

POST-CRISIS EXPORT PERFORMANCE: THE INDONESIAN EXPERIENCE IN REGIONAL PERSPECTIVE

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This paper examines post-crisis export performance in Indonesia against the backdrop of pre-crisis experience and the comparative export performance of other Southeast Asian countries. It surveys trends and patterns of export performance, focusing on comparative experience in major commodity categories and changing revealed comparative advantage. It also examines the implications for Indonesia's export performance of China's emergence as a major competitor in world trade, considers market prospects for textile and garment exports following the demise of the Multi-fibre Arrangement, and explores the factors contributing to the post-crisis export slowdown. The findings support the view that Indonesia's poor export performance in the post-crisis era is largely supply driven. They strengthen the case for reversal of recent backsliding in macroeconomic policy reform, and for speedy implementation of the 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.

INTRODUCTION

The economic boom in Indonesia from the late 1980s until the onset of the financial crisis in mid-1997 was underpinned by rapid export growth, accompanied by a dramatic shift in the commodity composition of exports away from crude oil, then the principal export, towards non-oil primary products and manufacturing. Rapid growth of non-oil exports was the foundation of Indonesia's success in maintaining international creditworthiness and macroeconomic stability following the end of the oil boom in the mid-1980s. The expansion of manufacturing exports, in particular, was instrumental in bringing about rapid employment growth. Against this backdrop, there is serious concern in contemporary Indonesian policy circles about the failure of export performance to regain its pre-crisis

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dynamism.¹ The purpose of this paper is to inform this debate by examining post-crisis export performance in Indonesia from a comparative East Asian perspective, against the backdrop of pre-crisis experience and ongoing changes in patterns of international production. Particular attention will be paid to the perceived or real challenges arising from China's meteoric rise as a major competitor in global markets, and from the phasing out of the Multi-fibre Arrangement (MFA), which regulated world trade in textiles and garments for over 40 years.

The paper begins with an overview of Indonesia's export trends – with emphasis on the relative growth performance of oil and gas and non-oil and gas exports – and a survey of comparative ASEAN experience in the post-crisis era.² The next section examines comparative export experience using a commodity classification specifically designed to focus on emerging trends in world merchandise trade. This section also compares Indonesia's changing revealed comparative advantage in merchandise trade with that of Thailand. The subsequent sections deal with the possible implications for Indonesia's export performance of China's emergence as a major force in world trade, and the implications of MFA abolition for textile and garment exports from Indonesia. This is followed by an assessment of the causes of the post-crisis export slowdown. The key findings are summarised in the final section.

EXPORT TRENDS

At the end of the oil boom in the early 1980s, petroleum and petroleum and gas products (henceforth referred to as 'oil' for brevity) accounted for almost three-quarters of total merchandise exports from Indonesia (table 1, figure 1). The collapse of oil prices in 1982, followed by another precipitous fall in 1985–86, therefore brought about a massive decline in total export earnings. Export earnings (in current dollars) contracted at an average annual rate of 7.4% between 1982 and 1986 (table 1), compared with a staggering 37.6% growth between 1973 and 1981. In the trough of 1986, total exports amounted to \$15 billion (18% of GDP), compared with a peak level of \$22 billion (31% of GDP) in 1982. But the Indonesian economy managed to regain export dynamism from about 1987 by shifting to non-oil exports of both primary products and manufactures. In the decade 1987–96, total export earnings grew at an average rate of 13% per year, with all years except 1993, 1994 and 1996 (when the growth rates were slightly below 10%) recording double-digit growth. Rapid export expansion, with manufacturing exports playing the pivotal role, was a key factor in Indonesia's rapid economic growth. The dramatic shift in export composition towards manufacturing lessened the vulnerability of the economy to sudden external shocks, and thus provided a congenial setting for sound macroeconomic management. Rapid growth of labour-intensive exports also made a significant contribution to employment expansion and poverty alleviation (Hill 2000).

1 See, for instance, Aswicahyono and Hill (2004): 288–94; World Bank (2005a).

2 Most of the data used are for the original five members of ASEAN (the ASEAN-5: Indonesia, Malaysia, the Philippines, Singapore and Thailand). Vietnam is included in some of the analysis, with the acronym 'ASEAN-6' used for the ASEAN-5 + Vietnam.

TABLE 1 *Key Indicators of Export Performance, Indonesia*

	Total Merchandise Exports (\$ billion)	Share in Total Exports (%)			Total	Export Growth (% p.a.)			Share in World Exports (%)	
		Oil & Gas ^a	Non-oil Primary	Manufacturing		Oil & Gas ^a	Non-oil Primary	Manufacturing	Non-oil Primary	Manufacturing
1967-72 ^b	1.0	41.4	57.1	1.5	18.8	28.7	14.8	18.6	0.36	0.01
1973-81 ^b	12.1	68.8	29.4	1.9	37.6	49.0	23.6	45.1	0.54	0.05
1982-86 ^b	19.7	70.4	19.1	10.5	-7.4	-13.4	0.8	35.7	0.47	0.21
1987	16.9	49.0	26.0	25.0	14.0	2.0	14.2	47.9	0.52	0.33
1988	18.9	39.5	30.7	29.7	12.1	-9.6	32.6	33.3	0.58	0.37
1989	21.8	40.2	27.9	31.9	15.2	17.3	4.5	23.4	0.60	0.42
1990	25.6	44.0	20.6	35.4	17.4	28.3	-13.2	30.3	0.59	0.47
1991	29.0	38.5	20.7	40.7	13.5	-0.6	14.0	30.7	0.61	0.50
1992	33.8	33.3	19.2	47.5	16.6	0.9	7.8	35.9	0.79	0.70
1993	36.6	28.4	18.6	53.1	8.4	-7.8	5.1	21.0	0.83	0.75
1994	39.9	26.4	21.8	51.8	8.9	1.3	27.8	6.4	0.81	0.69
1995	45.4	25.4	24.0	50.6	13.7	9.4	25.3	11.0	0.77	0.64
1996	49.7	25.9	22.7	51.4	9.6	11.8	3.7	11.3	0.81	0.68
1997	46.7	28.2	23.7	48.1	-6.0	2.3	-2.1	-12.0	0.70	0.57
1998	40.8	23.1	24.1	52.8	-12.6	-28.3	-11.2	-4.2	0.65	0.54
1999	47.2	23.7	20.8	55.5	15.6	18.7	-0.3	21.6	0.76	0.66
2000	61.7	25.4	17.5	57.1	30.8	40.1	10.1	34.5	0.88	0.80
2001	55.9	25.5	18.1	56.4	-9.5	-9.0	-6.6	-10.6	0.82	0.74
2002	56.8	24.5	21.1	54.4	1.7	-2.5	19.0	-1.9	0.83	0.70
2003	60.7	25.9	22.1	52.0	6.9	12.9	11.7	2.3	0.74	0.62
2004	64.2	17.8	26.4	55.8	5.7	-27.0	26.3	13.3	0.73	0.59

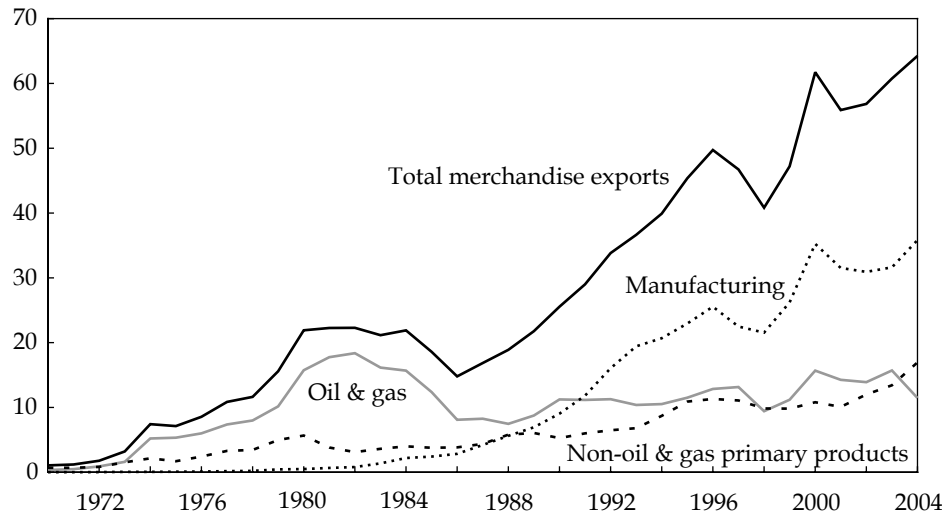
^a Exports of natural gas commenced in 1977. Until then the data relate solely to petroleum exports.

^b Annual averages.

Source: Compiled from UN Comtrade database.

Rapid export growth was underpinned by a dramatic shift in export composition away from oil and towards non-oil primary products and manufacturing. By the early 1990s, the share of manufacturing had surpassed that of both agricultural goods and oil and gas in the export structure. The dollar value of total non-oil exports grew at an average annual rate of 17.5% during the period 1990-96, with manufacturing exports expanding at a rate of 20%. By the mid-1990s, manufactured goods contributed over 50% of total merchandise exports, compared with around 10% in the mid-1980s. Indonesia's share in total world non-oil exports increased persistently from 0.47% during the years 1982-86 to 0.77% in 1995. The growth of the share in world manufacturing exports between the two time points was even faster, from a mere 0.21% to 0.64% (table 1).

FIGURE 1 *Indonesian Exports*
(\$ billion)



Source: Based on data compiled from UN Comtrade database.

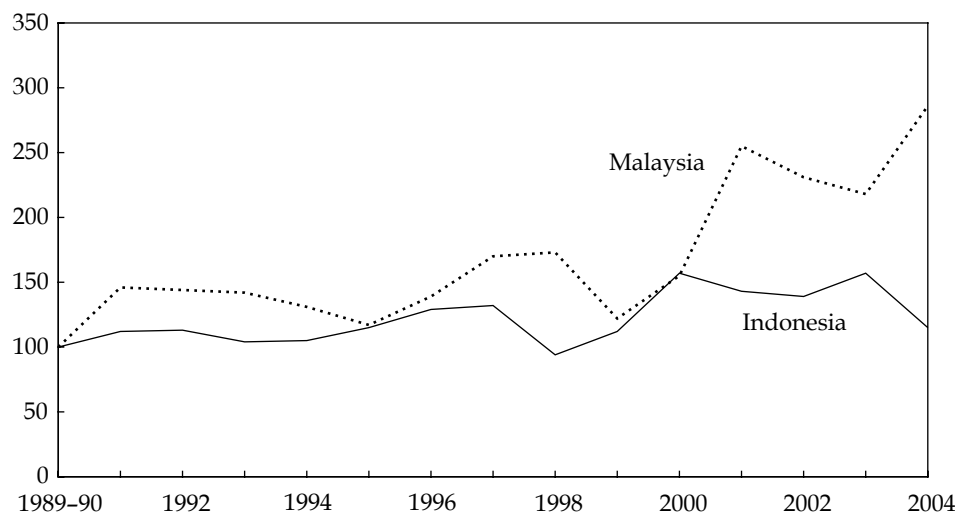
This impressive export performance record was interrupted by the onset of the crisis in mid-1997. Total export earnings in dollar terms contracted by 6% in 1997 and 12.6% in 1998, with non-oil primary products and manufacturing experiencing significant contraction and oil and gas growing by a mere 2.3%. The decline in export value (in dollar terms) was a common pattern observed across all crisis-affected countries. This was mainly the outcome of sluggish adjustment of both domestic-currency export prices and volumes to massive exchange rate depreciation.³ In addition, massive contraction of domestic demand during the crisis may have encouraged exporters to pass on a part of the exchange rate depreciation to foreign buyers in order to boost export demand (Rosner 2000).

There was a sharp recovery during the next two years, lifting export value by 15% over the pre-crisis (1990-96) average. This was followed by a 9.5% export contraction in 2001, which at the time was interpreted as a reflection of the global economic downturn. However, the ensuing years have failed to restore Indonesia's pre-crisis growth dynamism, notwithstanding a notable improvement in the international economic environment. The average annual growth of total non-oil exports for 2000-04 was a mere 8.7% compared with 17.5% for 1990-96. The average growth rate of manufactured exports declined from 19.6% to 7.5% between these two periods. Oil and gas exports also recorded a significant contraction, notwithstanding Indonesia's considerable resources, and recent increases in world oil prices.⁴ Interestingly, over the past five years, Indo-

3 The well-known 'J-curve' effect of currency devaluation/depreciation.

4 Given rampant smuggling of oil and oil products from Indonesia to locations with higher prices, because of Indonesia's subsidised domestic fuel prices, official statistics are likely to understate actual oil exports. However, it is unlikely that the remark-

FIGURE 2 *Oil and Gas Exports from Indonesia and Malaysia*
(\$, 1989–90 = 100)^a



^a 1989–90: average of two years.

