Indonesia

A new Indo-Pacific partner?

Samina Sultan / Gero Kunath / Henrik Förster/ Jürgen Matthes

Köln, 15.02.2024

IW-Report 9/2024

Wirtschaftliche Untersuchungen,
Berichte und Sachverhalte

INSTITUT DER DEUTSCHEN WIRTSCHAFT

Herausgeber
Institut der deutschen Wirtschaft Köln e. V.
Postfach 10 19 42
50459 Köln

Das Institut der deutschen Wirtschaft (IW) ist ein privates Wirtschaftsforschungsinstitut, das sich für eine freiheitliche Wirtschafts- und Gesellschaftsordnung einsetzt. Unsere Aufgabe ist es, das Verständnis wirtschaftlicher und gesellschaftlicher Zusammenhänge zu verbessern.

Das IW in den sozialen Medien

Twitter
@iw_koeln

LinkedIn
@Institut der deutschen Wirtschaft

Instagram
@IW_Koeln

Autoren

Dr. Samina Sultan
Economist für europäische Wirtschaftspolitik und Außenhandel
sultan@iwkoeln.de
0221 – 4981-312

Gero Kunath
Economist für Außenwirtschaft
kunath@iwkoeln.de
0221 – 4981-568

Henrik Förster
Wissenschaftlicher Mitarbeiter
foerster@iwkoeln.de

Jürgen Matthes
Leiter Themencluster Internationale Wirtschaftspolitik, Finanz- und Immobilienmärkte
matthes@iwkoeln.de
0221 – 4981-754

Alle Studien finden Sie unter www.iwkoeln.de

In dieser Publikation wird aus Gründen der besseren Lesbarkeit regelmäßig das grammatikalische Geschlecht (Genus) verwendet. Damit sind hier ausdrücklich alle Geschlechteridentitäten gemeint.

Stand:
Februar 2024

Table of Contents

JEL-Classification

F02 – International economic order and integration
O11 – Macroeconomic analyses of economic development
O53 – Economywide country studies – Asia including Middle East

Summary

Indonesia will elect a new president on 14 February. After ten successful years in office, Joko Widodo is not allowed to run for office again. He has ushered in an era of reform in the country. This is one of the reasons why Indonesia has been growing at an average annual rate of around 5 per cent for two decades and has also coped surprisingly well with the crises of recent years. The infrastructure, such as roads and the railway network, but also the digital sector, has been greatly expanded. Widodo has prioritised economic interests and shown a great deal of enthusiasm for reform. This course has supported growth, even if various challenges remain, for example in the education sector or with regard to corruption.

With a population of over 277 million people, Indonesia is an important country in the Indo-Pacific region. This region plays an important role for the European Union (EU) when it comes to reducing its critical dependencies on China by diversifying its trade relations. However, Indonesia cannot replace China due to its limited economic importance. This is because the EU's trade with Indonesia only accounts for around 4 per cent of the EU's trade with China. Nevertheless, more economic exchange with Indonesia is an important building block for the de-risking from China that the EU is striving for. In addition to Indonesia, other countries in the Indo-Pacific region, Latin America and Africa must also be included in the EU's de-risking strategy.

There is great potential in mutual trade between the EU and Indonesia. This is because the comparative advantages between Indonesia and the EU are very different: While Indonesia is specialised particularly in agricultural goods and raw materials, the EU's specialisation lies in sophisticated industrial goods. In fact, estimates by the European Commission show that a free trade agreement between the EU and Indonesia could increase EU exports to Indonesia by up to 44 per cent in the medium term, while EU imports from Indonesia could increase by 18 per cent. An increase in trade with Indonesia of around 25 per cent, for example, could thus compensate for a fifth of an assumed 5 per cent decline in EU trade with China, which may result from de-risking vis-à-vis China.

At present, however, this potential cannot be realised because:

- Indonesia and the EU each impose relatively high tariffs on precisely those goods where the other partner has comparative advantages.
- Indonesia has already concluded free trade agreements with other Asian countries – especially China – so that the EU suffers from strong trade diversion effects because EU players are discriminated against in trade.

China in particular benefits from trade diversion in its favour and to the detriment of the EU. China has a similar trade specialisation in industrial goods as the EU and is therefore in close competition with European companies. This has contributed to China's large gains in exports and imports with Indonesia. China's share of Indonesia's total exports has risen from 11.4 per cent in 2012 to 22.6 per cent in 2022. On the import side, China's share was 15.3 per cent in 2012 and 28.5 per cent in 2022. In addition, China's investment in Indonesia as part of the Belt and Road Initiative is contributing to a further increase in trade with Indonesia.

In contrast, the importance of the EU as a trading partner for Indonesia has continued to decline over the last decade. Indonesia has also lost relevance from the EU's perspective: Between 2012 and 2022, Indonesia's share of total EU imports stagnated at around 0.35 per cent because imports from Indonesia grew less

dynamically than EU imports as a whole. On the export side, the picture is even more alarming: While Indonesia's share of total EU exports was still 0.22 per cent in 2012, this share fell to just 0.13 per cent by 2022. During this period, the absolute value of EU exports to Indonesia barely increased. German exports to Indonesia even fell by around 5 per cent between 2012 and 2022.

The picture is similar for foreign direct investment. Between 2015 and 2022, the stock of foreign direct investment from the EU in Indonesia fell in absolute terms from around 47 billion euros to around 29 billion euros. This contributed to a significant decline in the EU's share of foreign direct investment in Indonesia. China, on the other hand, was able to increase its share from 2.2 per cent to 6.5 per cent during this period.

In terms of trade and foreign direct investment, the opposite of diversification with Indonesia has taken place in the last decade. From the EU's perspective, Indonesia's share should have increased for this to happen. Figuratively speaking, the train of diversification with Indonesia is not travelling forwards, but even backwards.

The EU should therefore urgently strive for a free trade agreement with Indonesia, which would make it possible:

- to exploit the trade potential indicated by the respective comparative advantages,
- to stop trade diversion to the detriment of the EU,
- to slow down China's advance in Indonesia by significantly increasing EU trade with Indonesia.

In addition, European companies should pay more attention to Indonesia and the opportunities available there. This should be flanked by trade and investment policy agreements in order to make the local investment conditions sufficiently attractive. This also requires economic partnership agreements with Indonesia that provide for the establishment of EU companies in Indonesia. In this respect, export processing zones, i.e. less regulated regions in which multinational companies can settle, should be considered.

In order to implement such agreements, it is important to understand that there is a clear convergence of interests between the EU and Indonesia: The EU has an interest in supporting industrial and technological development in Indonesia in order to promote Indonesia's role as a growing trade and investment partner, both for exports and imports. For example, the EU could work with Indonesia on de-risking by helping Indonesia to develop large-scale battery production for electric vehicles and possibly also in the solar panel production. These endeavours are also entirely in Indonesia's interests.

1 Introduction

The European Union (EU) is striving to enlarge its economic and political footprint in the Indo-Pacific region. In September 2021 the European Commission issued a strategy of the EU for cooperation in the Indo-Pacific (European Commission, 2021). It acknowledges the increasing importance of the region as home to three-fifths of the world's population and origin of 60 per cent of global gross domestic product (GDP). Moreover, geopolitical dynamics have highlighted its pivotal strategic role – not least, due to the increasing competition from China. Thus, the EU aims to foster its relations and reinforce cooperation with the Indo-Pacific partners, also to reduce its own dependence on China. This diversification of trade relations can serve to make the EU and European value chains more resilient. The following report focuses on one of the major economies in the region: Indonesia. Not least because of the upcoming decisive presidential elections, which will end the decade-long rule of Joko Widodo, the country deserves more attention.

Figure 1-1: Indonesia and the Indo-Pacific region

Indonesia (highlighted in blue) with Jakarta as the current and Nusantara as the future capital

Source: German Economic Institute (IW), made with Natural Earth, 2022

With more than 17,000 islands of which over 6,000 are inhabited, the archipelago of Indonesia (see Figure 1-1) is home to around 277 million people. This makes Indonesia the fourth most populous country, the third largest democracy and the largest Islamic country in the world. Since the turn of the millennium, the population of the archipelago has increased by more than 50 million people. According to current projections, it will continue to grow substantially, albeit on a slight downward trend, to over 290 million in 2030 and even to 317 million in 2050 (UN, 2022). This rapid population growth is also reflected in the country's demographics. In 2022, only 7 per cent of the population was older than 65. The proportion of people of working age (15–64 years) is 68.8 per cent (OECD, 2023a). This implies that around 190 million people of working age currently live in the country.

Indonesia has the world's sixteenth largest economy and the largest one in the Association of Southeast Asian Nations (ASEAN), a grouping of ten Southeast Asian countries that account for about 8 per cent of the world's population (IMF, 2023). The founding members in 1967 were Indonesia, Thailand, Malaysia, the Philippines and Singapore. Since then, Brunei, Vietnam, Laos, Myanmar and Cambodia have also joined. Large deposits of valuable raw materials reinforce its growing economic and geopolitical clout. Indonesia is a member of the Group of 20 (G20), a forum for the world's 20 most important industrialised and emerging economies. By hosting the G20-summit in 2022, the country has shown that it has arrived on the stage of the major global players in an increasingly multipolar world.

This report is centred around the question of whether Indonesia has the potential to become a new Indo-Pacific economic partner of the EU. It begins with an overview of the historical and political background of the country (Section 2). Section 3 focuses on Indonesia’s economic development by first assessing the country’s economic performance, followed by an analysis of the economic drivers. Section 4 examines Indonesia’s industrial structure. The country’s trade relations, in particular with the EU and China, are analysed in Section 5. Indonesia’s attractiveness as business location and its foreign direct investment relations are the focus of Section 6. Finally, this report concludes by examining whether and to what extent Indonesia has the potential to enable the EU to diversify from China (Section 7).

2 Historical and political background

Indonesia is a dynamically developing country in the Indo-Pacific region. Although it still suffers from many political and economic challenges, there are also various opportunities. The current government has laid a focus on making Indonesia more successful, particularly in economic and political terms, in order to seize upon and further develop its potential as the world’s fourth largest nation in terms of population. Indonesia has many relevant features that could help or hinder this objective. These features need to be understood by the EU in order to realise where and how Indonesia can become a larger partner in the Indo-Pacific region.

In the following assessment, the ASEAN-5 countries are generally used as benchmarks. Instead of Singapore, however, Vietnam is included in the comparison group. The reason for this is that Singapore, as a city state with a very advanced economy, would not serve as a meaningful benchmark. This leaves us with a suitable comparable group of: Vietnam, Malaysia, Thailand and the Philippines (also referred to as ASEAN peer nations). The analysis will focus on the period from 1997/1998, the time of the Asian financial crisis, to the present day.

Historical perspective

Indonesia has frequently been the centre of extensive political and social change, often accompanied by violence. Like many of its Southeast Asian neighbours, Indonesia has been shaped by its long colonial history. Parts of present-day Indonesia were under Dutch colonial rule for around 350 years. Dutch domination did not end until 1943, when Japan occupied large parts of Indonesia during the Second World War. However, Japanese rule lasted only two years until Japan's surrender in World War II on 15 August 1945. As a result, Indonesia proclaimed independence on 17 August 1945. This was followed by a bloody war of independence with the Netherlands, which attempted to restore its former power on the archipelago. The war ended in 1949 after tens of thousands of deaths and with the sovereignty of Indonesia (Harinck et al., 2017).

