that incorporate to the maximum possible local know-how and local materials. That will ensure that the locals can address any future problems potentially arising related to the project outputs and outcomes.