Source: Based on data compiled from UN Comtrade database.

nesia's oil and gas exports have clearly lagged behind those of neighbouring Malaysia (figure 2).

Table 2 summarises changes in export volume, value and price (unit value) by commodity category at the one-digit level of the Standard International Trade Classification (SITC). During the pre-crisis period (1988–96), export earnings growth across non-oil commodity categories was more closely associated with growth of export volume than with changes in unit values. By contrast, during the post-crisis period (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 latter pattern is much more prominent for the three non-oil primary product categories (food and live animals, beverages and tobacco, and crude materials) and for oil and gas than for the manufacturing categories. Given that Indonesia is by and large a price taker ('small country') in world trade, these contrasting patterns seem to suggest that the relatively slow export growth during the post-crisis era was predominantly supply, rather than demand, driven.

During the post-crisis years until about 2000, Indonesia's export growth kept pace with that of its ASEAN neighbours (figure 3). Indonesia's average growth rate of non-oil exports during the pre-crisis years 1990–96 (18.2%) was slightly

able slowdown in reported oil and gas exports can be ascribed to such under-reporting alone. In any case, there is little room for smuggling or under-reporting when it comes to trade in gas, which accounts for almost half of Indonesia's total oil and gas exports.

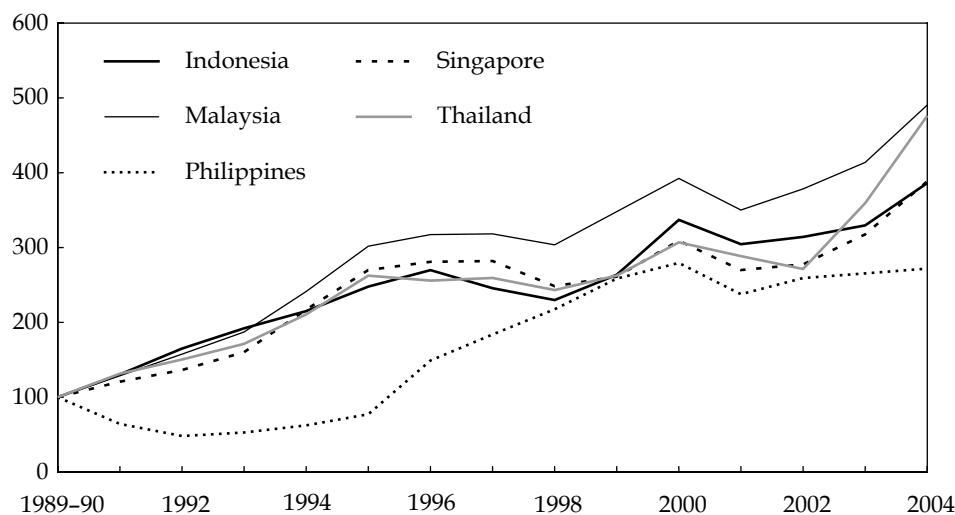
TABLE 2 *Annual Average Growth Rates of Exports (%)*

	Volume (kg)			Unit Value (\$)			Value (\$)		
	88-96	97-00	01-05	88-96	97-00	01-05	88-96	97-00	01-05
Primary products									
Food & live animals	9.1	1.5	4.0	1.2	-2.1	3.9	8.5	-1.7	5.6
Beverages & tobacco	3.5	1.2	7.3	16.9	0.4	2.0	19.8	0.9	8.9
Crude materials, inedible	23.9	1.6	8.8	1.1	2.6	18.8	11.0	-2.6	15.6
Animal & vegetable oils & fats	6.7	3.0	8.1	8.9	3.5	18.8	16.8	7.1	27.9
Manufacturing									
Chemical products	12.0	25.8	17.8	14.8	4.3	-7.5	23.7	16.8	7.8
Manufactured goods classified by material	11.1	20.7	0.4	3.3	-12.1	3.8	12.4	4.5	3.3
Textile yarns & fabrics	22.8	21.7	-0.1	0.2	-9.3	-0.1	23.6	7.1	-0.3
Machinery & transport equipment	2.1	17.9	-4.8	58.7	16.9	11.0	60.9	27.6	5.3
Miscellaneous manufactured articles	39.3	22.3	9.4	-6.6	-8.6	-7.3	29.3	5.1	0.7
Clothing	19.6	15.3	1.4	2.0	-4.2	0.4	22.4	10.2	1.6
Footwear	46.8	-1.9	-5.3	8.5	-1.2	2.8	61.1	-3.6	-2.6
Total non-oil & gas	7.7	2.9	5.0	8.5	5.0	1.9	16.1	6.8	6.2
Oil & gas									
Petroleum & petroleum products	1.2	-5.9	-1.2	4.2	15.0	8.0	4.9	6.7	6.1
Gas, natural & manufactured	5.3	-1.4	2.4	3.4	15.9	5.2	8.4	13.2	7.3
Total merchandise exports	6.5	1.7	4.3	6.4	6.4	2.4	12.5	7.1	6.3

Source: Compiled from CEIC Asia Database (based on BPS data).

below that of Malaysia (21.5%) and Singapore (19.2%), but above that of the other two countries and above the regional average (17.8%). The export contraction following the onset of the crisis continued for a much longer time in Indonesia than in Malaysia, Singapore and Thailand, but by and large export performance during the crisis and immediate post-crisis years (1997-2000) was consistent with regional trends. However, from 2000 to 2004, Indonesia's export growth persistently lagged behind that of the other countries; its exports grew at an annual average rate of 3.9%, compared with 13.2% in Thailand, 6.3% in Malaysia and 6.7% in Singapore. The 2000-01 global economic downturn affected each of these countries differently, depending on the peculiarities of its export composition.

FIGURE 3 *Non-oil Exports from Indonesia, Malaysia, the Philippines, Singapore and Thailand^a*
 (\$, 1989-90 = 100)^b



^a Average annual growth rates:

	Indonesia	Malaysia	Philippines	Singapore	Thailand	ASEAN-5
1990-96	18.2	21.5	14.0	19.2	17.5	17.8
1997-2000	6.8	5.8	17.2	3.0	5.0	5.5
2001-04	3.9	6.3	-0.3	6.7	13.2	6.7

^b 1989-90: average of two years.

Source: Based on data compiled from UN Comtrade database.

For instance, Korea's and Malaysia's export growth was more adversely affected than that of Indonesia and Thailand, because the heavy concentration of exports in electronics and related products was more vulnerable to the global recession. Even then, the export decline in Indonesia in 2001 was greater than that in Thailand. Over the ensuing three years, Indonesia's export growth deviated more and more widely from regional trends (figure 3).

More specifically, what are the products and product categories in which Indonesia's performance has lagged behind that of its ASEAN neighbours? 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? We now turn to an analysis of comparative export experience at the level of key commodities and commodity groups, with a view to broadening our understanding of these and related issues.

CHANGING COMMODITY COMPOSITION AND EXPORT PERFORMANCE

Data on the export performance of Indonesia and the other four ASEAN-5 economies are summarised in table 3, and are presented in the context of structural shifts in export composition by broad commodity category. The commodity classification used here has been designed to shed light on the implications of two important developments in world trade that have opened up new export opportunities for developing countries: the emergence of *processed food* as a dynamic export line within the broader category of food, and the expansion of trade in *parts and components* within vertically integrated production systems, recorded under the machinery and transport equipment category (SITC 7).⁵ Before we turn to analysis of the data, a brief discussion of the rationale for the special treatment of processed food and parts and components, and its implications for assessing export opportunities for Indonesia, is in order.

Since about the late 1970s there has been a notable compositional shift in world food trade. The relative importance of 'classical' food products (coffee, tea, sugar, cocoa and so on) has been sharply eroded by the rapid expansion of trade in products such as fresh fruit and vegetables, poultry, fish and dairy products, which are exported after being subjected to technologically sophisticated processes (i.e. becoming 'processed foods').⁶ Powerful forces on both the demand and the supply sides have underpinned this structural shift (Athukorala and Sen 1998; Athukorala and Jayasuriya 2003). On the demand side, 'internationalisation of food habits' – the increased importance of imported processed items in consumption patterns in developed countries, as well as among large sections of the populace in many developing countries – appears to have played a key role. Factors such as international migration, the communications revolution and international tourism have contributed to this phenomenon. This significant demand-side impetus seems to have been supported by important supply-side developments such as improvements in food technology, refrigeration facilities and transport that have made various processed food products, which are generally highly perishable, internationally tradable. Indonesia is well placed to benefit from this structural shift in world food trade, given its rich agricultural resource base and the ample availability of labour (because food processing and packaging for export are highly labour intensive).

5 The analysis is based on a systematic separation of processed food, and parts and components, from the UN trade data (SITC Revision 3) at the five-digit level of disaggregation. The commodity list used in this reclassification of the standard UN trade data is available from the author on request. For details on the classification system, see Athukorala and Sen (1998) and Athukorala (2006a).

6 The term 'processed food' as used in this paper refers to food items that undergo substantial processing in the country of origin before export; they are typically high value and subject to increasingly stringent food safety standards. While international trade in many of these items is not entirely 'new', their trade has experienced very rapid expansion in recent years, and they are often described as 'new food exports', or 'non-traditional food exports'. To maintain the focus on these new dynamic export items, we exclude from the definition traditional beverages (such as tea and coffee) and cereal grains (such as wheat, maize and rice) exported in bulk form, regardless of the degree of processing involved.

The emergence of parts and components (or 'middle products') as a dynamic export line is a reflection of the ongoing process of *product fragmentation*⁷ – the cross-border dispersion of component production and assembly within vertically integrated production processes mostly, but not solely, dominated by multinational enterprises (MNEs) (Feenstra 1998; Athukorala 2006a). International product fragmentation allows companies to unbundle stages of production so that each stage can be relocated to countries in which the intensively used inputs are cheap. The electronics MNEs based in the US started the process in the mid-1960s as a strategic response to import competition from Japanese firms. The involvement of Japanese and western European MNEs in outsourcing gained importance from the late 1970s. More recently, MNEs based in East Asian newly industrialising economies (NIEs), notably Korea and Taiwan, have also joined this process of internationalisation of production. In response to rapid domestic wage increases, the growing reluctance of domestic labour to engage in low-paid blue-collar employment, and stringent restrictions on the importation of labour, firms in the electronics industry and other durable consumer goods industries in the East Asian NIEs have begun to produce components and carry out sub-assembly activities in neighbouring countries where labour costs are still low.

The transfer abroad of component assembly operations now occurs in many industries where the technology of production permits the separation of labour-intensive components from other stages of production. The other products with significant international production sharing include television and radio receivers, optical products, musical equipment, watches, sewing machines, typewriters and other office equipment, aircraft parts, chemicals, pharmaceuticals, synthetic fibres, wearing apparel and travel goods. In general, industries that have the potential to break up the production process to minimise transport costs are more likely than other industries to move to peripheral countries. This phenomenon has been reflected in a rapid growth of trade in parts and components, at a rate exceeding that of trade in final goods, because goods cross multiple borders during the production process. Indonesia is particularly well placed to benefit from this new form of international specialisation, given the availability of relatively low-cost and trainable labour, and its location in a region that has become the growth centre of component production and assembly in the world (Athukorala 2006a).

Several important features stand out from the data reported in table 3. First, notwithstanding the rapid growth of manufacturing exports from the late 1980s, non-oil primary products, both agricultural products and minerals, still accounted in 2003–04 for a larger share of non-oil exports from Indonesia (31%) than from the other three resource-rich countries in the region: Thailand (21%), Malaysia (13%) and the Philippines (9%).