The country was initially governed democratically, but slipped more and more into authoritarian rule. The resulting political and social unrest sparked an attempted coup in 1965, which was blamed on the communist spectrum. It ended in a massacre in which more than 500,000 people died, most of them members or supporters of the Indonesian communist party (ITCJ, 2011). In the resulting chaos, commander-in-chief Hadji Mohamed Suharto seized power in 1967/1968. This was followed by around three decades of authoritarian rule and oppression, but also economic stability and success. It was only in the context of the Asian economic crisis, which reached its peak in 1997/1998, that Suharto resigned in 1998 under public pressure and protest.

In the subsequent post-Suharto era, referred to as the Reform Era (Era Reformasí), the country achieved notable economic, social and political success. It underwent comprehensive social and economic transformation as well as a period of democratic consolidation that led to an amended constitution, an independent judiciary and the strengthening of civil society rights. In 1999, the first free, open and democratic elections since 1955 were held (Ulum, 2020). From 1999 to 2002, four major amendments to the constitution were made, including the establishment of the Indonesian Constitutional Court as a key institution representing an independent judiciary (Eddyono, 2018). Under great social pressure, the ruling elites gave up some of their own power as part of the aforementioned constitutional amendments. This opened the door to improving the political representation of the population and to increasing party competition to a considerable extent. At the same time, however, new rules were introduced that ultimately secured the power of the existing elites by making it administratively disproportionately difficult for new parties to gain foothold. What followed was admittedly a democratic period, but one characterised by power-sharing between old elites from the Suharto era (Jaffrey, 2023).

Reform era during the presidencies of Joko Widodo since 2014

In 2014, Joko Widodo, popularly known as Jokowi, was elected president and is now in his second and final term of office. The former mayor of Surakarta and former governor of Jakarta is part of the Indonesian Democratic Party of Struggle (PDI-P), a secular-nationalist party. With 128 out of 575 seats in parliament and around 19 per cent of the vote, the PDI-P is currently the strongest party in the Indonesian parliament. What is particularly remarkable is that Widodo is the first president without direct ties to the old military and political elite around the Suharto regime. This and his background as a simple furniture maker, who grew up in the slums of Surakarta, make him one of the most popular heads of state in the world (The Economist, 2023a).

His era is characterised by liberalism, the strengthening and opening up of Indonesia's economy and the promotion of numerous infrastructure projects. Besides the construction of a high-speed railway network on Java, the decision to "relocate" the current capital Jakarta by building a new capital "Nusantara" from scratch on the island of Borneo attracted particular attention.

In 2020, he also enacted a so-called Omnibus Law on Job Creation. This was arguably the government's most ambitious reform measure in the current term of office. It intends to improve Indonesia's competitiveness and quality as a production and investment location by addressing many regulatory shortcomings at one stroke. Above all, it aims at opening up most economic sectors to foreign investment (with the exception of 7 "strategic" sectors), reducing corporate taxes, dismantling regulatory and bureaucratic obstacles and including a comprehensive reform of labour law in favour of companies. However, due to several court proceedings, it has still only been implemented to a rather limited degree (see Section 6.1).

In general, Indonesia's ambitious goals are also underlined by the Golden Indonesia 2045 Vision. Indonesia has set itself high targets for its centenary of independence such as "per capita income equivalent to that of developing countries", "poverty towards 0 per cent and reduced inequality" and "expanding international leadership and influence" (Indonesian Ministry of National Development Planning, 2023). Widodo himself has emphasised on several occasions that he wants Indonesia to become the fourth largest economy by 2045 (Cabinet Secretariat of Indonesia, 2019).

Indonesia increasingly sought the global political spotlight under Widodo. In the summer of 2022, Indonesia hosted the G20 summit. In 2023, Indonesia took over the leadership of ASEAN. Furthermore, the Indonesian president also took part in the BRICS summit in South Africa. BRICS is an intergovernmental organisation consisting of Brazil, Russia, India, China and South Africa as the founding members in 2010. Indonesia, however, is not one of the countries joining BRICS in a process of enlarging this group on 1 January 2024. This is in line with Widodo's strategy to not tying Indonesia to geopolitical blocs, but maintaining good relations with both the West and its partners. This strategy becomes particularly evident when looking at its relations with the US and China:

- Since Widodo took office in 2014, China has become Indonesia's most important trading partner and an increasingly important investor in the country (see Section 5.3 and 6.2). The prestigious high-speed train on Java was financed and built by China as part of the Belt and Road Initiative and is operated by a Chinese company (Cai, 2023a). Like China, Indonesia also expressed strong concerns with respect to the enhanced security partnership AUKUS, established in 2021 between Australia, the United Kingdom and the US with the wider strategic goal of deterring China's growing military threat in the region (East Asia Forum, 2021).
- At the same time, however, the relations between the US and Indonesia are also improving. In November 2023, US President Biden welcomed Widodo at the White House. During this visit, a comprehensive strategic partnership was announced with the aim of further deepening bilateral economic relations between the two countries. This initiative also includes cooperation in the critical area of the semiconductor industry (The White House, 2023).

The past decade under Widodo has been characterised by stability, economic advancement, increased prosperity and deeper international integration. Indonesia is currently considered one of the most stable democracies in the region with regular and fair elections (Bauer, 2023).

Upcoming presidential elections and questions about future economic course

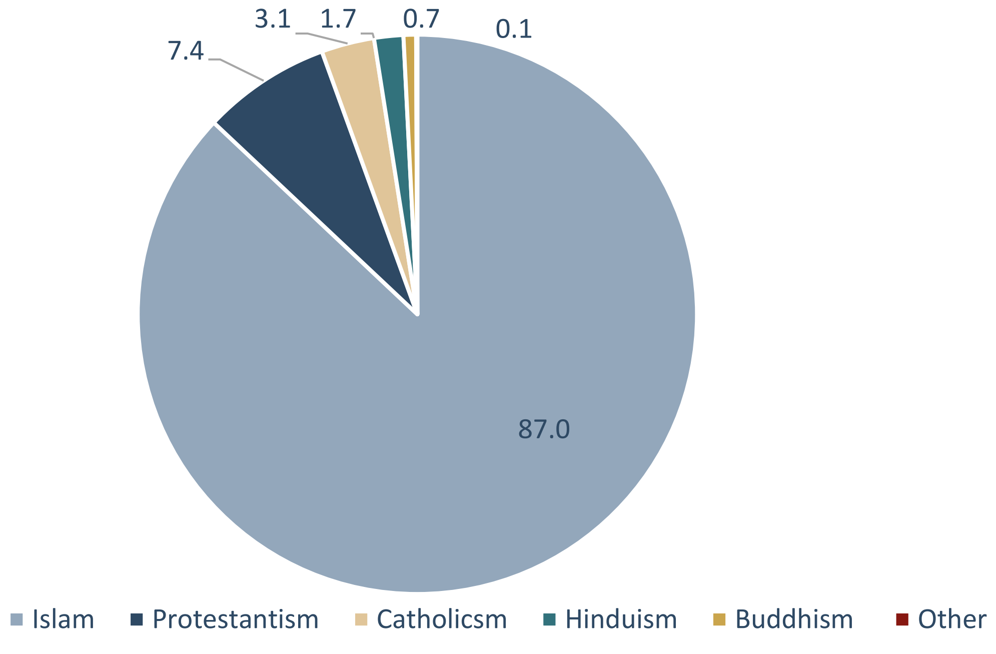
The next presidential elections will take place at the same time as the parliamentary elections on 14 February 2024. These will be the fifth for the country since the end of authoritarian rule in 1998 and, with around 205 million voters the world's largest elections on a single day. As Widodo is not permitted to run for a third time, these elections will determine his successor. To be able to run in the presidential elections, candidates must be officially supported by a political party or a coalition that won at least 20 per cent of the seats or 25 per cent of the votes in the previous parliamentary elections.

The upcoming elections raise the question of whether Indonesia will continue its path of economic growth, deeper international integration and democratic consolidation under the new leadership. Indeed, the recent past also reveals tendencies of democratic backsliding rather than further consolidation. Additionally, rumours of a cautious attempt to allow a third term in office caused unrest among the population. However, these rumours were quickly put to rest by the Indonesian government (Cabinet Secretariat of Indonesia, 2021). While this incidence speaks in favour of a democratically and politically aware society, Widodo is trying to form a political dynasty by sending his eldest son (36) into the race as vice president (Bagaskara/Setyarso, 2023). Controversially, Indonesia's Constitutional Court, headed by Widodo's brother-in-law, recently paved the way for this candidacy by suspending the minimum age of 40. Ironically, towards the end of his term of office, the first "outsider" president seems to be returning, at least in part, to the patterns of the old elites.

Three candidates are running in the upcoming presidential elections. The majority of the latest opinion polls see the current defence minister Prabowo Subianto from the nationalist and conservative Gerindra party, in the lead (Redaski, 2024). After two defeats against Widodo in the previous presidential elections, he is now entering the presidential election as the favourite. This time, however, with the prominent support Widodo's eldest son as his vice president. Thus, Widodo's attempt to shape a political dynasty appears to be within reach. The second place, and thus Prabowo Subianto's potential competitor in the second round of elections, will be decided between Anies Baswedan, former governor of Jakarta and from the Coalition of Change for Unity, and Ganjar Pranowo, former governor of Java and of Widodo's current leading party, PDI-P. There is currently no clear favourite who will receive the second most votes according to the polls. Both the current leading candidate Prabowo Subianto and the PDI-P candidate Ganjar Pranowo are positioning themselves as Widodo's successor with a focus on continuity. It therefore seems unlikely that there will be a major change in domestic or foreign policy after the upcoming elections (EIU, 2023).

Figure 2-1: Relevance of major religious groups in Indonesia

Share in the population in per cent in 2022



Source: DataIndonesia.id, 2023

In contrast, Anies Baswedan is aiming for a political change of direction with a much stronger conservative-religious Islamic orientation. Although the actual election chances are currently relatively low, this indicates that religious motives could potentially pose a threat to the government's economic orientation in the future. In fact, Islam is of major importance in Indonesia. In 2022, almost 242 million Indonesians, i.e. roughly 87 per cent of the population, professed Islam. This makes Indonesia the country with the most Muslims in the world, just ahead of Pakistan and India. However, Islam is not the state religion. In addition to Islam, Indonesia's constitution officially recognises Protestantism, Catholicism, Buddhism, Hinduism and Confucianism. This makes Indonesia a multi-faith state. Just over 10 per cent of Indonesians, that is around 29 million, are Christians (7.43 per cent Protestants and 3.06 per cent Catholics). A further 1.69 per cent are Hindus and 0.73 per cent are Buddhists. (see Figure 2-1).

3 Economic development

3.1 Economic performance

Indonesia is one of the fastest growing economies in the world and has steadily expanded for more than two decades following the Asian financial crisis in 1997 and the collapse of the Suharto regime in the following year. The Indonesian economy has made significant progress in developing across all sectors, i.e., industry, services and agriculture. The post-Suharto era has been not only a period of political, but also of economic stability. The following section unravels central aspects of the development of the Indonesian economy over the past 20 years and provides an overview of its current structure.