Second, there is clear evidence of the emergence of processed food as a dynamic line in Indonesia's export structure. During the period 2001–04, processed food exports from Indonesia grew at a faster rate (5.7%) than those from Malaysia (2.8%), the Philippines (4.3%) and Thailand (3.0%). However, Indonesia's world market share of this dynamic product category in 2003–04 (0.91%) was only one-third that of neighbouring Thailand (2.93%), a difference that certainly goes

7 This phenomenon goes under various names, such as 'vertical specialisation', 'slicing the value chain', 'international production sharing' and 'outsourcing'.

TABLE 3 *Non-oil Export Performance by Major Commodity Category*

	Growth ^a			Share in Total Exports ^b			Share in World Trade ^b		
	89-96	97-00	01-04	89-90	99-00	03-04	89-90	99-00	03-04
INDONESIA									
Primary products	14.1	-0.8	12.6	41.5	25.1	31.1	1.48	1.60	1.87
Agricultural products	12.8	-2.0	13.4	32.2	18.7	22.8	1.47	1.55	1.85
Agricultural raw materials	21.0	-5.2	13.2	12.6	5.2	6.9	2.15	2.01	2.70
Food	9.4	0.1	13.6	19.6	13.5	15.9	1.22	1.43	1.63
of which processed foods	11.6	6.8	5.7	10.3	6.0	5.8	0.98	1.05	0.91
Minerals (incl. crude fertiliser)	19.9	3.5	11.6	9.3	6.5	8.2	1.51	1.77	1.91
Manufactures^c	13.3	10.0	0.8	58.5	74.9	68.9	0.49	0.73	0.63
Chemicals & related products	14.5	16.6	6.7	4.1	6.8	7.6	0.27	0.55	0.49
Resource-based manufactures	8.4	4.0	-0.3	35.1	26.4	21.5	1.50	1.69	1.26
Machinery & transport equip't	42.8	27.6	2.5	2.1	19.6	21.8	0.03	0.34	0.37
of which parts & components	37.9	30.6	2.3	0.9	8.5	9.1	0.05	0.40	0.43
Miscellaneous manufacturing	13.2	5.1	-1.6	17.2	22.1	18.1	0.91	1.30	1.02
Total	13.5	6.8	3.9	100.0	100.0	100.0	0.68	0.85	0.79
MALAYSIA									
Primary products	7.0	-6.5	13.6	37.5	11.6	13.3	2.19	1.49	1.66
Agricultural products	6.7	-7.3	14.2	34.5	10.4	12.2	2.57	1.75	2.04
Agricultural raw materials	1.7	-9.0	6.7	19.1	3.0	2.8	5.35	2.40	2.23
Food	11.1	-5.0	17.4	15.4	7.3	9.4	1.57	1.57	1.99
of which processed foods	11.6	2.7	2.8	4.9	2.4	3.2	0.76	0.85	1.06
Minerals (incl. crude fertiliser)	11.2	1.9	10.9	3.0	1.2	1.1	0.81	0.66	0.55
Manufactures^c	18.1	7.8	5.4	62.5	88.4	86.7	0.86	1.75	1.64
Chemicals & related products	26.6	12.6	17.8	2.1	3.9	6.2	0.23	0.64	0.83
Resource-based manufactures	17.2	-2.1	10.7	7.6	6.9	7.5	0.53	0.89	0.91
Machinery & transport equip't	19.9	9.6	3.5	41.6	68.7	63.4	1.09	2.44	2.22
of which parts & components	18.3	12.6	2.3	24.8	40.7	36.3	2.09	3.90	3.55
Miscellaneous manufacturing	9.4	3.2	8.3	11.2	8.9	9.6	0.97	1.06	1.12
Total	15.5	5.8	6.3	100.0	100.0	100.0	1.11	1.72	1.64
PHILIPPINES									
Primary products	3.1	-2.1	8.7	18.4	7.0	9.2	0.64	0.39	0.41
Agricultural products	3.8	-2.3	9.3	12.9	5.3	7.3	0.57	0.39	0.43
Agricultural raw materials	6.7	-3.1	3.0	1.4	0.6	0.7	0.24	0.21	0.19
Food	3.6	-1.8	10.1	11.5	4.7	6.6	0.70	0.43	0.50
of which processed foods	4.6	4.5	4.3	18.6	3.3	5.2	0.71	0.52	0.49
Minerals (incl. crude fertiliser)	1.6	1.6	6.8	5.7	1.7	1.9	0.90	0.40	0.33
Manufactures^c	26.4	19.8	-0.9	89.0	93.0	90.9	0.73	0.80	0.61
Chemicals & related products	3.1	-0.9	6.9	2.8	0.9	1.2	0.18	0.06	0.06
Resource-based manufactures	9.6	4.8	-3.3	5.0	2.8	2.5	0.21	0.15	0.11
Machinery & transport equip't	40.1	26.3	-0.8	35.0	78.0	75.8	0.55	1.20	0.94
of which parts & components	59.6	25.7	2.1	47.2	58.2	59.6	2.38	2.42	2.07
Miscellaneous manufacturing	14.8	1.8	-1.5	49.3	11.4	11.4	2.56	0.59	0.47
Total	18.3	17.2	-0.3	100.0	100.0	100.0	0.66	0.75	0.58

^a Annual average (%). ^b Two-year average (%). ^c Defined as SITC 5 through 8 less SITC 68 (non-ferrous metals).

TABLE 3 (continued) Non-oil Export Performance by Major Commodity Category

	Growth ^a			Share in Total Exports ^b			Share in World Trade ^b		
	89-96	97-00	01-04	89-90	99-00	03-04	89-90	99-00	03-04
SINGAPORE									
Primary products	8.1	-8.5	3.8	12.9	4.7	3.8	1.33	0.82	0.66
Agricultural products	5.1	-9.5	1.3	10.4	3.3	2.5	1.38	0.77	0.59
Agricultural raw materials	0.2	-11.9	0.4	3.7	0.6	0.4	1.87	0.61	0.44
Food	6.8	-8.9	1.5	6.7	2.8	2.1	1.20	0.81	0.63
of which processed foods	6.0	1.4	1.1	3.4	1.2	1.0	0.95	0.57	0.47
Minerals (incl. crude fertiliser)	22.0	-4.9	9.4	2.4	1.3	1.3	1.15	0.99	0.87
Manufactures^c	14.1	3.7	6.9	87.1	95.3	96.2	2.12	2.58	2.52
Chemicals & related products	10.2	8.6	22.3	7.9	8.2	13.4	1.54	1.84	2.52
Resource-based manufactures	7.1	-6.5	6.4	7.3	3.4	3.3	0.91	0.61	0.55
Machinery & transport equip ^t	16.1	3.7	5.0	61.0	74.5	70.1	2.84	3.61	3.40
of which parts & components	22.2	10.2	7.9	22.3	42.8	45.2	3.34	5.60	6.12
Miscellaneous manufacturing	8.3	5.2	6.2	11.0	9.2	9.4	1.69	1.49	1.51
Total	13.6	3.0	6.7	100.0	100.0	100.0	1.97	2.35	2.28
THAILAND									
Primary products	9.7	-2.0	12.7	38.8	21.2	20.5	2.13	1.98	2.23
Agricultural products	9.7	-3.1	12.7	37.6	19.9	19.4	2.64	2.43	2.84
Agricultural raw materials	16.1	-4.6	47.3	6.1	3.5	6.6	1.62	1.99	4.67
Food	8.4	-2.4	6.4	31.5	16.5	13.5	3.01	2.55	2.50
of which processed foods	7.9	13.5	3.0	22.0	12.6	11.4	3.26	3.26	2.93
Minerals (incl. crude fertiliser)	11.3	25.2	12.3	1.2	1.2	1.1	0.31	0.49	0.47
Manufactures^c	12.8	7.3	13.4	61.2	78.8	79.5	0.79	1.13	1.31
Chemicals & related products	23.1	21.8	21.8	1.9	5.9	7.5	0.20	0.70	0.88
Resource-based manufactures	9.6	4.8	12.8	13.0	11.8	11.8	0.86	1.11	1.25
Machinery & transport equip ^t	18.8	9.6	16.2	20.3	45.3	48.1	0.50	1.17	1.47
of which parts & components	16.0	14.5	8.3	10.2	23.5	20.5	0.81	1.63	1.74
Miscellaneous manufacturing	6.3	-0.3	3.8	25.9	15.9	12.6	2.13	1.37	1.28
Total	11.9	5.0	13.2	100.0	100.0	100.0	1.05	1.25	1.43
ASEAN-5									
Primary products	3.1	-2.1	8.7	18.4	7.0	9.2	0.64	0.39	0.41
Agricultural products	8.3	-4.8	11.6	23.5	10.2	11.3	8.64	6.88	7.75
Agricultural raw materials	8.1	-7.4	20.8	8.1	2.3	3.1	11.23	7.23	10.24
Food	8.4	-3.6	10.0	15.4	7.9	8.3	7.70	6.79	7.24
of which processed foods	21.7	4.8	7.6	9.3	4.4	4.5	6.67	6.24	4.39
Minerals (incl. crude fertiliser)	15.4	2.1	10.3	3.6	1.9	2.1	4.70	4.32	4.12
Manufactures^c	14.8	7.1	6.1	73.8	87.9	86.6	4.98	7.00	6.72
Chemicals & related products	13.7	12.0	18.8	4.5	5.8	8.6	2.43	3.79	4.78
Resource-based manufactures	9.7	1.1	6.3	11.6	8.6	8.2	4.01	4.45	4.08
Machinery & transport equip ^t	18.4	8.6	5.3	38.8	61.4	58.6	5.02	8.75	8.40
of which parts & components	22.2	13.2	5.2	20.9	36.2	34.8	8.67	13.96	13.91
Miscellaneous manufacturing	9.0	2.9	3.6	19.3	12.2	11.3	8.26	5.81	5.40
Total	13.6	5.5	6.7	100.0	100.0	100.0	5.47	6.91	6.73

Source: Compiled from UN Comtrade database.

beyond contrasts in the agricultural resource endowments of the two countries.⁸ Indonesia has done much better than the Philippines, however, and more or less matched the performance record of Malaysia in this product category.

Third, miscellaneous manufacturing (predominantly wearing apparel and footwear) and resource-based manufacturing (mostly mineral products) continued to account for almost two-thirds of Indonesia's manufactured exports. By contrast, in Thailand, Malaysia and the Philippines, exports of machinery and transport equipment (SITC 7) expanded rapidly, dwarfing these 'traditional' export products.

Fourth, Indonesia has not so far been able to catch up with its regional neighbours in benefiting from the rapidly unfolding market opportunities associated with international product fragmentation, an increasingly important source of export dynamism. For instance, in 2003–04 parts and components accounted for a mere 9.1% of exports from Indonesia, compared with 36.3% in Malaysia, 59.6% in the Philippines, 45.2% in Singapore and 20.5% in Thailand. During the period 2001–04, parts and components exports from Indonesia grew at an average annual rate of 2.3%, compared with a regional average rate of 5.2%.

Against this background, we now turn to an analysis of Indonesia's changing comparative advantage in world trade, using Thailand as the comparator.⁹ In particular, what are the products in which Indonesia's performance in world markets has been better than its overall export performance? Has the list of products that meet this criterion expanded or shrunk over the years? A useful analytical tool that helps answer these questions is the index of revealed comparative advantage (RCA), which measures a country's export performance in individual product categories relative to its overall export performance in world trade (Balassa 1965).

The RCA index of a given country (country i) in the export of product j is defined as:

$$RCA_j^i = \frac{[X_j^i / X_j^w]}{[X_i^i / X_i^w]} \quad (1)$$

where: X_j^i is the value of country i 's exports of commodity j ; X_j^w is world exports of commodity j ; X_i^i is total exports of all goods from country i ; and X_i^w is world exports of all goods. If the value of the RCA index exceeds unity for commodity j , the country is said to have 'revealed' comparative advantage in world trade of that commodity. In contrast, if the RCA index is below unity, the country is at a comparative disadvantage in world trade of the commodity.

8 In addition to a rich agricultural resource endowment, a number of other factors seem to have underpinned Thai export success in processed food. These include: a highly liberal foreign investment policy that facilitated involvement of MNEs in *both* production (in the early years of export expansion) *and* trade; the long-standing policy of the Thai government not to intervene in domestic wholesale or retail trade, which provided an environment conducive to the evolution of highly efficient domestic marketing and distribution networks; and the pivotal role played by the ethnic Chinese business community – in particular the Charoen Pokphand (CP) Group – in branching out into food processing for export, based on their deep historical roots in domestic trade in agricultural products and as suppliers of fertiliser and seeds to Thai farmers (Jaffee and Gordon 1993; Kohpaiboon 2005: ch. 7).