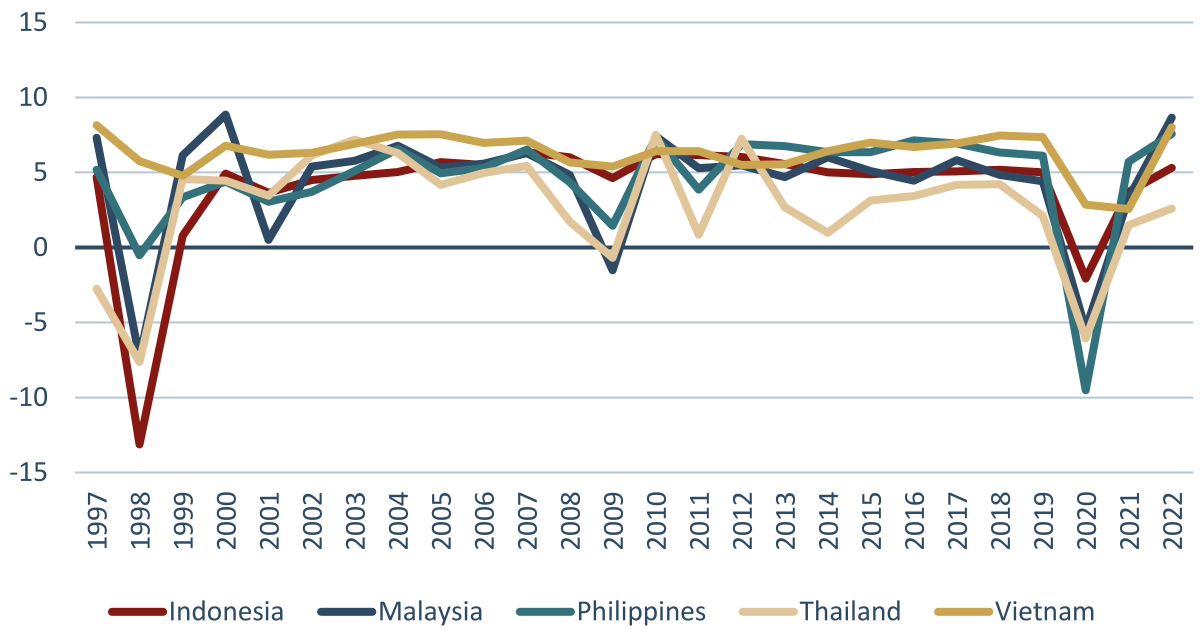
Macroeconomic indicators

In terms of **economic growth**, the Indonesian economy grew steadily at rates of around 5 per cent for two decades after recovering from the Asian financial crisis. It largely defied the global financial crisis in 2008/2009 and proved relatively resilient to the COVID pandemic, with GDP growth quickly reverting from –2.1 per cent in 2020 to 3.7 per cent in the following year, reaching a nine-year high of 5.3 per cent in 2022 (see Figure 3-1). GDP growth for 2023 is estimated at 5.0 per cent underlining the overall resilience of the Indonesian economy to the Ukraine war and other geopolitical tensions (Consensus Economics, 2024). However, compared to the also fast-growing ASEAN peer countries, Indonesia does not stand out, but displays a moderate performance with an average annual growth rate of 4.9 per cent in the period following the Asian financial crisis between 2000 and 2022. In comparison, Vietnam exhibited the strongest average annual growth in this period with a rate of 6.3 per cent, followed by the Philippines with 4.9 per cent and Malaysia with 4.6 per cent. Thailand grew relatively moderately with an average annual growth rate of 3.3 per cent.

In terms of **living standards**, the dynamic economic development has contributed to substantial improvements in Indonesia. GDP per capita doubled from around USD 6,400 in 1997 to around USD 12,400 in 2022 based on purchasing power parities (see Figure 3-2). Indonesia reached the status of an upper-middle income country for the first time in 2020 and regained it in 2023 after falling back to lower-middle income status during the peak of the COVID pandemic in 2021 and 2022 (Malerius, 2023a). It is the third of the ASEAN peer nations to reach that status, following Malaysia in 1992 and Thailand in 2010, which both had higher living standards in 2022.

Figure 3-1: Economic growth in selected ASEAN countries

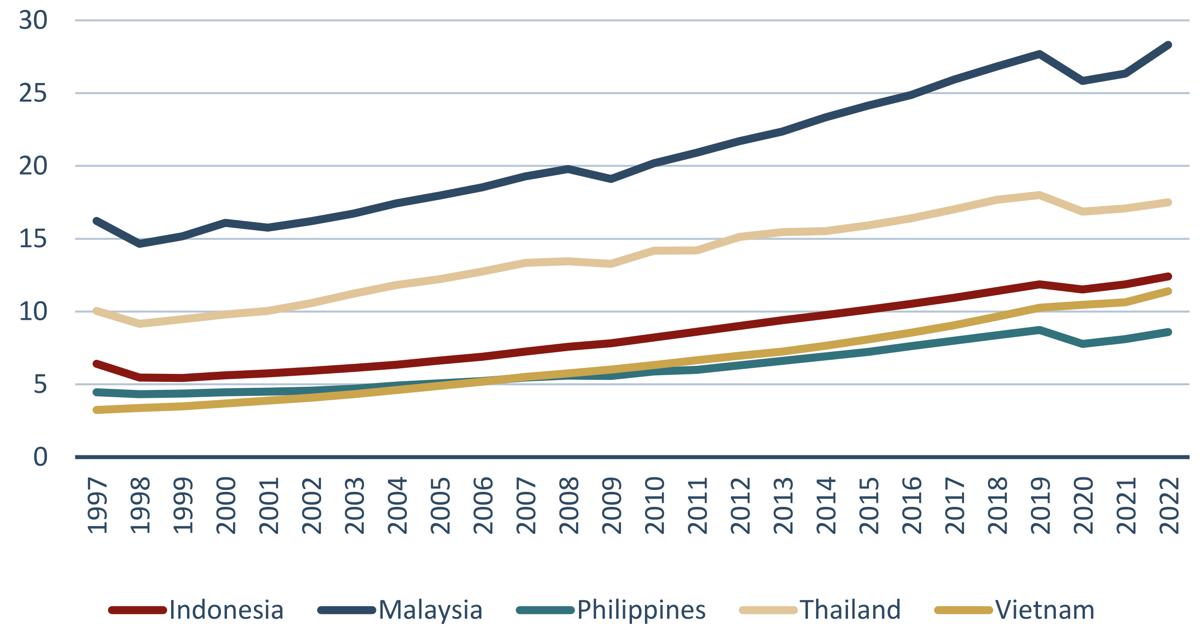
Change in real GDP year-on-year in per cent



Source: World Bank

Figure 3-2: Living standards in selected ASEAN countries

GDP per capita in constant prices (USD PPP), in thousands



Source: World Bank

Inflation performance has also improved considerably over time. After a historic surge to around 60 per cent during the Asian financial crisis, inflation rates hovered around 10 per cent in the late 1990s and the first decade of the 2000s before stabilising at rates around 5 per cent in the early 2010s and around 3 per cent in the late 2010s (World Bank, 2023a). Despite a temporary increase after the outbreak of the Ukraine war due to rising global commodity prices that sparked a substantial increase in gasoline prices, inflation has remained relatively subdued in recent crisis years. It is estimated at 3.7 per cent for 2023 and is expected to soften in 2024 (Ilman/Hapsari, 2023; Consensus Economics, 2024).

The Indonesian **labour market** has immensely profited from economic development. After difficult years in the early 2000s, the unemployment rate fell from its peak at 11.2 per cent in the second half of 2005 to 5.3 per cent in the second half of 2023 (Badan Pusat Statistik – BPS, 2023). Similarly, youth unemployment sunk from its historical peak at 26.4 per cent in 2005 down to 13 per cent in 2022 (World Bank, 2023a). The labour market participation rate moderately fluctuated around 69 per cent of the labour force over the past two decades (BPS, 2023). However, informal employment remained high and accounted for almost 60 per cent of total employment in 2022 (BPS, 2023). It seems that there is still a shadow labour market alongside the formal labour market, and many employees seem to work in both to sustain their living.

A sound countercyclical **fiscal policy** has contributed to the relatively stable economic development despite the various crises. Indonesia counteracted the global financial crisis by launching a USD 6.4 billion fiscal stimulus package, which was supported by other stabilising measures and substantially cushioned the economic fallout of the crisis (Basri, 2018). In light of the COVID pandemic, the Indonesian government lifted the annual budget deficit above 3 per cent of GDP from 2020 to 2022 to allow for fiscal measures worth estimated USD 43 billion within the Economic Recovery Program (PEN) such as tax breaks, interest subsidies for small enterprises, liquidity support for banks as well as financial support for vulnerable households (Medina, 2020). As a result, government debt substantially rose from 32.5 per cent of GDP at the outbreak of the COVID pandemic in the first quarter of 2020, up to its peak at 41.6 per cent one year later before slowly falling to around 38 per cent by the end of 2023 (Bank Indonesia, 2024). The successful management of the COVID pandemic earned Indonesia notable praise from the IMF and demonstrated the country's macroeconomic and fiscal stability (Cabinet Secretariat of the Republic of Indonesia, 2022).

Poverty and inequality

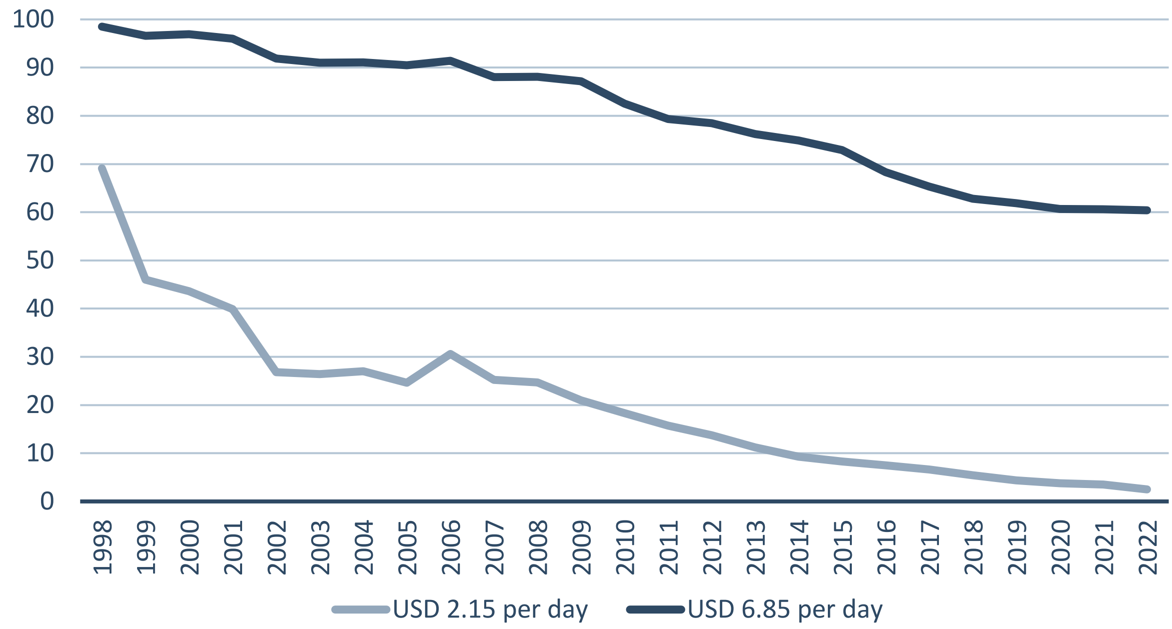
Thanks to its economic success, Indonesia has managed to lift millions of people out of poverty in the last decades. In 1998, almost 144 million Indonesians, i.e. 69 per cent of the population, lived below the extreme poverty line of USD 2.15 per day (based on purchasing power parity inflation-adjusted at prices of 2017 – 2017 PPP). Since then, the poverty rate has steadily decreased in almost every year. Under Widodo alone, the number of people living in extreme poverty has fallen from 23.7 million in 2014 to 6.8 million in 2021. In relative terms this is a reduction from 9.3 per cent to 2.5 per cent (see Figure 3-3).

However, progress has to continue as poverty and inequality still remain relatively high:

- Considering the higher official poverty line of USD 6.85 (2017 PPP) per day shows that a large proportion of Indonesians continue to live in poverty. In 2022, more than 60 per cent, or 166 million, were still living on less than USD 6.85 (2017 PPP) a day.

Figure 3-3: Development of poverty in Indonesia

Share in the total population of people living below the extreme poverty line*and below the upper-middle-income countries poverty line* in per cent



*The poverty lines are in real US dollars based on purchasing power parities that are inflation-adjusted at prices of 2017.
Source: World Bank

- The Gini coefficient also shows that, despite the success in reducing extreme poverty, overall inequality has not improved. The Gini coefficient is a statistical measure of income inequality. It takes the value of 0 for perfect equality, i.e., when every household has the same income, and the value of 1 for perfect inequality, i.e. when one household has the entire income. In Indonesia, the Gini coefficient increased from 0.32 in 1998 to 0.4 in 2015. It then fell again to 0.38 by 2018, where it has remained up to now. Yet, Indonesia is not doing particularly badly in terms of inequality. In fact, the income distribution in the ASEAN peer nations is similar to that in Indonesia. The most recent values for the Gini coefficients were 0.41 for the Philippines and Malaysia, 0.37 for Vietnam and 0.35 for Thailand (World Bank, 2023a).

Long-term national development plans

The development of the Indonesian economy was planned and outlined in the 2005–2025 Long-Term National Development Plan (RPJPN). This plan was carried out in four five-year Medium-Term National Development Plans (RPJMN). The RPJPN envisioned an Indonesia that is developed and self-reliant, just and democratic as well as peaceful and united. To achieve these goals, the plan formulated the following main objectives (Indonesia Investments, n.d.a):

- Development of a solid infrastructure and an economy with the agricultural sector as well as mining and quarrying as foundation.
- Efficient and modern production of goods in a globally competitive manufacturing sector that is the engine of economic growth while the service sector fosters economic resilience.

- Income per capita should reach a level that is comparable to other middle-income nations by 2025 with a relatively even distribution of wealth and less than 5 per cent of the population living in poverty.
- Achievement and maintenance of food self-sufficiency and food availability for every household.

So far, some of these goals have been impressively exceeded, while others remain to be fulfilled. Infrastructure development and the centralisation of the Indonesian economy around natural resources – the so-called "downstreaming" strategy (see Section 3.2) – have made substantial progress. Income per capita has reached a middle-income level and extreme poverty has nearly been tackled while regular poverty remains a challenge. The manufacturing sector is still a major driver of growth, but is lagging behind its potential, while the service sector has developed strongly. Food self-sufficiency has not yet been achieved.

In early 2023, Widodo presented the final draft of the 2025–2045 RPJPN which provides the roadmap for achieving the goals of the Golden Indonesia 2045 Vision (Wiradji, 2023) and is centered around the key objectives stability, sustainability and continuity as well as human capital development (Wiradji, 2023). Its implementation will play a crucial role in shaping the economic outlook for the Indonesian economy (see Section 3.2).

3.2 Drivers of economic development

In the following section, several important drivers of economic development are discussed that contributed to the positive economic performance of Indonesia in the past decades. Economic growth has been supported by political and macroeconomic stability. On top of this it has been driven, inter alia, by relatively sound institutions, a young and growing population, some improvement in education, infrastructure development, abundant natural resources and an incremental opening to the world economy.

Economic and political institutions

Economic development relies on sound and inclusive economic and political institutions, i.e. framework conditions which are required for a well-functioning market economy in which businesses can thrive and deliver prosperity (Acemoglu/Robinson, 2012). The World Bank (2023a) provides so-called governance indicators to measure important aspects of these framework conditions. Figure 3-4 summarises Indonesia's performance and compares it with the ASEAN peer nations using the Worldwide Governance Indicators (WGI). The WGI aggregate data from more than 30 think tanks, international and nongovernmental organisations as well as private firms for more than 200 countries covering the period from 1996 to 2022. It takes into account the perceptions of these sources along the following dimensions:

- **Voice and accountability** capture the ability of citizens to participate in choosing their government, as well as freedom of expression, freedom of association and free media.
- **Political stability and absence of violence/terrorism** capture the likelihood of political stability and politically motivated violence, including terrorism.
- **Government effectiveness** captures various aspects of the quality of the public sector such as the quality of public services, the quality of civil service and its independence from political pressure, the quality of policy formulation and implementation as well as the adherence of the government to its policies.

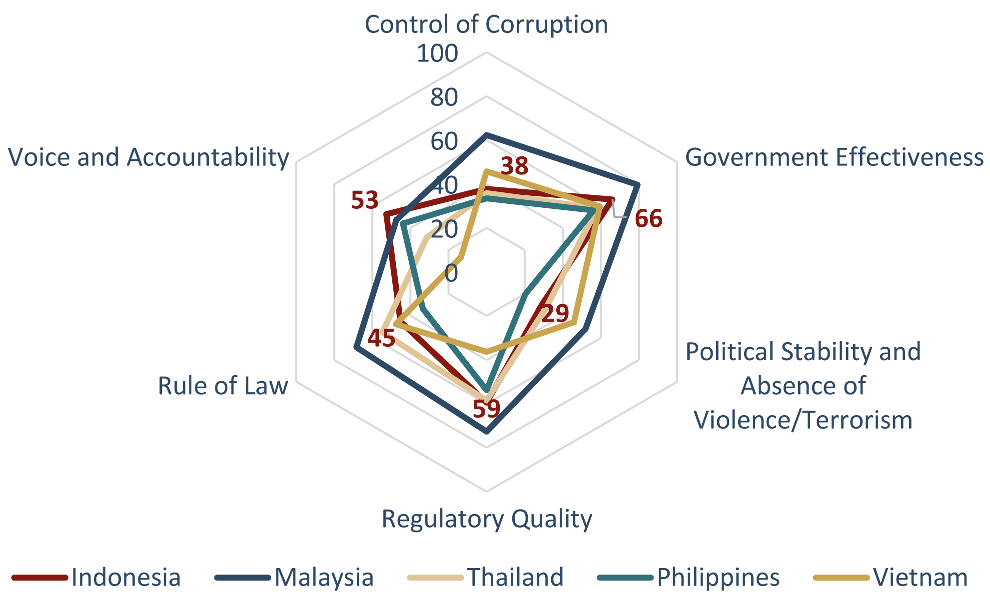
- **Regulatory quality** captures the government's ability to formulate and adopt policies and regulations that foster private sector development.

- **Rule of law** captures several legal aspects such as the confidence in adherence to the rules of society, in particular enforcement of contracts, protection of property rights, trust in police and courts, as well as the likelihood of crime and violences.

- **Control of corruption** captures the extent to which public power is abused for private gain covering overt and covert forms of corruption, as well as the meddling of elites of private interest groups in public affairs.

Figure 3-4: Indonesia's political governance performance

Selected World Bank Governance Indicators 2022, percentile ranks, scale 0 to 100



Source: World Bank, Worldwide Governance Indicators, 2023a

Figure 3-4 depicts the WGI percentile ranks for 2022 which indicate the share of all countries that perform worse and therefore have a lower rank. Indonesia performs better than most ASEAN peer nations in the political realm taking upper positions among the ASEAN peer nations in government effectiveness and regulatory quality. In terms of voice and accountability, Indonesia leads the ASEAN peer nations. The recent protests in the course of rumours about a potential unconstitutional third term for Widodo serve as an example of a democratically and politically aware society. In all these aspects, Indonesia positions itself above the global average and regarding voice and accountability as well as regulatory quality ahead of some more developed economies such as China. The rule of law positioning, however, is only mediocre, both in comparison to its peer nations and in a global context. Indonesia exhibits significant deficiencies in the control of corruption, where it manages to position itself slightly ahead of Thailand and the Philippines, but markedly falls behind Vietnam and especially Malaysia. Even Widodo, who himself was considered free of corruption for a long time, curtailed the anti-corruption agency shortly after taking office for his second term by restricting its rights and covering up a corruption scandal surrounding the Jiwasraya Insurance Company fraud (Syebubakar, 2020). Indonesia also ranks low in terms of political stability and absence of violence and terrorism not only relative to its peer nations but also from a global perspective. This, however, somewhat surprising considering Indonesia's relatively sound political landscape in the Era Reformasi. Moreover, despite some violent terrorist attacks in the early 2000s, Indonesia has maintained both political stability as well as public security.

Demographic dividend and domestic market

The economic development of the past twenty years was largely driven by a rapidly growing population and workforce. In other words, the production factor labour has increased considerably and contributed to the positive growth performance of Indonesia. This phenomenon is sometimes called demographic dividend. Moreover, Indonesia's workforce is relatively young. Indonesians aged between 15 and 24 currently make up 24 per cent of the working age population (15–64). In comparison, the share of young workers in the total working-age population lies at around only 15 per cent in countries such as Germany and China (U.S. Census Bureau, 2024).

The large population also offers a sizeable domestic market for Indonesian companies. Moreover, an aspiring middle class has emerged and carries private consumption:

- 52 million Indonesians are nowadays part of the so-called "concrete middle class" – a phrase used by the World Bank (2020). They have largely achieved economic security that liberates them from worries about poverty and vulnerability, with incomes allowing for moderate consumption above subsistence level. The concrete middle class is one of fastest growing segments of the Indonesian population and is the backbone of the large domestic market, accounting for about half of total household consumption (World Bank, 2020). Members of the concrete middle class spend relatively lower shares of their disposable income on basic goods such as food and relatively higher shares on durable goods (e.g. cars, residential property) and services (e.g. health, education, insurances), thereby driving economic growth and the development of industrial sectors. Their consumption and purchasing power contributed substantially to the resilience of the Indonesian economy during the COVID pandemic (Suhanda/Swasono, 2023).

- On top of this, the so-called "aspiring middle class" – in the wording of the World Bank (2020) – will also play a central role in the future. Around 115 million Indonesians who no longer live in poverty anymore have not yet achieved the economic security of the concrete middle class and remain vulnerable to falling back to the subsistence level (World Bank, 2020). The rise of this aspiring middle class up into the concrete middle class will be an important part of Indonesia's development to a high-income country.