9 Thailand is perhaps the best regional comparator because of the nature of its resource endowment, its stage of development and its export composition.

TABLE 4 *Indonesia and Thailand: Distribution of Non-oil Exports by Revealed Comparative Advantage (RCA) Category (5-year averages)*

RCA Index	Indonesia				Thailand			
	1990-94		2000-04		1990-94		2000-04	
	No. of Products	Export Share (%)	No. of Products	Export Share (%)	No. of Products	Export Share (%)	No. of Products	Export Share (%)
< 1	42	24.2	36	28.4	38	15.8	34	21.9
1-2	4	3.2	9	15.3	12	42.3	20	52.5
> 2	13	72.6	14	56.3	9	41.9	5	25.6
Total	59	100	59	100	59	100	59	100

^a For details of products by SITC category, see appendix table A.

Source: Compiled from UN Comtrade database.

We estimated the RCA index of Indonesia and Thailand in commodities identified at the two-digit SITC (Revision 3) level over the period 1990-2004. The analysis covered total merchandise exports excluding oil and gas (SITC 3) and special export items listed under SITC 9. In table 4, annual average RCA index estimates for 1990-94 (a period of very rapid export growth in the region, before the crisis) and 2000-04 (after the crisis and recovery period) are reported; RCA indices for individual commodities are shown in appendix table A, together with data on the share of each commodity in Indonesian and world exports.

These estimates must be used with caution, because domestic policy measures (such as production subsidies), foreign trade barriers (such as voluntary export restraints, or VERs), or trade preferences (such as preferential market access under the generalised system of preferences, or GSP), which have nothing to do with comparative advantage, can influence the measured value. In analysing Indonesia's export patterns, we have to keep in mind a notable supply-side factor: the log export ban introduced in 1981, which caused a boom in plywood and other processed wood exports (Lindsay 1989; Barbier et al. 1995; Resosudarmo and Yusuf 2005).¹⁰

10 In April 1981, the Indonesian government introduced a ban on manual logging coupled with a 'vertical integration requirement' for logging rights (that is, logging rights were issued only to companies that operated wood-processing mills) with the aim of reducing tax evasion by logging companies and, more importantly, promoting the domestic plywood industry and other wood-based industries. In 1992, the log ban was replaced by a cascading tariff structure for log and other forestry products (with rates as high as 200%). The ban was reintroduced in November 2001, with the declared aim of protecting plywood and other wood-processing industries from competition with China. These interventionist policies have certainly boosted plywood and other wood-based products through high effective protection, but it is questionable whether they have delivered net national economic gains in terms of government revenue and employment generation.

With this exception, export production in Indonesia during the period under study has not been supported by export taxes on inputs or direct export subsidies. On the demand side, exports of wearing apparel have been significantly influenced by export quotas under the MFA. Other than this, Indonesian exports have not significantly benefited from, or been adversely affected by, the trade policies of importing countries. So far Indonesia has resisted the temptation to embrace the newfound fondness for forming free trade agreements (FTAs).

The first impression from a comparison of the RCA estimates is that the revealed comparative advantage in world trade (the pattern of export specialisation) of both Indonesia and Thailand is broadly based, unlike that of many developing countries whose strength in international exchange lies in one or a few products. For instance, in Indonesia 23 products, accounting for 71.6% of total non-oil exports in 2000–04, had RCA indices above unity (table 4). The comparable figures for Thailand were 25 products and 78.1% of total export value. However, there are several notable differences in the RCA estimates of the two countries, and these are vital to explaining the differences in their overall export performance.

First, 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 in Indonesia (appendix table A). In 1990–94, there were 11 such products among the 17 products with above-unity RCA indices ('RCA products'), and they accounted for over one-quarter (27.0%) of total non-oil exports. In 2000–04, 13 of the 23 RCA products belonged to the primary product category, and these accounted for more or less the same share of total exports. By contrast, in Thailand the number of RCA products in the primary category increased from 9 out of 21 to 10 out of 25, and their share in total exports fell from 27.9% to 18.6% between 1990–94 and 2000–04.

Second, within the primary product category, RCA products in Thailand are heavily concentrated in food and beverages, reflecting the country's well-known success in the processed food trade. In contrast, Indonesia's revealed comparative advantage in primary exports is predominantly in agricultural raw materials and minerals. In the food and beverage sub-category, Indonesia has maintained above-unity RCA indices only in fish products (SITC 03), coffee, tea, cocoa and spices (SITC 07) and tobacco and tobacco manufactures (SITC 12), whereas Thailand's revealed comparative advantage in this area has been broadly based, encompassing meat and meat products (SITC 01, mostly chicken meat), fish and fish products (SITC 03), cereals and cereal preparations (SITC 04), vegetables and fruit (SITC 05) and sugar and sugar preparations (SITC 06). These patterns reconfirm our earlier inference that, despite having a broadly similar agricultural resource endowment, Indonesia has been less successful than Thailand in benefiting from the growing world demand for processed food.

Third, within manufacturing, Indonesia's comparative advantage has continued to remain confined largely to traditional labour-intensive manufactures—textiles (SITC 65), furniture (SITC 82), various categories of clothing (SITC 84), footwear (85) and a few domestic resource-based products—fertiliser (SITC 56), rubber goods (SITC 62), cork and wood manufactures (predominantly plywood)

(SITC 63)¹¹ and paper and paper products (SITC 64). Within the broad (one-digit) category of machinery and transport equipment (SITC 7), which has been the main vehicle for rapid growth in world trade during the period under study, only one product (telecommunications and sound equipment: SITC 76) has achieved RCA status in the Indonesian export structure. In contrast, Thailand's revealed comparative advantage in manufacturing has become increasingly broad-based over the years, with a number of products belonging to the machinery and transport equipment category accounting for an increasing share of total exports. The RCA indices of office machines (SITC 75), telecommunications and sound equipment (SITC 76) and electrical machine apparatus and parts (SITC 77) rose between 1990–94 and 2000–04, accompanied by an increase in their combined share in total exports from 22.6% to 34.4%. Thailand also continued to maintain RCA in a number of resource-based and traditional labour-intensive manufacturing products, although the magnitude of the RCA index recorded a notable decline in the cases of travel goods, clothing and footwear.

THE CHINA FACTOR

Ever since the People's Republic of China (henceforth 'China') began to emerge as a major trading nation in the early 1990s, there has been growing concern in Indonesia and other countries in the region that competition from this quarter would crowd out their export opportunities (James 2002; James et al. 2003; Holst and Weiss 2004). This concern gained added impetus from China's accession to the World Trade Organization (WTO) in 2001, and from the abolition of the MFA and the integration of textile and apparel products into the tariff-based system that came into effect from January 2005. The WTO accession not only provides China with most-favoured nation (MFN) status in major markets, but also enhances its attractiveness to export-oriented investment by reducing country investment risk.

The purpose of this section is to bring together some data relevant to this debate. We look first at competition from China in relation to exports from Indonesia and the other ASEAN countries in third-country markets. This is followed by an enquiry into new export opportunities for Indonesia in the expanding Chinese economy.

Competition from China in third-country markets

A useful starting point for examining the possible displacement of exports from ASEAN countries (or other countries) by exports from China in third-country markets is to gain some idea of the degree of overlap (similarity) in the exports of China and the ASEAN countries to these markets. The trade displacement effect would be important if and only if China exports the same types of commodities as other countries to a given market. If the exports are dissimilar (that is, subject to little or no 'commodity overlap') then there is little scope for trade displacement.

11 The very high RCA index for wood products mainly reflects high effective export protection emanating from the restrictions on log exports (see footnote 10).

A useful indicator that permits comparison of commodity composition among countries is the Finger-Kreinin export similarity index (Finger and Kreinin 1979). The index is defined by the formula

$$S(ab,c) = \left\{ \sum_i \text{Minimum}[X_i(ac), X_i(bc)] \right\} 100, \quad (2)$$

where a and b denote two countries (or country groups) exporting to market c , $X_i(ac)$ is the share of commodity i in a 's exports to c , and $X_i(bc)$ is the share of commodity i in b 's exports to c . If the commodity distribution of a 's and b 's exports is identical (that is, $X_i(ac) = X_i(bc)$), the index will take on a value of 100. If a 's and b 's export patterns are totally different (that is, for any given product i , $X_i(ac) > 0$, $X_i(bc) = 0$, and vice versa), the index will take on a value of zero. The index is intended to compare only patterns of exports across product categories; it is not influenced by the absolute value of total exports.

For this analysis we constructed the export similarity index using data for 3-digit SITC products, again excluding oil and gas (SITC 3) and special export items (SITC 9). These are the most disaggregated data available under the constraint that the commodity categories be consistent across the various importing countries. Estimation of export similarity between China and the ASEAN-5 countries was undertaken for the total world market and the three major regional markets, the US, Japan and the original 15 member countries of the European Union (EU). The estimates are reported in table 5.

The overlap between the export composition of China and that of each of the five countries is far from perfect. The index is below 60 for all five countries at all time points. This means that these countries should have ample room to experience independent growth trajectories regardless of China's rapid export growth. The magnitudes and time patterns of the index for Thailand and Indonesia are remarkably similar. The indices are much smaller for Singapore, Malaysia and the Philippines than for Thailand and Indonesia. This reflects the fact that the former countries' exports are more concentrated in electronics and electrical goods than those of China.

In sum, the estimates suggest that the impact of trade displacement occasioned by China's export expansion could be expected to be less severe than commonly thought. Moreover, it would appear that the impact of trade diversion would be similar for Thailand and Indonesia, but smaller for Singapore, Malaysia and the Philippines. Has the actual export experience of these countries been consistent with these expectations?

To shed light on this question, data on the comparative export performance of China and the five ASEAN countries in the US market are summarised in table 6. The table covers total manufacturing exports and three sub-categories thereof—consumer electronics, textiles and apparel, and other traditional labour-intensive products (mainly footwear, and travel and sporting goods)—which are of particular relevance to export market penetration for developing countries. Previous studies of competition from China in third-country markets have commonly used the share of China and other countries in imports to the given markets. This approach may be misleading, however, if imports from both China and a given country grow, but China maintains a faster growth rate. To allow for this possibil-

TABLE 5 *Indices of Non-oil Export Similarity between China and ASEAN-5 Countries*

Export Market	Competitor	1990	1995	2000	2003
World	Indonesia	38.3	50.1	58.0	54.6
	Malaysia	28.6	34.3	40.9	46.7
	Philippines	33.6	42.6	33.2	38.3
	Singapore	29.6	34.5	38.4	41.9
	Thailand	46.6	55.1	52.9	54.4
Japan	Indonesia	20.5	31.9	36.4	38.0
	Malaysia	11.0	26.5	29.5	34.7
	Philippines	24.5	25.4	25.5	29.5
	Singapore	13.3	24.2	26.8	26.4
	Thailand	23.6	38.8	41.0	45.0
US	Indonesia	48.9	48.6	51.4	39.8
	Malaysia	20.2	27.0	33.2	42.6
	Philippines	30.3	36.1	29.8	38.8
	Singapore	16.3	19.4	25.6	32.2
	Thailand	36.5	49.5	48.2	50.2
EU-15 ^a	Indonesia	36.2	37.9	41.6	36.8
	Malaysia	21.8	31.0	40.8	43.5
	Philippines	29.9	34.6	27.2	33.8
	Singapore	18.7	27.3	32.4	36.3
	Thailand	41.4	44.5	44.1	45.8

^a EU-15 refers to the 15 member states of the European Union before its enlargement in 2004: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.

Source: Compiled from UN Comtrade Database (importer records).

ity, both market shares and the growth rate of imports are used as complementary measures in the analysis.

China's share in US imports of manufactures increased from 7.5% in 1994–95 to 16.9% in 2003–04 (table 6). The combined share of the five ASEAN countries declined, but at a slow rate (from 9.0% to 6.7%) compared with the massive increase in China's market share. Estimates for other countries (not reported here) suggest that Hong Kong and Taiwan have experienced much sharper contractions in their market share than the ASEAN countries, combined with persistent negative export growth. This comparative performance record is consistent with the view that most of the growth in Chinese exports to developed country markets so far has stemmed from the rapidly diminishing comparative advantage of the NIEs in conventional labour-intensive product lines.