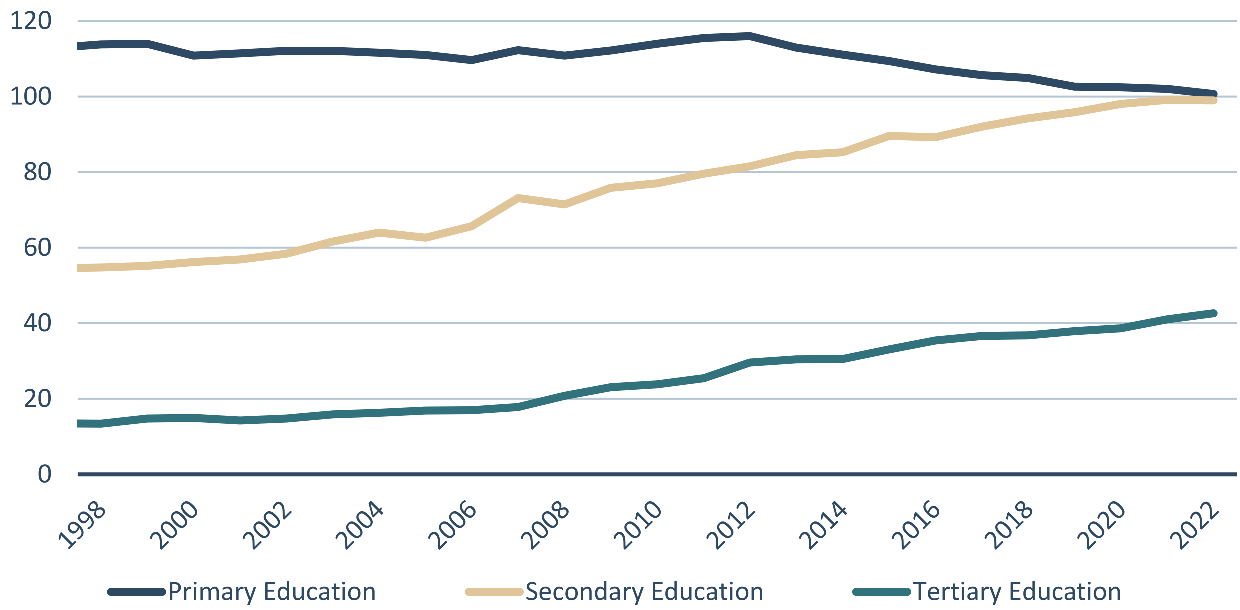
However, the "demographic dividend" regarding productive potential has not yet been fully reaped. While impressive in scale, the quality of the Indonesian work force is rather low. This is illustrated by the World Bank's Human Capital Index which ranks Indonesia 96th out of 173 countries worldwide and sixth of ten Southeast Asian countries (Jazuli, 2021). Two major problems are poor health conditions and low levels of education or training (see next subsection). Indonesia has to cope with nutritional problems ranging from undernutrition to overweight and obesity as well as non-communicable and infectious diseases (Jiwa Muda Indonesia, 2022). Meanwhile the Indonesian healthcare system suffers from several structural problems such as overall underfinancing as well as limited and inequitable access to healthcare services and medicine (ITA, n.d.).

Education

Apart from labour inputs, education is one of the key drivers of human capital and therefore of economic growth. In Indonesia, several positive developments are worth mentioning. Compulsory education of twelve years has been in force since 2013. It replaced the nine year compulsory education programme that had been in place since the 1990s (Natahadibrata, 2013). Moreover, in the last two decades, Indonesia has successfully increased the enrolment rates of secondary education to almost 100 per cent (see Figure 3-5). Enrolment rates for tertiary education almost tripled from 14.9 per cent in 2000 to 42.6 per cent in 2022. Overall, Indonesia has been able to significantly increase access to education for young people in the recent past. At the secondary and tertiary level, only Thailand has higher gross enrolment rates (World Bank, 2023a). Access to education for young people is therefore no longer a major issue in Indonesia.

Figure 3-5: Gross enrolment rates per level of education in Indonesia

Ratio of total enrolment to the population of the age group that officially corresponds to the level of education in per cent



Source: World Bank – World Development Indicators, 2023a

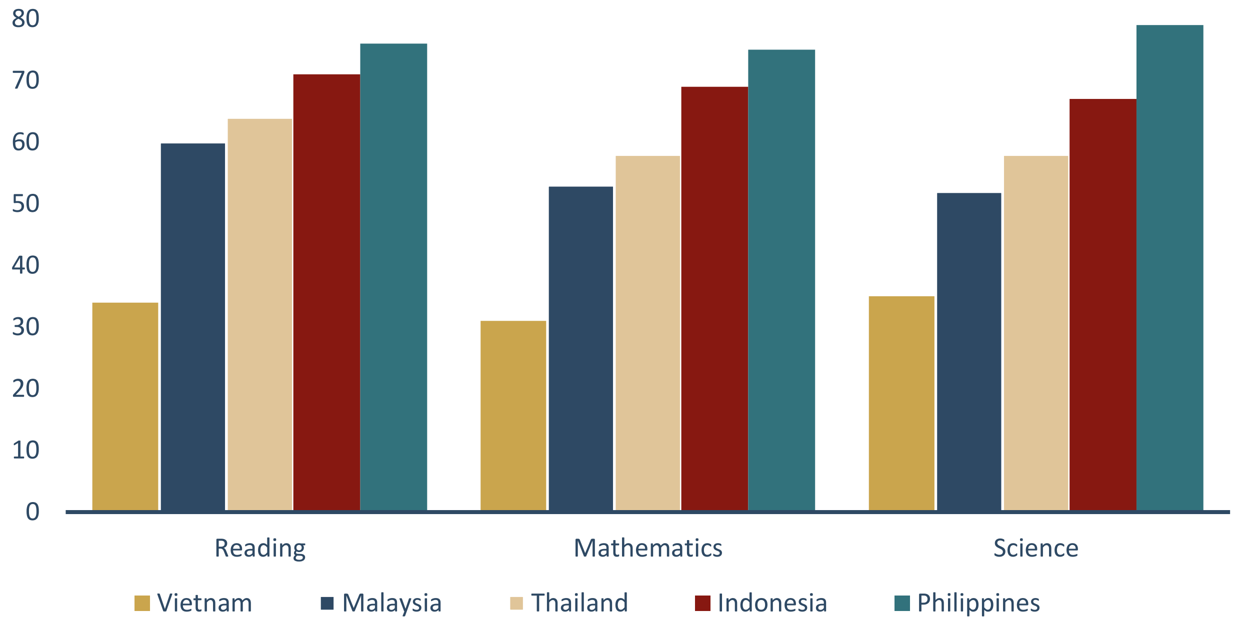
A look at the completion rates also shows an overall positive picture. Around 98 per cent who attend primary school (grades one to six) also complete it. In junior secondary school (grades seven to nine), the proportion drops to 90 per cent, but remains relatively high. However, the completion rates beyond basic education are lower. Only around two thirds of senior high school students complete this level of education (BPS, 2023).

Moreover, several other challenges and shortcomings remain:

- The enormous improvement in access to education has not been accompanied by the necessary improvements in educational quality (Rosser, 2018). In the latest PISA tests for 2022, Indonesia was among the bottom 15 countries among a total of 81 countries in all categories. Within our comparison group, only the Philippines performed worse, as Figure 3-6 shows. In general, the Indonesian education system suffers from several structural problems such as underfinancing, shortage of qualified teaching staff as well as inequality and discrimination (Tan, n.d.). In addition, the COVID pandemic thwarted recent efforts and put a strain on educational achievements (World Bank, 2023b).

Figure 3-6: Pupils' skills according to PISA examinations

Rankings in the PISA 2022 examinations among 81 countries participated (Rank 1 = best performing)



Source: OECD, 2023b

- Educational services do not reach all potential beneficiaries. While educational access for the young people is hardly a problem anymore, nearly a quarter of Indonesia's total population does not participate in education, employment or training at all, and nearly 90 per cent of the workforce have not received any workforce training (Prihadi, 2023). This is in part a legacy of the weakness of the education system in the past, i.e. in the time before the above-mentioned educational improvements occurred.

- Regarding tertiary education, earlier studies have pointed out that the higher education system does not produce well-qualified professionals with the essential skills needed by the employers (World Bank, 2014). In the latest QS World University Ranking, five Indonesian universities ranked in the top 500, with the best "Universitas Indonesia" ranking 237th. Compared to the benchmark group, however, Indonesia still performs relatively well. No university from Vietnam, one from the Philippines and two from Thailand made it in the top 500. In contrast, Malaysia has eight universities in the top 500, the best of which is ranked 65th (QS, 2024). The below-average quality of Indonesian universities is also reflected in the research sector. Looking at the citable scientific publications per capita, only the Philippines published fewer in the ASEAN peer group. The quality of these publications also appears to be relatively poor. With 0.5 citations per document, Indonesia ranks 217th placing it among the 20 lowest performing countries in the world and last in the peer group (SJR, 2023).

Taking these challenges into account, Indonesia has been relatively successful in substantially increasing access to education. However, in international rankings, Indonesia regularly performs poorly at both the secondary and tertiary education level. Graduates of the education system often lack essential qualifications for the labour market. The situation is exacerbated by the fact that there is no professional training as such in Indonesia so that low-qualified workers have to be trained by employers at considerable expense (Malerius, 2023b).

Infrastructure development

Public infrastructure is an essential part of an economy's productive capital facilitates business activities and thus contributes to economic development. The progress in infrastructure development under Widodo has been considerable. So far, 1,700 kilometres of toll roads, 18 ports and 21 airports have been built since Widodo took office in 2014 (Amenan et al., 2022).

The most prominent infrastructure projects of the Widodo administration, which have gained much national and international attention, are the "Whoosh" high-speed railway, that is part of the Chinese Belt and Road Initiative, and the planned creation of the future capital Nusantara completely from scratch:

- The "Whoosh" train connection was inaugurated in October 2023 and connects the capital Jakarta and the regional capital of West Java, Bandung. The USD 7.3 billion project was largely funded by Chinese state-owned enterprises and is operated by a joint venture of four Indonesian state firms and China Railway International. Intended to foster economic productivity and to solve traffic jams in the region, the benefit for the ordinary population remains ambiguous, as the ticket prices are substantially higher than those of alternative modes of transport such as regular trains or shuttle buses (Cai, 2023b).
- The relocation of the Indonesian capital has an estimated price tag of USD 35 billion and is planned to be finalised in 2045. It is not only a reaction to overpopulation in Jakarta and to environmental dangers such as regular floods threatening the current capital, but also a highly prestigious project for the Indonesian government to underline its economic and environmental ambitions. Nusantara is conceptualised as future economic hub of Indonesia helping to distribute economic activity more evenly across Indonesia while solving some of the challenges faced by the inhabitants of the current capital Jakarta, such as traffic congestions – all while being fully sustainable. So far, the current progress does not match the ambitions with the government providing only a fifth of the total funding and private investors being hesitant due to the many uncertainties evolving around the project. Two important but unanswered questions remain: How to persuade Jakarta's current inhabitants to move to the as yet unimaginable future capital, and whether the relocation will continue under Widodo's successor (Jacob, 2023).

The development of water, electricity and internet infrastructure has been less impressive than that of transport infrastructure.

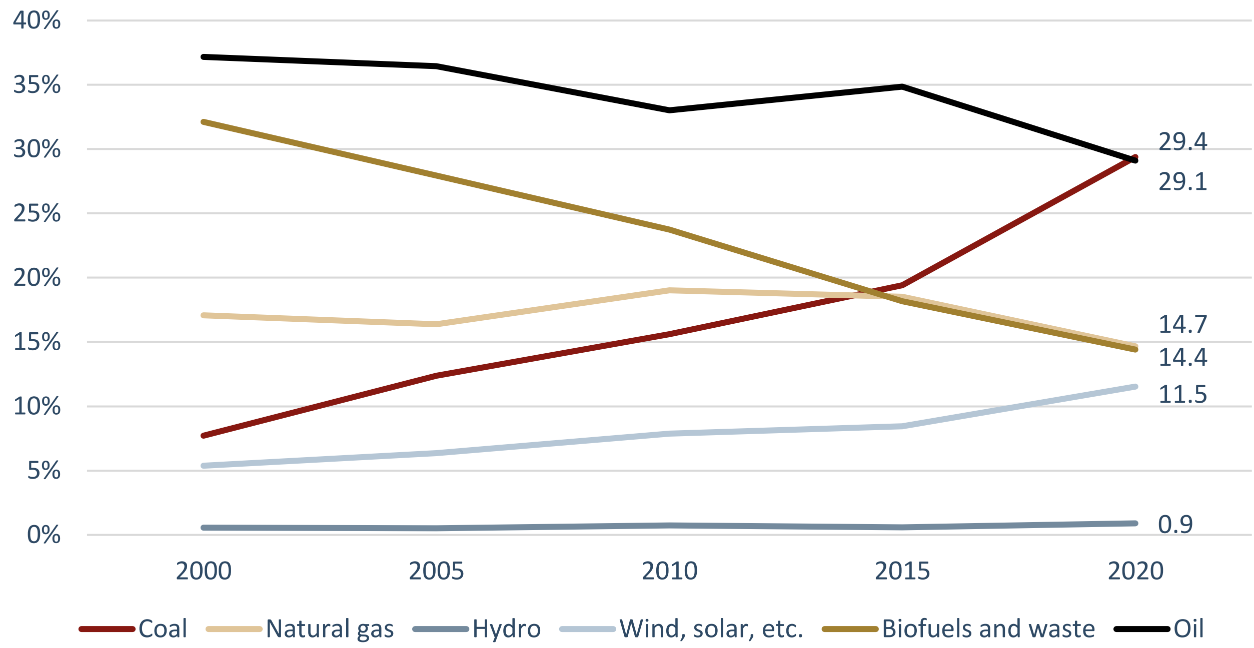
- While widespread in range, the water system is rather poor in quality. Currently nine out of ten Indonesians have access to some form of water supply and eight of ten have access to basic sanitation. However, only two out of ten have access to piped water and seven out of ten still consume contaminated water (USAID, n.d.).
- Although almost all Indonesians have access to some form of electricity, the development of an integrated grid network is dispersed and largely concentrated on Java, Bali and Sumatra (Malerius, 2022).
- Internet access is available for only every second Indonesian, despite rapidly increasing internet use (Wibisana et al., 2022).

Resource nationalism and downstreaming

Indonesia has an abundant wealth of natural resources which also shape its industrial structure. It has substantial reserves of coal, natural gas and oil (Ministry of Energy and Mineral Resources Republic of Indonesia, 2022). Regarding energy supply (that serves domestic and foreign demand), the shares of oil and natural gas have decreased, while the production of coal has increased. The shares of renewable energy sources such as hydropower and biofuels have stagnated or even decreased, while only the shares of wind and solar energy generation have risen (see Figure 3-7). Thus, fossil fuels (coal, oil and natural gas) make up more than 70 per cent of total energy supply in 2020. The transition to renewables will not be an easy task as nearly all sectors, from industry to transportation, construction and are heavily dependent on fossil fuels.

Figure 3-7: Structure of energy supply in Indonesia

Shares of resources in total energy supply in per cent



Sources: International Energy Agency; IW

Apart from energy resources, Indonesia is abundantly endowed with minerals and holds not only the world's largest nickel reserves, but is also endowed with substantial deposits of cobalt, tin, bauxite and copper (Wrede, 2023, see Section 4).

The Widodo administration in particular embraced "resource nationalism", i.e. the strategical use of the country's resources to foster economic growth. The so-called "downstreaming" strategy aims at building up domestic industries further down the value chains of many products, i.e., industries that refine or directly use these raw materials and that are closer to final consumption. An example is the production of battery systems with nickel as major input.

In the past, fossil fuels and minerals were heavily exported, making Indonesia the world's largest exporter of coal and nickel and one of the world's largest exporters of LNG as well as tin and copper. However, in particular exports of minerals in particular have been restricted or banned over in recent years in order to enforce the development of local processing facilities.

The "downstreaming" approach has been largely successful for Indonesia so far, developing it from the world's biggest exporter of raw mined nickel to the world's largest producer of refined nickel (Mining Technology, 2023). While Indonesia had around 50 nickel mines but only three smelters in 2014 (UNCTAD, 2017), it had 127 mines (Zielonka, 2023) as well as 62 operational smelters in 2023 with another roughly 30 smelters under construction and another 50 more in the planning stage (Maulia, 2023a). Accordingly, nickel production jumped from 177,000 metric tons in 2014 to an estimated 1,800,000 metric tons in 2022 (Statista, 2024).

Outlook

Whether Indonesia will remain on track to fulfil its ambitious vision of becoming a high-income country and one of the five largest economies in the world by 2045 will largely depend on whether Widodo's successor will be able to sustain the economic upwind by harnessing the locational advantages. The medium-term perspectives for Indonesia's economic development remain good. The IMF (2023) forecasts economic growth rates of nearly 5 per cent by 2028. However, there are several challenges that could hamper the development of the Indonesian economy in the longer term:

Developing an educated and skilled workforce

Despite having made progress in broadening access to education, the quality of educational outcomes is still poor (see above subsection on education). The current lack of a skilled workforce is a relative disadvantage of the Indonesian economy in comparison to its ASEAN peer nations – despite the large potential of the young and growing population. The qualification of the workforce and in particular of those who suffered learning losses during the pandemic (World Bank, 2023b), that are about to enter the workforce in the upcoming years, will be crucial to realise several strategic goals of the Indonesian government. A skilled workforce is also a basic condition for the rejuvenation of the manufacturing sector as envisioned in the 2025–2045 RPJPN, as it allows the production of more sophisticated goods that are currently imported (see Section 5.3). Moreover, it enables Indonesians to take on formal employment and middle-class jobs.

Broadening the concrete middle class

Lifting the aspiring middle class, that recently accounted for around 45 per cent of the Indonesian population, into the concrete middle class will play an important role in continuously fostering private consumption – the major driving force of economic activity that accounted for roughly 61 per cent of GDP in 2022 (World Bank, 2020; 2023a). The broadening of the middle class also contributes to the diversification of the Indonesian economy. The economic security achieved by the concrete middle class allows for more varied consumption patterns including goods such as housing and automotives that have substantial multiplier effects on the whole economy. The same is true for services such as tourism, healthcare and education that are currently rather underdeveloped (World Bank, 2020; Suhanda/Swasono, 2023). Future governments should therefore put a priority on measures that allow the aspiring middle class to rise into the concrete middle class. To attain this aim, the integration into formal sector employment is important as well as the improvement of education, health and nutrition (Suhanda/Swasono, 2023).

Supporting domestic value chains and diversification of the economy

The centralisation of the Indonesian economy around its abundant natural resources has been an essential part of the development strategy outlined in the 2005–2025 RPJPN. While the "resource nationalism" has proven to be successful for example for the nickel industry, it has also led to a poorly diversified Indonesian economy. The Indonesian government plans to replicate this success by implementing export bans on further minerals such as tin and copper. However, it is doubtful whether these measures serve as a reasonable development strategy for the coming decades. For example, the latest export ban on bauxite introduced in 2023 raised doubts among miners. They feared that domestic capacities would be too limited to process the increased output that would be available domestically due to the export ban. It is also uncertain whether enough investors will build new bauxite processing plants, as the building costs are around three times higher than those of nickel smelters (Nangoy, 2023). Moreover, the focus on resources makes the Indonesian economy vulnerable to potential shifts in global demand. For example, the global demand for coal – currently Indonesia's leading export commodity – could decline in the course of the global transition to renewable energies. Furthermore, innovations could lead to new battery technologies for electric vehicles (EVs) that no longer require nickel, meaning that the global demand for nickel would no longer meet current projections. Such a development would severely hurt one of Indonesia's strategic sectors and would also question the "downstreaming" strategy in this respect (Moors, 2023).

Infrastructure Development

Despite the substantial progress made in the development of hard infrastructure over the past two decades, Indonesia still falls markedly behind the other ASEAN peer nations (see Section 6.1). This not only hampers Indonesia's attractiveness as a business location for foreign investors, but also strains domestic businesses dealing with high logistic costs, and is a particular burden for the people living in remote areas.

Another major challenge for the upcoming years will be the transition to more climate-friendly energy sources The target of 23 per cent of renewable energy in the energy mix by 2025 will most likely not be achieved, as even Widodo himself recently admitted. Against this background, despite some notable projects such as the recently inaugurated floating solar power plant in West Java, the next target of achieving a 44 per cent share of renewable energy in the energy mix by 2030 momentarily appears out of reach (Reuters, 2023a; 2023b). However, the recently announced USD 20 billion Comprehensive Investment and Policy Plan (CIPP) marks an important step in the right direction (Embassy of the Federal Republic of Germany Jakarta, 2023). The CIPP is part of the Just Energy Transition Partnership (JETP) which is co-led by the United States, Japan and Canada and that is backed by the EU and several member states as well the UK.

The infrastructure development is likely to remain a priority for future Indonesian governments. However, the successful realisation of projects will depend on the crowding-in of private investment, which is currently falling significantly behind the intended shares in funding. Here, the 2023 Omnibus Law on Job Creation marks an important step in the right direction, but its effectiveness has yet to be seen.

Exposure to natural disasters

Indonesia is already highly exposed to natural disasters and therefore vulnerable to climate change. Java, the economic heartland of Indonesia, particularly from natural disasters ranging from droughts floods to landslides that can damage the industrial basis. In the coming years, the country is projected to suffer particularly from rising sea levels which will require substantial adaptation efforts. In fact, Indonesia ranks fifth in the world regarding the size of the endangered population living in lower elevation and particularly vulnerable coastal zones. Moreover, climate change and extreme weather events are expected to jeopardise food and water security, and thus health and nutrition, which could increase inequality and poverty (Climate Change Knowledge Portal, 2024).

Integration into global value chains
So far, Indonesia's integration into global value chains has been rather sluggish and focused on a narrow range of goods. Further integration into global value chains will play a crucial role for the expansion of Indonesian economy beyond its domestic market.

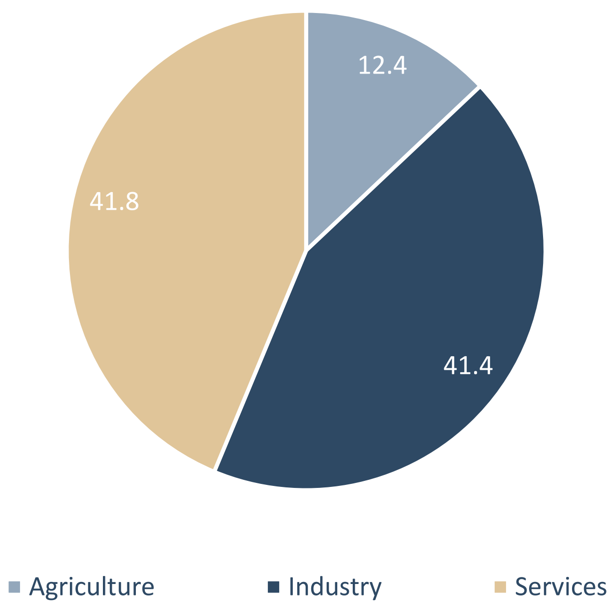
In sum, Indonesia has large potential to achieve its ambitious goals. However, this will require substantial efforts by future administrations to address the pressing issues outlined above.