These product lines have rapidly 'migrated' to China from the NIEs through investment links (Lardy 2002: 160–2). In textiles and apparel, both Indonesia and Thailand have managed to maintain their market shares, even though the rate of growth of exports has declined markedly. In consumer electronics, Indonesia has performed poorly compared to Malaysia and Thailand, while in other traditional labour-intensive products (mainly footwear, and travel and sporting goods) there is no notable difference in export performance among the three countries.

One interesting related issue that needs further analysis is whether Indonesia's poor performance in the US market could be ascribed to preferences offered to partner countries which compete directly with Indonesia in certain products that loom large in its exports to these markets (e.g. much higher tariffs on clothing imports to the US from Indonesia than from Mexico). However, as we shall see later in the paper, preferential tariffs do not seem to be a significant factor in explaining the relative export performance of these two countries in the US textile and clothing market.¹²

The patterns of change in the import market shares of China and the ASEAN countries in the Japanese and EU markets (not reported here) are broadly similar to those in the US market. The combined shares of the ASEAN countries in imports of textiles and apparel and other traditional labour-intensive products by both Japan and the EU have declined since 1994–95 in the face of rapid market penetration by imports from China. However, the magnitude of the decline is much smaller than the large increase in China's market share in both cases. A comparison of data for all major source countries (also not reported here) reveals that, as in the US case, the brunt of competition from China was borne by the East Asian NIEs, in particular Taiwan and Hong Kong. In both markets, there is no notable difference in the changes in market share in textiles and apparel and other traditional labour-intensive products between Indonesia, Thailand, Malaysia and the Philippines.

In sum, competition from China has obviously begun to have a considerable impact on the trading environment faced by Indonesia and other developing countries in the region. However, there is clear evidence that competition from China does not necessarily imply a proportionate loss in market share for all developing countries. In general, the East Asian NIEs have begun to experience greater market share losses than Indonesia, Malaysia, Thailand and the Philippines. It is also important to note that China's comparative advantage is not going to remain

12 An important point to note here is that the term 'free trade agreement' is a misnomer, because in order to become eligible for duty-free market access, partner countries must meet *rules of origin* (ROOs), which in most cases eat into the 'published' preference margin in practice. For instance, under the North American Free Trade Agreement (NAFTA), Mexico gains duty-free access to the US clothing market only if the products meet the 'triple transformation' condition (that is, that the transformation from raw material to finished clothing has been undertaken within the NAFTA area). The relative cost disadvantage arising from the use of yarn and textiles imported from the US (instead of from a low-cost source such as China or India) to meet this condition could well erase all or a significant portion of the preference margin for clothing exports to the US offered under NAFTA (Krishna 2004).

TABLE 6 *Manufacturing Imports to the US from Selected Asian Countries*

	Import Share (%) ^a				Import Growth (% p.a.) ^b		
	1989-90	1994-95	1999-00	2003-04	1989-94	1995-99	2000-04
Total manufacturing							
China	3.5	7.5	10.4	16.9	14.0	8.9	9.9
ASEAN-5	5.8	9.0	8.2	6.7	10.1	4.1	-0.7
Indonesia	0.4	0.9	0.9	0.8	13.7	5.7	-0.5
Malaysia	1.2	2.7	2.5	2.4	14.7	4.5	1.8
Philippines	0.7	1.0	1.4	0.8	8.5	8.6	-5.0
Singapore	2.4	2.9	1.9	1.3	6.9	0.6	-2.9
Thailand	1.0	1.6	1.5	1.4	9.7	4.5	1.0
Consumer electronics & electrical goods^c							
China	1.1	3.3	6.1	13.4	18.5	12.4	13.4
ASEAN-5	6.2	10.7	10.1	8.3	11.4	4.3	-1.6
Indonesia	0.0	0.3	0.5	0.4	43.1	8.9	-1.5
Malaysia	1.5	3.7	3.7	3.9	15.9	4.9	2.0
Philippines	0.5	0.9	1.7	1.0	12.7	12.7	-6.5
Singapore	3.5	4.4	2.9	1.8	7.6	0.5	-5.4
Thailand	0.7	1.4	1.3	1.2	12.7	4.4	0.0
Textiles & apparel							
China	12.3	15.1	13.0	18.7	7.0	3.2	8.1
ASEAN-5	11.5	12.5	11.2	9.8	5.6	3.7	0.6
Indonesia	2.2	3.0	3.0	2.9	8.0	5.2	2.1
Malaysia	2.0	2.5	1.8	1.4	7.0	1.6	-1.2
Philippines	3.4	3.4	2.7	2.2	4.6	2.6	-0.4
Singapore	2.0	0.9	0.5	0.3	-3.6	-2.7	-4.4
Thailand	1.9	2.7	3.1	2.9	9.0	6.6	1.4
Other traditional labour-intensive consumer goods^d							
China	10.6	21.9	25.3	32.6	13.0	6.9	6.8
ASEAN-5	15.3	20.9	15.2	10.7	8.1	1.7	-2.2
Indonesia	1.1	2.4	2.2	1.9	13.2	4.3	0.7
Malaysia	1.1	1.8	1.3	1.1	10.3	1.7	0.5
Philippines	1.9	2.1	1.6	1.2	5.7	2.1	-2.0
Singapore	9.0	11.9	7.8	4.3	7.6	0.5	-5.4
Thailand	2.0	2.7	2.3	2.2	7.6	3.7	2.0

^a Period average (% per annum).

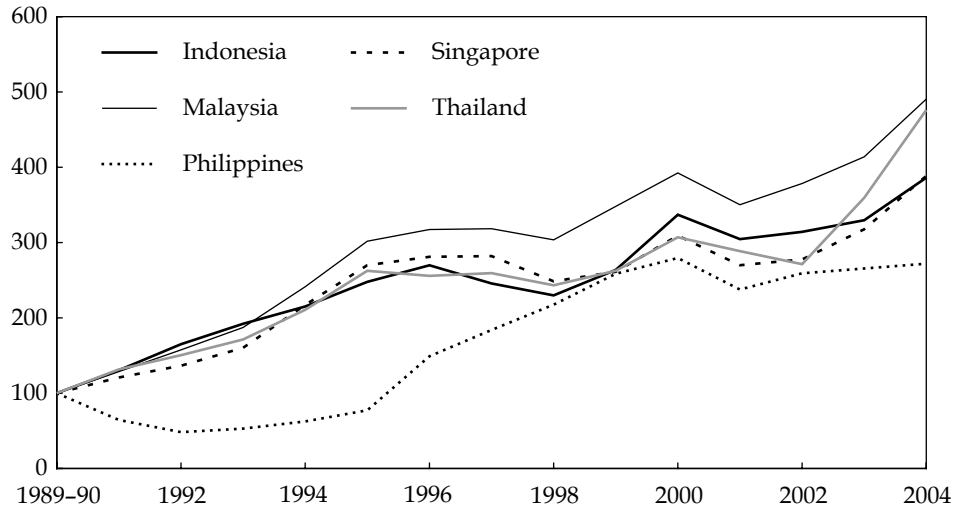
^b Annual averages.

^c Computers, peripherals, and television and radio receivers (including parts and components).

^d Mainly footwear, and travel and sporting goods.

Source: Compiled from UN Comtrade database (importer records).

FIGURE 4 *Non-oil Exports to China: Indonesia, Malaysia, the Philippines, Singapore and Thailand^a*
 (\$, 1989–90 = 100)



^a Compound annual growth rates for 1990–2004 are: Indonesia, 18.1%; Malaysia, 22.6%; Philippines, 33.2%; Singapore, 23.0%; Thailand, 27.8%; ASEAN-5, 22.2%. 1989–90 data are an average of the two years.

Source: Based on data compiled from UN Comtrade database.

the same over time. Economic theory and historical experience tell us that China's economic dynamism will change its international comparative advantage. As the Chinese economy becomes more integrated into the global economy, domestic wages will start to increase, eroding China's comparative advantage in labour-intensive products.

China as a new export market

China's trade has expanded at a record-setting pace with the promise its market offers to foreign firms. Its foreign trade expanded from about \$20 billion annually in the late 1970s to over \$800 billion in 2004. By that year, its share of total world trade had increased ten-fold since 1977, and it was the world's third-largest trading country after the US and Germany (WTO 2005). China has also become part of global production networks for computers and other information technology hardware, having increasingly been drawn into these networks as foreign firms took advantage of the combination of low labour costs and a liberal foreign investment environment. To what extent has Indonesia benefited so far from the new market opportunities in China, compared with its ASEAN neighbours?

Total merchandise exports from Indonesia to China increased from about \$350 million annually (about 2% of total Chinese imports) in the first half of the 1990s to over \$10 billion (5%) in 2004, recording an average annual growth rate of 28%. The growth of non-oil exports was somewhat slower, rising from \$300 million to \$9 billion (an average annual growth rate of 18%).

TABLE 7 ASEAN-6 Non-oil Exports to China^a

	1989-90 ^b	1994-95 ^b	1999-00 ^b	2001	2002	2003	2004
Country composition of exports to China (%)							
Indonesia	25.7	21.0	17.5	13.5	14.1	12.8	10.7
Malaysia	20.1	27.0	19.5	23.3	25.5	22.6	19.4
Philippines	4.5	2.5	4.6	4.9	6.6	7.2	7.9
Singapore	35.3	32.3	33.8	32.1	32.9	33.6	35.1
Thailand	14.4	17.3	16.7	17.4	14.0	19.0	23.5
Vietnam	0.0	0.0	8.0	8.7	6.9	4.8	3.4
ASEAN-6	100	100	100	100	100	100	100
Exports to China as a share of total exports (%)							
Indonesia	2.9	3.6	4.4	3.9	5.1	6.3	7.2
Malaysia	2.1	3.0	3.0	4.3	5.6	6.7	6.9
Philippines	0.9	1.9	1.7	2.5	3.9	5.9	9.1
Singapore	2.1	2.2	3.7	4.5	5.6	7.2	8.8
Thailand	1.9	2.5	3.7	4.5	4.9	7.3	9.8
Vietnam	0.0	0.0	8.6	9.5	8.6	7.8	7.0
ASEAN-6	2.1	2.7	3.6	4.4	5.4	6.9	8.3

^a ASEAN-6 is Asean-5 plus Vietnam.

^b Two-year average (%).

Source: Compiled from UN Comtrade database.

Total non-oil exports from the ASEAN-5 countries to China in the years 1989-90 to 2004 are plotted in figure 4. While Indonesia's export growth rate for the period (18%) is respectable, it is notably lower than those of the other four countries (Malaysia 23%, Singapore 23%, Thailand 28%, and the Philippines 33%). The growth rate differentials between Indonesia and the other four countries have in fact widened over the years. For instance, during the period 2000-05, Indonesian exports grew at an average annual rate of 22.2%, whereas the growth rates for the other countries varied between 29.4% for Malaysia and 46.5% for Thailand, and the regional average was 33.1%.¹³ Reflecting these differences in growth rates, Indonesia's share in non-oil exports from the ASEAN-5 countries plus Vietnam ('ASEAN-6') to China declined from 25.7% in 1989-90 to 10.7% in 2004 (table 7). Meanwhile Thailand's share rose markedly and those of the other ASEAN-5 countries stayed much the same. While the proportion of each economy's exports going to China rose, the increase was slower for Indonesia than for the other countries.

The data reported in table 8 help to explain the sources of Indonesia's relatively poor performance in penetrating the Chinese market. Contrary to popular belief, manufactured goods, *not* primary products, have been the most dynamic export product category in ASEAN-China trade. Manufacturing's share in total

¹³ Growth rates computed from data obtained from the UN Comtrade database.