4 Industrial structure

The Indonesian economy is based on a large industrial sector that is centered around the extraction and processing of natural resources such as fossil fuels and minerals, as well as a large service sector serving the domestic market. The agricultural sector plays a rather subordinate role in generating economic value, although it provides an income for a significant portion of the Indonesian population and delivers relevant raw materials such as palm oil for the manufacturing sector (see Figure 4-1).

Figure 4-1: Indonesia's sector structure

Sectoral value added as a share of total value added of the economy in 2022 in per cent



Note: Industry comprises manufacturing, mining and quarrying and construction.
Source: World Bank

Over the past two decades, employment increasingly concentrated in the services sector with its share of total employment growing from 37.3 per cent in 2000 to 49.3 per cent in 2021. The share of agriculture in total employment contracted significantly from 45.3 per cent in 2000 to 29 per cent in 2021, while the share of the industrial sector fluctuated around 20 per cent (World Bank, 2023a). The divergence between the value-added shares and the employment shares indicates large differences in productivity. While the 29 per cent who work in agriculture produce only 12 per cent of value added with an obviously very low productivity, around 20 per cent of those employed in industry account for 41 per cent of value added with a significantly higher productivity.

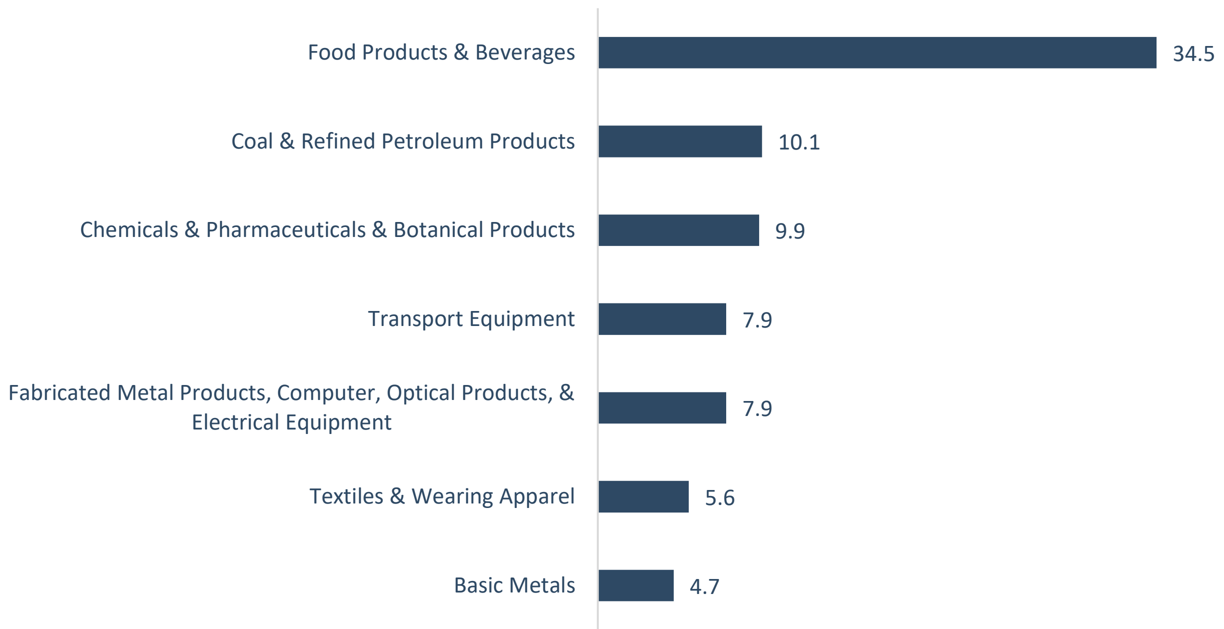
The following sections provide an overview of the industrial, the service and agricultural sectors of the Indonesian economy and highlight their most relevant industries.

Manufacturing

The manufacturing sector, the core of the industrial sector, has accounted for around 20 per cent of GDP over the past two decades and despite some recent downturn and will remain an engine of economic growth for the foreseeable future (World Bank, 2023a). Production activities are largely concentrated on the island Java – the economic heartland – and are predominantly carried out by micro, small and medium-sized enterprises (ASEAN Briefing, n.d.). The manufacturing sector is centered around natural resources. It is rather undiversified and unsophisticated, with notable industries ranging from the production of food and beverage (F&B), basic chemicals and pharmaceuticals to coal, refined petroleum products, textiles and apparel (see Figure 4-2):

Figure 4-2: Top 7 industries in the manufacturing sector

Share of nominal gross value added of selected manufacturing industries in total nominal gross value added of the manufacturing sector in 2022 in per cent



Sources: Bank Indonesia; IW

- The large **F&B sector** serves the already large and further expanding population, while also producing significant surpluses of products such as palm oil, fish, cocoa and coffee, which are exported to other Asian countries as well as EU members states. However, it is reliant on imports of products such as wheat, dairy or processed food products (Business Indonesia, n.d.a). Indonesia is the world's largest producer of palm oil, accounting for more than half of global production (USDA, 2023). While palm oil production has raised substantial parts of the population out of poverty (Edwards, 2019), it is also responsible for large-scale deforestation – a contentious issue of the EU-Indonesia trade relationship (Hutt, 2023a, see Section 5.1).

- The **chemical sector** mainly produces and exports oleochemical intermediate goods that are derived from palm oil, such as fatty acids, fatty alcohols and glycerine. However, it is heavily reliant on imports of technologically more sophisticated commodities such as industrial chemicals, fertilisers and plastics (Malerius, 2023c). The same applies to the pharmaceutical sector. Although it produces and exports generic pharmaceutical products especially to developing nations (Politico, 2023), the reliance on imports of raw materials is high and output volumes are not able to cover the increasing domestic demand (Business Indonesia, n.d.b).

- The production of **coal and refined petroleum products** such as liquefied natural gas (LNG) and biofuels not only contributes to the national energy supply, but also plays a pivotal role in Indonesia's exports (see Section 3.2).

The Indonesian government identifies the manufacturing sector as a key contributor to economic development. It is eager to expand it and to further integrate it into global value chains by pushing forward not only domestic policies and reforms, but also by actively promoting it to international investors in order to attract FDIs. Real value added of manufacturing more than doubled between 1997 and 2022 (World Bank, 2023a). However, the role of the manufacturing sector in the Indonesian economy has been weakening (Humas, 2023). As other sectors' value added grew even more dynamically, the share of manufacturing value added in GDP declined from almost 27 per cent in 1997 to around 18 per cent in 2022 (World Bank, 2023a). This tendency has been more pronounced in Indonesia than in other ASEAN peer countries such as Malaysia and Thailand and calls for solutions to the several structural challenges hampering the development of the manufacturing sector, such as the shortage of skilled workforce, low productivity, sluggish diversification and obstacles to doing business (see Section 6.1).

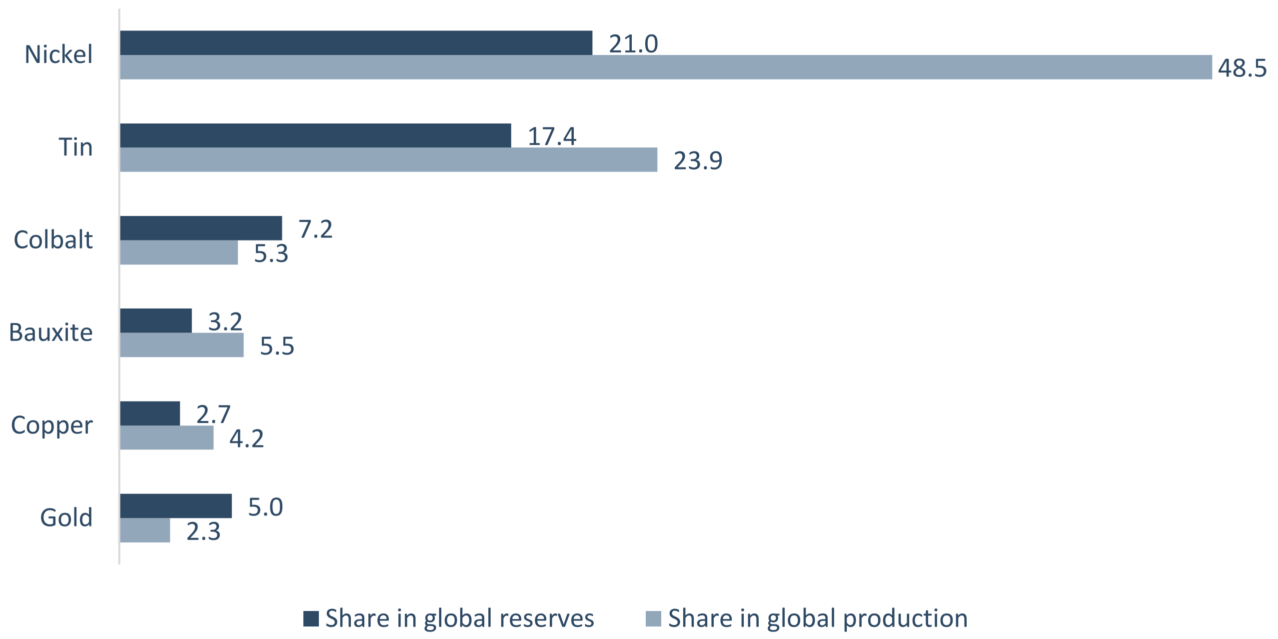
The challenges are notable, but the ambitions remain high. The Indonesian government aims to overhaul the economy with the 2020 Omnibus Law on Job Creation and modernise the manufacturing sector with the "Making Indonesia 4.0" initiative. The implementation of these initiatives will be crucial for the planned rejuvenation of the manufacturing sector as one of the major key drivers of economic growth.

Mining and quarrying

Mining and quarrying activities, which are also part of the industry sector, have substantially expanded over the past few years and currently account for around 9 per cent of GDP (Rayos, 2023). The extraction and processing of the fossil fuels coal and oil as well as the extraction of the minerals nickel and bauxite dominate the sector (see Figure 4-3). However, the production of natural gas and especially liquefied natural gas as well as copper, tin and gold also play an important role. Coal production has heavily expanded and is expected to reach a historical high of 695 million metric tons in 2023, of which the bulk is exported, securing Indonesia's position as one of the world's largest producers and exporters of coal (Reuters, 2023c). Both oil and gas production have contracted over the past decade and fall increasingly short of covering domestic consumption, making Indonesia a net importer of both commodities. This is not due to a lack of reserves, but rather a consequence of the sluggish exploration of new gas and oil fields and the delayed development of lifting facilities (Pwc, 2023). However, the production of fossil fuels still remains substantial (see Figure 3-7).

Figure 4-3: Production and reserves of selected minerals in Indonesia

Share in global production and global reserves in 2022 in per cent



Source: U.S. Geological Survey

While fossil fuel production has weakened, the production of minerals has gained momentum due to the steady development of mines and smelters as part of the "downstreaming" strategy as well as ramping up global demand for minerals such as nickel and tin, which are essential for the production of batteries for EVs and therefore play an important role in achieving net zero emissions (Fernyhough, 2022).