TABLE 8 ASEAN-5 Non-oil Exports to China by Commodity Group

	Growth ^a			Share in Total Exports ^b		
	1989-2000	2001-04	1989-04	1989-90	1999-2000	2003-04
INDONESIA						
Primary products	12.8	12.0	11.6	11.9	41.5	46.3
Agricultural products	14.9	10.1	12.6	7.9	40.3	39.9
Agricultural raw materials	20.5	8.4	15.9	1.7	23.1	20.6
Food	11.6	12.2	10.8	6.2	17.1	19.3
of which processed foods	47.8	12.3	43.7	4.2	7.1	3.3
Minerals (incl. crude fertiliser)	0.1	40.3	8.2	4.2	1.2	6.4
Manufactures^c	4.1	8.9	4.9	88.0	58.5	53.7
Chemicals & related products	8.2	13.2	8.7	11.6	17.2	20.6
Resource-based manufactures	2.8	3.0	2.6	71.0	36.4	22.7
Machinery & transport equipment	4.4	24.9	8.4	5.4	3.8	9.1
of which parts & components	38.0	22.5	31.0	0.0	2.3	4.5
Miscellaneous manufactures	28.6	13.8	22.6	0.0	1.1	1.4
Total	6.2	10.3	6.6	100.0	100.0	100.0
MALAYSIA						
Primary products	3.1	14.9	5.5	81.9	30.7	27.9
Agricultural products	2.6	15.8	5.3	81.6	27.7	26.7
Agricultural raw materials	4.2	8.3	4.8	24.8	11.5	7.0
Food	1.8	19.8	5.5	56.9	16.3	19.7
of which processed foods	9.2	60.5	25.9	14.2	3.0	6.1
Minerals (incl. crude fertiliser)	21.1	2.5	14.9	0.2	2.9	1.2
Manufactures^c	15.3	17.1	14.5	18.1	69.3	72.1
Chemicals & related products	15.7	22.6	15.9	2.3	9.4	13.4
Resource-based manufactures	9.8	7.3	8.4	9.0	12.5	7.1
Machinery & transport equipment	19.3	17.8	17.4	5.8	44.5	48.4
of which parts & components	23.9	19.7	20.9	1.9	30.5	36.8
Miscellaneous manufactures	14.0	18.2	13.8	0.9	2.8	3.1
Total	8.1	16.5	9.3	100.0	100.0	100.0
PHILIPPINES						
Primary products	6.5	11.5	7.1	44.2	32.5	14.6
Agricultural products	8.0	10.4	7.9	10.0	9.9	4.1
Agricultural raw materials	6.3	5.4	5.6	2.0	1.3	0.4
Food	8.4	11.1	8.3	8.0	8.5	3.7
of which processed foods	46.9	18.1	34.9	4.0	6.7	2.9
Minerals (incl. crude fertiliser)	6.0	12.0	6.9	34.2	22.7	10.5
Manufactures^c	9.1	29.6	12.7	55.8	67.5	85.4
Chemicals & related products	-5.8	7.4	-2.5	53.8	3.2	1.0
Resource-based manufactures	14.8	7.7	11.9	0.9	2.9	1.0
Machinery & transport equipment	41.3	30.5	35.1	0.2	59.0	78.5
of which parts & components	69.6	26.0	52.0	0.0	52.1	54.2
Miscellaneous manufactures	13.2	44.1	18.5	0.9	2.4	6.4
Total	8.1	25.2	11.1	100.0	100.0	100.0

^a Annual average (%). ^b Two-year average (%). ^c Defined as SITC 5 through 8 less SITC 68 (non-ferrous metals).

TABLE 8 (cont.) ASEAN-5 Non-oil Exports to China by Commodity Group

	Growth ^a			Share in Total Exports ^b		
	1989-2000	2001-04	1989-04	1989-90	1999-2000	2003-04
SINGAPORE						
Primary products	-0.2	9.7	2.0	36.6	5.9	4.0
Agricultural products	-3.0	8.0	-0.4	34.2	3.1	1.9
Agricultural raw materials	-2.2	4.7	-0.5	17.0	1.8	0.9
Food	-3.9	11.8	-0.2	17.3	1.2	1.0
of which processed foods	-4.4	51.6	10.3	13.3	0.5	0.5
Minerals (incl. crude fertiliser)	9.8	11.3	9.3	2.4	2.8	2.1
Manufactures^c	11.1	16.3	11.3	63.2	94.1	96.0
Chemicals & related products	6.8	18.6	8.9	25.5	16.8	19.5
Resource-based manufactures	6.9	10.7	7.2	6.0	4.1	2.9
Machinery & transport equipment	13.4	16.3	13.0	28.3	64.6	65.9
of which parts & components	17.3	17.1	15.8	9.0	42.0	44.8
Miscellaneous manufactures	13.8	13.6	12.6	3.6	8.6	7.5
Total	9.0	16.0	9.8	100.0	100.0	100.0
THAILAND						
Primary products	2.7	16.5	5.5	89.9	31.4	25.1
Agricultural products	2.5	17.0	5.5	89.8	30.2	24.9
Agricultural raw materials	3.1	28.1	8.2	42.7	16.3	24.9
Food	1.9	4.0	2.3	47.1	14.0	5.1
of which processed foods	19.5	34.3	27.3	21.2	9.0	5.7
Minerals (incl. crude fertiliser)	18.6	13.7	15.9	0.2	1.1	0.8
Manufactures^c	18.6	21.9	17.8	10.0	68.6	74.9
Chemicals & related products	17.8	21.8	17.3	2.4	14.5	15.7
Resource-based manufactures	14.8	22.2	15.2	3.1	11.0	12.1
Machinery & transport equipment	23.3	21.9	21.0	2.6	41.0	44.6
of which parts & components	34.2	13.3	26.2	0.3	29.8	19.5
Miscellaneous manufactures	8.8	22.6	11.1	1.8	2.2	2.4
Total	8.1	20.4	10.1	100.0	100.0	100.0
ASEAN-5						
Primary products	4.8	11.9	4.0	51.9	26.1	19.9
Agricultural products	4.4	12.1	6.1	48.3	22.7	17.5
Agricultural raw materials	5.0	16.1	9.6	19.4	10.2	10.1
Food	4.0	10.5	5.7	28.9	12.5	8.6
of which processed foods	12.3	26.3	19.2	12.4	3.9	2.7
Minerals (incl. crude fertiliser)	8.0	13.4	15.4	3.6	3.5	2.9
Manufactures^c	10.6	17.7	18.6	48.1	74.0	80.2
Chemicals & related products	8.0	18.8	3.2	14.5	13.6	15.7
Resource-based manufactures	5.6	10.0	28.5	19.7	11.6	7.8
Machinery & transport equipment	15.3	19.2	43.1	12.0	44.3	52.3
of which parts & components	20.4	18.1	52.3	3.4	30.2	33.5
Miscellaneous manufactures	13.3	17.0	30.8	1.8	4.4	4.7
Total	8.3	16.3	9.4	100.0	100.0	100.0

Source: Compiled from UN Comtrade database.

ASEAN-5 exports to China increased from 48.1% in 1989–90 to 80.2% in 2003–04, and manufacturing accounted for over 75% of the total export increment between these two periods. Within manufacturing, machinery and transport equipment, and in particular its parts and components sub-category, has been the most dynamic export item. It seems that China is becoming increasingly involved in intra-regional specialisation in assembly activities in these industries, and ASEAN countries have begun to benefit from this new form of intra-regional specialisation (Athukorala 2005). However, Indonesia has not been able to profit from these market opportunities to the same extent as other countries. In fact, among the ASEAN-5 countries, Indonesia is unique for the persistent decline in the share of manufacturing (from 88.0% in 1989–90 to 53.7% in 2003–04) in its exports to China. This decline seems to reflect its poor performance in machinery and transport equipment exports, and especially in the parts and components sub-category. Interestingly, Indonesia has done relatively well in non-oil primary exports compared with the other two resource-rich countries, Thailand and Malaysia. However, this has failed to make a big difference in overall relative export performance, given the strong manufacturing bias in China's demand for ASEAN exports.

THE IMPLICATIONS OF MFA ABOLITION

In the lead-up to the expiry of the Multi-fibre Arrangement in January 2005, there was much anxiety and confusion in Indonesian policy circles about the future of the country's textile and apparel exports. The widely held view was that Indonesia was highly vulnerable to export contraction in the new quota-free market, in the face of strong competition from China and from relatively low-cost Asian competitors such as Sri Lanka, Bangladesh and India (James 2002; James, Ray and Minor 2003; Aswicahyono and Hill 2004: 291–2). Competitive pressure was also expected to come from African countries, which enjoy privileged access to the US market under the African Growth and Opportunity Act (AGOA), and from various other developing countries that had entered into preferential trading agreements with the US and the EU. Relatively higher wage growth in Indonesia (under the new minimum wage legislation) and other labour market rigidities were cited as additional disadvantages Indonesia was likely to suffer in the new non-MFA market context (Alisjahbana and Manning 2002: 293).

The data on textile and clothing exports from Indonesia for the first 11 months of the post-MFA era, reported in table 9, are not consistent with these predictions, however. The combined export value of these products rose 11.3% during this period compared with the same period in 2004. At this rate, 2005 is likely to record the highest ever value of textiles and clothing exports (about \$8 billion) from Indonesia. Clothing exports have increased at a much faster rate (13.2%) than textile exports (8.6%). As one would expect *a priori*, export value growth between January and November 2005 has emanated predominantly from export volume growth in both textiles and clothing. Removal of export quotas naturally leads to a reduction in (competitive) market prices as the quota rent dissipates. At the same time, exporting countries have greater room for volume expansion based on relative cost advantage as the quota restrictions are removed. It seems that, even under various constraints on the supply side (see below), Indonesia

TABLE 9 *Textile and Clothing Exports from Indonesia*

	2001	2002	2003	2004	2004 Jan–Nov	2005 Jan–Nov	2005 Growth Jan–Nov (%)
Textiles							
Volume (kg million)	1,214	1,220	1,156	1,147	1,052	1,118	6.3
Unit value (\$/kg)	2.64	2.37	2.53	2.75	2.73	2.79	2.2
Value (\$ million)	3,202	2,896	2,923	3,152	2,875	3,123	8.6
Clothing							
Volume (kg million)	430	376	380	376	346	391	12.9
Unit value (\$/kg)	10.54	10.49	10.79	11.84	11.75	11.78	0.2
Value (\$ million)	4,531	3,945	4,105	4,454	4,069	4,605	13.2
Textiles & clothing							
Volume (kg million)	1,644	1,596	1,536	1,523	1,398	1,509	8.0
Unit value (\$/kg)	13.18	12.87	13.32	14.59	4.97	5.12	1.0
Value (\$ million)	7,733	6,841	7,028	7,606	6,944	7,728	11.3

Source: Compiled from CEIC Asia Database (based on BPS data).

has considerable potential to expand its textile and clothing exports (particularly the latter) in the post-MFA era. The data on clothing imports to the US, by far the largest single market (absorbing nearly 40% of total world exports and over half of Indonesian exports of these products), are consistent with this inference (table 10).¹⁴

In 2005 the value of US imports of clothing from China increased by a staggering 69.6%, compared with a 6.1% increase in total US clothing imports. Naturally, the growth of clothing imports from Indonesia was much slower than that from China, but the growth rate (19.7%) was still far higher than that of total US imports of clothing. In order to place these figures in context, it is important to note that most of the low-cost producers in the region (such as Bangladesh, India, Laos and Sri Lanka) also posted impressive growth in exports to the US in 2005. On the other hand, disaggregated data from the same source (not reported here) indicate that total exports from sub-Saharan Africa declined by 12.5% (with only one country, Botswana, reporting significant positive growth) in spite of duty-free access to the US market under the AGOA. Likewise, Mexico experienced a 7.3% export contraction, notwithstanding market access privileges under NAFTA (see footnote 13). It seems that in the post-MFA era preferential market access privileges are not a substitute for natural relative cost advantages in achieving export success.

14 We do not consider textile imports here because the US is not a major market for textile exports from Indonesia. In 2004, the US accounted for less than 5% of Indonesia's total textile exports.

TABLE 10 *US Clothing Imports from Selected Asian Countries^a*

Exporter	Value (\$ million)			Growth in 2005	Volume (million m ²)			Growth in 2005
	2003	2004	2005	(%)	2003	2004	2005	(%)
World	61,162	64,768	68,715	6.1	18,864	19,951	22,013	10.3
China	7,258	8,928	15,144	69.6	2,290	2,973	5,885	98.0
ASEAN-6	10,736	11,151	11,956	7.2	3,316	3,468	3,669	5.8
Indonesia	2,158	2,403	2,875	19.7	618	703	823	17.1
Malaysia	686	712	678	-4.8	191	211	211	0.4
Philippines	1,853	1,786	1,830	2.5	546	514	519	1.0
Thailand	1,712	1,799	1,808	0.5	496	533	537	0.7
Vietnam	2,375	2,562	2,725	6.3	739	777	802	3.1
Hong Kong	3,702	3,849	3,511	-8.8	785	739	597	-19.3
Taiwan	1,611	1,549	1,134	-26.8	591	572	391	-31.6
South Korea	1,806	1,809	1,155	-36.2	576	624	360	-42.3
Bangladesh	1,848	1,978	2,372	19.9	913	942	1,125	19.4
Cambodia	1,240	1,429	1,713	19.9	528	635	710	11.9
India	2,002	2,217	2,976	34.2	532	609	790	29.7
Pakistan	1,015	1,138	1,259	10.7	444	519	578	11.3
Sri Lanka	1,436	1,549	1,650	6.5	395	415	454	9.3

^a Data relate to products covered by the Multi-fibre Arrangement.

Source: Compiled from US Department of Commerce, OTEXA Database.

One can of course cast doubts on the above inferences for two reasons. First, perhaps it is too early for the full effect of quota elimination to be reflected in reported data. It is important to note, however, that MFA abolition was not a 'policy surprise'. The phasing out and subsequent abolition of MFA quotas was announced at the time the WTO Agreement on Textiles and Clothing was signed in 1995. So market participants could have factored its possible implications into their decisions well before the winding up of the MFA in January 2005. Second, according to the conditionality built into China's accession to the WTO, the post-MFA era was never meant to be an 'era of free trade' in textiles and apparel for China. This became clearly evident when the US and the EU invoked this conditionality and imposed punitive restrictions on imports from China in mid-2005. Mindful of this possibility, international buyers would presumably have continued to keep the procurement networks formed during the currency of the MFA largely intact, notwithstanding the MFA phase-out. However, given the obvious country-risk considerations, it is unlikely that international buyers would 'put all their eggs in one (Chinese!) basket', even in an entirely free market setting.

DEMAND VERSUS SUPPLY FACTORS

To summarise the findings so far, Indonesia's export performance during the post-crisis period, in particular during the first five years of the new millennium, 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 underpinned by a failure to maintain growth dynamism in existing product lines or to benefit from emerging new opportunities for international production. Indonesia has remained an under-performer in exploiting the rapidly expanding market opportunities associated with the process of product fragmentation within vertically integrated global production networks. The emergence of China as a major exporter of labour-intensive products has obviously begun to have a considerable impact on the trading environment faced by Indonesia and other exporting countries in the region. However, there is compelling evidence that competition from China does not necessarily imply a proportionate loss in market share for Indonesia and other developing countries. Moreover, the rapid expansion in imports by China has opened up new market opportunities for these countries. Finally, there is no evidence to support the gloomy predictions of catastrophic loss of market opportunities in textiles and clothing for Indonesia under the new competitive market conditions following the abolition of the MFA. All in all, our findings are consistent with the view that the explanation for Indonesia's export success or failure lies on the supply side rather than on external demand constraints.

What are 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 period 1987-96.¹⁵ Perhaps the most important and widely publicised lesson from the Indonesian experience during this period relates to the role of sound and credible macroeconomic management in ensuring international competitiveness in production of tradables. When the current account moved sharply into deficit following the precipitous decline in oil prices in the first half of the 1980s, the government responded swiftly with a determined policy that combined expenditure reduction with exchange rate realignment. The significant devaluations of the rupiah in 1983 and 1986, coupled with relatively tight controls on the money supply and budget deficits, were instrumental in redressing real exchange rate misalignments; these policies persisted during the oil boom period ('getting the prices right'), thereby setting the stage for the take-off of non-oil exports.¹⁶

15 A number of excellent and detailed accounts of the reform process are available; see in particular Myint (1984); Hill (2000); Gelb and Associates (1988); Woo, Glassburner and Nasution (1994); and Temple (2003).

16 Indonesia was the only oil-exporting developing country to respond successfully to the macroeconomic crisis following the 1980s collapse of oil prices. Indonesia's choice of policies at the time is widely regarded as a highly successful policy experiment, in which expenditure reduction was combined with exchange rate realignment to stabilise the economy in the face of a severe external economic shock (Gelb and Associates 1988).

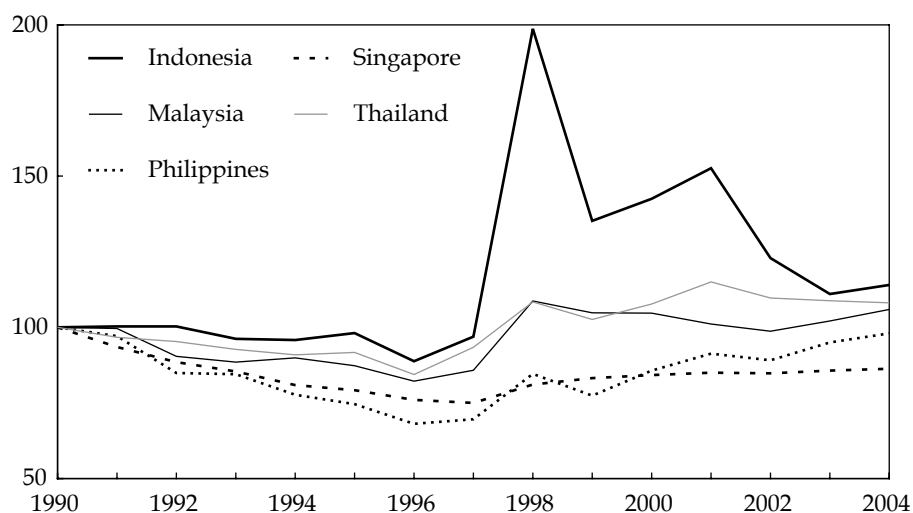
However, the rapid expansion of non-oil exports during the ensuing decade was not a matter of sound macroeconomic policy alone; microeconomic reforms were also an integral part of the story. In the second half of the 1980s, there was a series of wide-ranging microeconomic reforms that represented a decisive shift in overall development strategy from import substitution towards export orientation. These included contracting out customs administration to a Swiss company (with effect from 1985) and deregulation of shipping as part of a sweeping trade facilitation reform package (Inpres No. 4/1985); introduction of an efficient and transparent duty drawback scheme with a view to providing exporters with prompt duty-free access to imported inputs; gradual dismantling of quantitative import restrictions, with a shift toward tariffs as the preferred tool of trade policy; and liberalising the foreign investment regime, with emphasis on promoting foreign direct investment (FDI) in export-oriented production. In addition, the provision of physical and social infrastructure began to improve substantially. Although there were no bold initiatives to address the perennial issue of corruption, the government provided a stable economic and policy environment, and protected property rights through what has been described as a 'franchise system' spearheaded by the president (McLeod 2005; see also Boediono 2005). All in all, the policy context and the domestic investment environment turned out to be highly conducive to private sector participation in the domestic economy. The Heritage Foundation, in its first release of the Index of Economic Freedom in 1989, ranked Indonesia above 31 of the 101 countries covered by the index, including the Philippines, India, China and Vietnam.

Over the past five years, the Indonesian government has made good progress in restoring order to the macroeconomic house shattered by the 1997-98 financial crisis. The tumultuous post-crisis phase of massive fluctuations in domestic prices and the nominal exchange rate has ended, and the real exchange rate has now settled at a level more or less comparable with that of the other countries in the region (figure 5), but somewhat more depreciated than the average during the 1987-96 economic boom. Unfortunately, however, there has been little progress in the sphere of microeconomic reform. On the contrary, as is well documented in a number of *BIES* 'surveys of recent developments',¹⁷ there has been some notable backsliding from the reforms of the late 1980s. This includes transferring customs administration back to the customs department (without undertaking necessary reform); creeping protectionism in the form of new and increased import duties on some politically sensitive products, and a host of new restrictive import licensing arrangements;¹⁸ and the introduction of a comprehensive set of labour regulations covering minimum wages and labour conditions and standards. As electoral positioning has intensified in the new democracy, and priorities in budgetary allocation have come to assume a more populist disposition, the economy has begun to experience serious infra-

17 See in particular Athukorala (2003); Alisjahbana and Manning (2002); MacIntyre and Resosudarmo (2003); Aswicahyono and Hill (2004); and Sen and Steer (2005).

18 Increased agricultural protection (particularly in rice and sugar) is presumably a key factor that constrains diversification of production into high-value export crops. Trade protection in the sugar sector penalises downstream food processing (Alisjahbana and Manning 2002; Stapleton 2006).

FIGURE 5 *Real Exchange Rate: Indonesia, Malaysia, the Philippines, Singapore and Thailand*
(1990 = 100)^a



^a The index (1990 = 100) measures producer (wholesale) prices in the 10 major export trading partners relative to consumer prices in the given country, both prices expressed in the currency of that country. An increase in the index implies real depreciation (improvement in international competitiveness). It is a reasonable proxy measure of the textbook definition of the real exchange rate – the ratio of tradable to non-tradable prices.

Source: Compiled using data extracted from IMF, *International Financial Statistics* (exchange rates and prices) and IMF, *Direction of Trade* (export shares in 1995) databases.

structure bottlenecks.¹⁹ This policy backsliding, coupled with the confusion generated by ongoing political and institutional changes and the government's failure to come up with a definitive agenda for economic reform, has created an unpredictable business environment. In recent years, various global business confidence surveys have rated the domestic investment climate in Indonesia as poorer than that of other countries in the region and beyond, including Indonesia's new competitors, China, India and Vietnam (World Bank 2005b).

Perhaps the most obvious and important manifestation of the adverse investment climate is Indonesia's dismal record in attracting FDI, particularly into export-oriented industries. Net annual FDI inflows into Indonesia have persistently been negative since 1998 (UNCTAD 2005). In recent years there have been many reported cases of foreign investors pulling out of export-oriented industries (Alisjahbana and Manning 2002: 297–8; MacIntyre and Resosudarmo

19 For example, according to a recent survey by the University of Indonesia's Institute for Economic and Social Research (LPEM-UI 2005, as cited by Sen and Steer 2005: 295), firms lose about 6% of their potential output because of power shortages.

2003: 146).²⁰ These developments are very disturbing, because there is strong evidence that the involvement of MNEs is virtually essential for export success, given that export performance in the global economy is closely associated with vertically integrated trade spearheaded by MNEs (Athukorala 2006b: ch. 2). In China, for example, the unprecedented expansion of manufactured exports has been underpinned by an increase in the share of MNEs in total manufacturing exports from less than 3% in the mid-1980s to over 50% by the turn of the century. The MNE share of total manufacturing exports for Indonesia *circa* 2001 was about 35%, the lowest among the 'ASEAN-6' countries.²¹ The explanation for Indonesia's dismal performance in oil and gas exports, too, is closely related to the poor investment climate, which has kept away foreign investors.²² Indonesia's many oil fields are shallow – unlike, for instance, those in oil-producing countries in the Middle East – so maintaining a steady level of oil output requires sustained exploration. Over the past five years, exploration activities by foreign oil companies have stagnated. This can be attributed partly to negative perceptions about Indonesia's investment climate in general, exemplified in the long-running dispute between Chevron-Mobil Oil and Pertamina about oil exploration in the rich Cepu field on the border between Central and East Java (Sen and Steer 2005: 299; Kuncoro and Resosudarmo 2006: 12).

CONCLUSION

Indonesia's export performance since the crisis has so far failed to regain its pre-crisis dynamism. The analysis in this paper provides strong support for the view that this lack-lustre export record is rooted primarily in domestic (supply-side) rather than external factors. Growth in export value has closely followed growth in export price (unit value) rather than growth in volume. Export performance over the past five years has persistently lagged behind that of Indonesia's ASEAN neighbours other than the Philippines. Compared with Thailand, Malaysia and Singapore, Indonesia has performed poorly not only in processed food and assembly activities, with their emerging opportunities for international specialisation within vertically integrated global industries, but also in other manufacturing production (with the partial exception of textiles and clothing). In manufacturing generally, Indonesia has so far remained an under-performer in benefiting from these opportunities.

20 The departure of several high-profile foreign firms (mostly Korean) involved in sub-contracting activities for Nike and Reebok contributed to a precipitous fall in Indonesia's world market share in footwear, from 4.2% in 1995 to 2.5% in 2003 (based on data from the UN Comtrade database). Many cases of foreign firms leaving the textile and clothing industries have also been reported. There are no reported cases of entry by foreign firms into the electronics and electrical goods industries in Indonesia in recent years, even though these industries have been the major attraction for foreign investors in export-oriented manufacturing elsewhere in the region (Athukorala 2006b).

21 The figures for the other 'ASEAN-6' countries were: Malaysia and the Philippines 86%; Singapore 87%; Thailand 63%; Vietnam 57%; see Athukorala (2006b: table 2) for data sources.

22 I owe this point to Thee Kian Wie of the Indonesian Institute of Sciences.

The emergence of China as a major exporter of labour-intensive products and the abolition of the MFA have obviously made life more challenging for exporters from Indonesia and other exporting countries in the region. However, there is no evidence that competition from China necessarily implies a proportionate loss in market share for these countries. Moreover, the emergence of China as an economic powerhouse has begun to offer them lucrative new market opportunities. Finally, experience in the first year (2005) following the abolition of the MFA has run counter to the widely held prediction that Indonesia and other countries in the region would suffer a significant contraction in their textile and clothing exports under the new competitive market conditions.

The immediate economic policy challenge in setting the stage for export recovery is to reverse recent backsliding in microeconomic policy reform and to push ahead with the speedy implementation of the unfinished reform agenda inherited from the pre-crisis era. The case for market-oriented reform is much more pressing in the current international economic environment—characterised by the rapid expansion of global production networks and the emergence of China as an economic force—than it was at the end of the oil boom in the mid-1980s. Prudent macroeconomic management, while absolutely necessary, is not sufficient for achieving rapid and sustained export growth in this climate.

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APPENDIX TABLE A *Non-oil Export Composition, Share in World Exports and Revealed Comparative Advantage (RCA) Indices (5-year averages)*

SITC Code & Commodity Description	Indonesia						Thailand					
	Share in Total Exports (%)		Share in World Exports (%)		RCA Index		Share in Total Exports (%)		Share in World Exports (%)		RCA Index	
	90-94	00-04	90-94	00-04	90-94	00-04	90-94	00-04	90-94	00-04	90-94	00-04
PRIMARY PRODUCTS	31.7	30.6	1.4	1.9	1.9	2.2	30.0	20.7	2.0	1.9	1.8	1.5
Food, beverages & tobacco	12.9	8.2	1.0	0.9	1.3	1.1	24.7	15.4	2.9	2.6	2.6	2.1
00 Live animals	0.1	0.1	0.2	0.4	0.3	0.4	0.0	0.0	0.1	0.3	0.1	0.2
01 Meat & meat preparations	0.1	0.1	0.1	0.1	0.1	0.1	1.3	1.5	1.2	2.1	1.1	1.7
02 Dairy products & eggs	0.0	0.2	0.0	0.3	0.1	0.3	0.1	0.1	0.1	0.3	0.1	0.3
03 Fish, crustaceans & molluscs	5.6	3.3	4.2	3.3	5.4	3.9	9.7	6.1	10.5	8.5	9.4	6.7
04 Cereals & cereal preparations	0.2	0.2	0.1	0.2	0.2	0.2	4.6	2.9	3.6	3.7	3.3	2.9
05 Vegetables & fruit	1.3	0.7	0.6	0.4	0.8	0.5	5.0	2.0	3.4	1.9	3.0	1.5
06 Sugar & sugar preparations	0.2	0.2	0.5	0.5	0.6	0.5	2.3	1.3	6.7	5.8	6.0	4.6
07 Coffee, tea, cocoa & spices	4.0	2.3	5.4	4.2	7.0	5.0	0.2	0.1	0.5	0.3	0.4	0.2
08 Animal feed	0.5	0.2	0.8	0.5	1.0	0.6	0.6	0.5	1.2	1.5	1.1	1.2
09 Miscellaneous edible products	0.1	0.4	0.3	0.9	0.3	1.0	0.5	0.6	1.3	1.9	1.2	1.5
11 Beverages	0.1	0.0	0.1	0.0	0.1	0.1	0.1	0.2	0.2	0.3	0.1	0.2
12 Tobacco & tobacco manufactures	0.7	0.5	0.9	1.2	1.1	1.4	0.3	0.1	0.6	0.4	0.5	0.3
Agricultural raw materials	12.8	15.1	2.4	4.2	3.1	4.9	4.6	4.2	1.3	1.7	1.1	1.4
22 Oil seeds & oleaginous fruit	0.1	0.0	0.1	0.1	0.2	0.1	0.0	0.0	0.1	0.1	0.1	0.1
23 Crude rubber	4.6	2.7	14.8	14.5	19.2	17.0	3.6	2.9	17.0	21.2	15.2	16.7
24 Cork & wood	1.6	0.9	1.4	1.2	1.8	1.5	0.2	0.3	0.3	0.6	0.2	0.5
25 Pulp & waste paper	0.3	1.4	0.5	3.4	0.7	4.0	0.0	0.2	0.1	0.7	0.1	0.5
26 Textile fibres	0.2	0.3	0.2	0.8	0.3	1.0	0.4	0.4	0.7	1.5	0.6	1.2
29 Animal & vegetable material	0.3	0.2	0.6	0.5	0.7	0.6	0.4	0.2	0.9	0.7	0.8	0.6
32 Coal, coke & briquettes	2.2	4.0	3.4	7.9	4.4	9.2	0.0	0.0	0.0	0.0	0.0	0.0
41 Animal oils & fats	0.0	0.0	0.5	0.1	0.6	0.1	0.0	0.0	0.0	0.1	0.0	0.1
42 Fixed vegetable fats & oils	2.9	5.3	6.8	15.3	8.8	17.9	0.0	0.1	0.1	0.5	0.1	0.4
43 Animal & vegetable fats & oils n.e.s. ^a	0.6	0.3	5.5	4.1	7.1	4.8	0.0	0.1	0.2	1.1	0.1	0.9
Minerals	6.0	7.3	1.4	1.9	1.8	2.3	0.6	1.2	0.2	0.5	0.2	0.4
27 Crude fertiliser, mineral	0.4	0.2	0.8	0.7	1.0	0.9	0.3	0.4	1.1	2.2	1.0	1.7
28 Metallic ore, scrap	3.9	4.6	3.1	4.1	4.0	4.8	0.1	0.2	0.1	0.3	0.1	0.2
68 Non-ferrous metals	1.7	2.5	0.7	1.0	0.9	1.2	0.2	0.6	0.1	0.4	0.1	0.3
MANUFACTURING^b	68.2	69.4	0.6	0.7	0.8	0.8	70.0	79.3	0.9	1.2	0.8	0.9
51 Organic chemicals	0.9	2.6	0.3	0.9	0.4	1.0	0.4	1.3	0.2	0.7	0.2	0.5
52 Inorganic chemicals	0.2	0.5	0.2	0.6	0.3	0.7	0.1	0.2	0.2	0.3	0.2	0.2
53 Dyes & colouring material	0.2	0.3	0.2	0.4	0.3	0.4	0.3	0.2	0.5	0.4	0.5	0.3
54 Medicinal & pharmaceutical products	0.1	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.1

^a n.e.s.: not elsewhere specified.^b SITC 5 though 8 less SITC 68 (non-ferrous metals).

APPENDIX TABLE A (cont.) *Non-oil Export Composition, Share in World Exports and Revealed Comparative Advantage (RCA) Indices (5-year averages)*

SITC Code & Commodity Description	Indonesia						Thailand					
	Share in Total Exports (%)		Share in World Exports (%)		RCA Index		Share in Total Exports (%)		Share in World Exports (%)		RCA Index	
	90-94	00-04	90-94	00-04	90-94	00-04	90-94	00-04	90-94	00-04	90-94	00-04
MANUFACTURING (cont.)												
55 Essential oil, perfume, etc.	0.7	0.8	0.7	0.7	0.9	0.8	0.2	0.6	0.3	0.9	0.3	0.7
56 Fertiliser	0.9	0.3	2.0	1.0	2.6	1.1	0.0	0.0	0.0	0.2	0.0	0.1
57 Plastic in primary form	0.3	1.2	0.1	0.6	0.2	0.7	0.4	2.8	0.3	2.3	0.2	1.8
58 Plastic in non-primary form	0.2	0.6	0.2	0.6	0.2	0.7	0.4	0.5	0.6	0.8	0.6	0.6
59 Chemical material. n.e.s. ^a	0.2	0.5	0.1	0.3	0.2	0.4	0.6	0.7	0.5	0.7	0.5	0.6
61 Leather & leather goods	0.2	0.2	0.5	0.4	0.6	0.5	0.8	0.6	2.4	2.0	2.1	1.5
62 Rubber manufactures n.e.s. ^a	0.4	1.0	0.4	1.0	0.5	1.2	0.8	1.2	1.0	1.9	0.9	1.5
63 Cork & wood manufactures	17.9	6.1	27.2	8.9	35.2	10.5	0.6	0.6	1.4	1.4	1.2	1.1
64 Paper, paper boards etc.	1.6	4.4	0.6	2.1	0.8	2.5	0.2	0.9	0.1	0.7	0.1	0.5
65 Textile yarn & fabrics	9.7	6.6	2.2	2.1	2.9	2.4	3.9	3.0	1.3	1.4	1.2	1.1
66 Non-metallic mineral manufactures	1.3	1.6	0.4	0.7	0.6	0.8	4.0	2.5	1.9	1.6	1.7	1.3
67 Iron & steel	1.3	1.1	0.3	0.4	0.4	0.4	0.6	1.3	0.2	0.7	0.2	0.5
69 Metal manufactures n.e.s.	1.0	1.1	0.3	0.4	0.4	0.5	1.3	1.7	0.6	0.9	0.6	0.7
71 Power generating machines	0.1	1.0	0.0	0.3	0.0	0.3	0.7	1.9	0.3	0.8	0.2	0.6
72 Special industrial machines	0.1	0.4	0.0	0.1	0.0	0.1	0.4	0.5	0.1	0.2	0.1	0.2
73 Metal working machines	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.2	0.2	0.3	0.2	0.2
74 General industrial machines n.e.s. ^a	0.3	1.0	0.1	0.2	0.1	0.2	2.8	3.6	0.7	1.1	0.6	0.8
75 Office machines	0.6	5.0	0.1	0.7	0.1	0.8	7.9	12.4	1.8	2.5	1.6	2.0
76 Telecom & sound equipment	3.0	6.8	0.6	1.1	0.8	1.3	5.7	6.2	1.6	1.5	1.4	1.7
77 Electrical machine apparatus & parts n.e.s. ^a	1.5	5.6	0.2	0.5	0.2	0.5	9.0	15.8	1.3	1.9	1.2	1.5
78 Road vehicles	0.8	1.3	0.1	0.1	0.1	0.1	1.4	4.6	0.2	0.6	0.1	0.4
79 Other transport equipment	0.5	0.2	0.1	0.1	0.1	0.1	0.6	0.6	0.2	0.3	0.2	0.2
81 Fabricated building material, etc.	0.1	0.2	0.3	0.3	0.3	0.4	0.3	0.3	0.7	0.8	0.6	0.6
82 Furniture, bedding, etc.	2.3	3.2	1.9	2.4	2.4	2.8	1.5	1.4	1.8	1.6	1.6	1.2
83 Travel goods, handbags & similar containers	0.2	0.3	0.7	0.8	0.8	0.9	1.0	0.6	3.8	2.4	3.4	1.9
84 Clothing & accessories	12.2	9.2	2.6	2.2	3.4	2.5	11.6	5.4	3.6	1.9	3.2	1.5
85 Footwear	5.7	2.9	4.4	3.0	5.6	3.5	3.3	1.2	3.7	1.8	3.3	1.4
87 Scientific equipment n.e.s. ^a	0.1	0.1	0.0	0.1	0.0	0.1	0.4	0.5	0.2	0.3	0.2	0.2
88 Photographic apparatus n.e.s. ^a & clocks	0.5	0.4	0.3	0.3	0.4	0.3	1.4	1.4	1.1	1.3	0.9	1.0
89 Miscellaneous manufactures n.e.s. ^a	3.1	2.7	0.5	0.5	0.7	0.6	7.0	4.4	1.7	1.3	1.5	1.0
TOTAL	100.0	100.0	0.8	0.9	1.0	1.0	100.0	100.0	1.1	1.3	1.0	1.0

Source: Compiled from UN Comtrade database.

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