Nickel production dominates the mining and quarrying sector and is likely to gain even more relevance in the upcoming years due to increasing global demand driven by green transformation efforts of developed economies. Thus, Indonesia could become an important partner for the EU's efforts to diversify the supply sources of relevant minerals such as nickel. However, getting access to the Indonesian nickel industry might be challenging. The huge expansion of the Indonesian nickel industry over the past years has largely been backed by Chinese investors securing them a dominant position and cheap access to the commodity (Tritto, 2023). The head start and resulting dominance of Chinese firms in the industry might prove to be a significant competitive hurdle for US and European companies (Rachman, 2023). While Western companies often face significant barriers to doing business (Fraser Institute, 2022), Chinese companies are both desired because they create jobs and disputed because they hurt the environment and the living conditions of Indonesians (Goodman, 2023).

Both the US and EU currently seek to get a hold on the Indonesian nickel reserves:

- The Biden administration has recently made a first step by initiating preliminary talks with the Widodo administration on a mineral-specific trade agreement that would allow the US to import more nickel needed for their EV industry, while Indonesia could benefit from tax incentives outlined in the Inflation Reduction Act (IRA) (Hendrix, 2023).

- The EU and Indonesia have been negotiating a Comprehensive Economic Partnership Agreement (CEPA) for seven years, which could ease access to the Indonesian economy for European countries, but have made little significant progress recently despite repeated pledges to come to terms (Hutt, 2023b) (see Section 5.1). The potential for future progress largely depends on the outcome of the upcoming elections. In case of a victory for Prabowo Subianto, tensions could increase in case his anti-EU stance from his election campaign permeates into his political leadership.

In addition to nickel, tin increasingly gains strategic relevance for the Indonesian economy as it is another important component of EV batteries and other energy storage systems. The Indonesian Ministry of Energy and Mineral Resources recently classified the mineral as critical to the national strategic and energy objectives (International Tin Association, 2023) and the Indonesian government has held out the prospect of future export bans on the commodity (The Economist, 2023b). The measures can be interpreted as an attempt to counteract the downward trend in tin production over the past decade and to repeat the successful development of the nickel industry. Although Indonesia is the world's largest exporter of tin, only 5 per cent of the mined tin is refined domestically, as domestic processing capabilities are limited (Maulia, 2023b).

Services

The service sector is another major pillar of the Indonesian economy whose value added accounted for 41 per cent of GDP in 2022 (World Bank, 2023a):

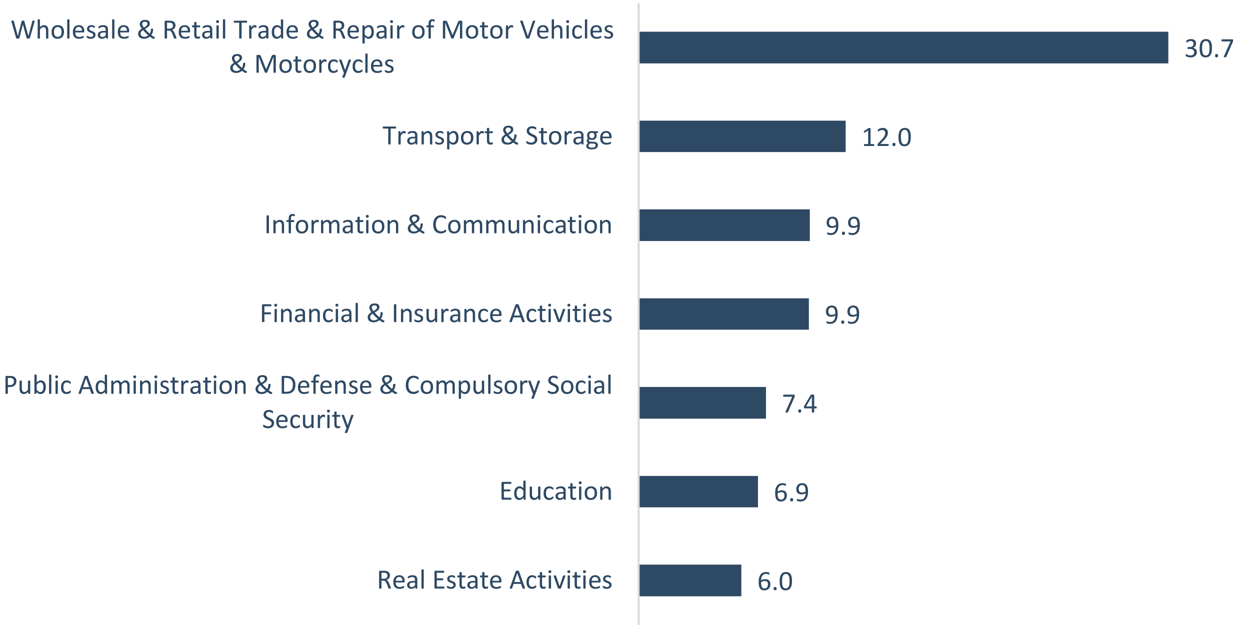
- Services are dominated by wholesale and retail trade which serve the growing domestic market (see Figure 4-4). In addition to classical outlets such as modern shopping centres, e-commerce via platforms such as Tokopedia and Bukalapak plays an increasingly important role in retail trade (ISN Magazine, 2023). The logistical requirements of wholesale and retail trade contribute to the second position of the transport & storage subsector.

- In addition, Information and communication services make up a significant share of the total service sector. Indonesia has the third largest mobile phone market with over 355 million network subscriptions, trailing only India and China (ITA, 2024).

- Other relevant industries are transport and storage, financial and insurance activities as well as education services – the latter two are predominantly driven by the Indonesian middle class which spends a larger share of its disposable income on non-food items (World Bank, 2020). The tourism industry – important parts of which are represented by the accommodation and food services subsector – is less relevant than one might expect when thinking of Indonesia as a popular destination for Western tourists and is not one of the most relevant service industries presented in Figure 4-4. Indonesia's purely domestic service industries are considerably more relevant in terms of value added.

Figure 4-4: Top 7 industries in the service sector

Share of nominal gross value added of selected services industries in total nominal gross value added of the services sector in 2022 in per cent



Sources: Bank Indonesia; IW

Other sectors and industries

Agriculture

The sector mainly produces agricultural products such as palm oil and rubber, which are cultivated on large-scale plantations, while cocoa, coffee, rice, soybeans, corn as well as fruits and vegetables are predominantly grown by small-scale farmers (Indonesia Investments, n.d.b). However, the share of the agricultural sector's value added in total value added has contracted over the past two decades (World Bank, 2023a), in spite of the fact that the growing population requires food and that the government strives to achieve food self-sufficiency. Challenges include a shortage of young workers entering agriculture due to increasing production costs, relatively low wages in comparison to other manual labour, a decreasing supply of agricultural land and challenging weather conditions (Iswara, 2023).

Construction

The construction sector contributed close to 10 per cent of GDP in 2023 (BPS, 2023). The growing and increasingly affluent population is driving the demand for residential housing as well as for commercial construction including shopping centres and retail outlets. The Indonesian government has defined infrastructure projects totalling about USD 500 billion in the National Medium Run Development Plan (RPJMN) 2020-2024 and has recently underlined its commitment to further infrastructure development in the RPJPN 2025-2045 (AHK, n.d.a; VOI, 2023). However, the government budget has only covered 37 per cent of the total budget and the sector has struggled with the crowding-in of private investment due to difficult land acquisitions processes, unforeseen delays and lack of legal certainty (Junifta, 2023; AHK, n.d.b) (see Section 6.1). Overcoming these hurdles will determine whether flagship projects such as the relocation of the capital from

Jakarta to Nusantara, the development of industrial parks across the country and other Belt and Road projects will be able to sustain construction activities at a high level in the near future.

5 Trade relations

In Indonesia's quest to rise to one of the largest economies in the world, its international integration will be pivotal. It has successfully boosted its exports, thanks also to rising commodity prices. However, there remain many hurdles when accessing the Indonesian market. This has an impact on its trade relations with the world and the EU, as well as global and European investment in Indonesia. Regarding trade as per cent of GDP, Indonesia can still be regarded as relatively closed to trade: The sum of exports and imports as a share of GDP merely accounts for roughly 45 per cent in 2022 (World Bank, 2023a). This is low compared to Germany, where this figure is close to 99 per cent. Moreover, on the World Bank's trading across borders indicator, Indonesia lies on rank 116 out of 188, while Germany ranks 42nd.

This Section focuses on Indonesia's trade relations. First an overview of the country's trade agreements is provided, with a particular focus on the ongoing negotiations with the EU. Afterwards, the existing trade barriers are discussed. The Section is rounded off by an empirical analysis of Indonesia's trade relations. Again, the focus lies on the import and export relations with the EU, but also on those with China.

5.1 Trade agreements

Indonesia's trade agreements with Asia and in a global context

As a founding member of ASEAN, Indonesia is also part of the ASEAN Free Trade Area (AFTA). It was established in January 1992 with the aim of eliminating tariffs and non-tariff barriers between the member countries within a certain period of time and becoming more attractive to foreign investment. Since 2003, AFTA has been fully enforced in Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand. For Vietnam, Laos, Myanmar and Cambodia, who joined ASEAN later, the deadline for meeting the AFTA obligations was extended, but since 2010 it has also been fully enforced in these countries. The primary mechanism of AFTA is the Common Effective Preferential Tariff (CEPT) scheme. It requires that for goods originating within ASEAN, member states only apply a tariff rate of between 0 and 5 per cent. There are only a few exceptions to this general rule, such as for temporary exclusions. However, AFTA does not formulate a common external tariff for imported goods, as would be the case in a customs union. Hence, for goods originating from outside of ASEAN, each member state may impose tariffs according to its national schedules.

In order to further facilitate trade in goods between the ASEAN member states and create an even more integrated market, a more comprehensive ASEAN Trade in Goods Agreement (ATIGA) was signed in 2009 and came into force in May 2010 (ASEAN, 2010). ATIGA goes beyond CEPT, as it also includes rules on the removal of non-tariff barriers, rules of origin, and sanitary and phytosanitary measures.

ASEAN has signed a number of Free Trade Agreements (FTAs) with third countries. As a member of ASEAN, Indonesia is automatically part of these FTAs. These include the ASEAN-Australia and New Zealand FTA, which has been in effect since 2010 (ASEAN, 2021). Other important FTAs are in effect with India (2010), Japan (2008), and China (2005). In 2012, ASEAN and its Indo-Pacific FTA partners Australia, China, India, Japan, New Zealand and the Republic of Korea started negotiations on the Regional Comprehensive Economic Partnership Agreement (RCEP). The idea is to combine the separate FTAs into a single agreement, thereby creating a more coherent trading zone. However, India withdrew from the negotiations in 2019. The other countries signed the agreement in 2020. In Indonesia, RCEP came into force in 2023. In a global comparison, RCEP is now the largest FTA in terms of members' GDP. While it is not expected to lead to large overall tariff reductions and agriculture is not included, it does set common rules for rules of origin, which offer a large potential to facilitate trade among its members (Harding/Reed, 2020).

In addition to the FTAs implemented through ASEAN, Indonesia is also negotiating or has already signed several bilateral FTAs, such as with Chile or the countries of the European Free Trade Association (Iceland, Liechtenstein, Norway and Switzerland). The FTA with the EFTA countries came into force in November 2021. Palm oil imports from Indonesia were one of the contested issues in the negotiations. The agreement now includes tariff quotas on the amount of palm oil that can be imported by EFTA countries with tariff preferences under the condition that certain sustainability criteria are met.

Trade policy relations between Indonesia and the EU

Consultation on an FTA between ASEAN and the EU was started in 2007. However, due to major obstacles it was mutually agreed to pause the consultations in favour of bilateral agreements, which are meant to serve as building blocks towards a region-to-region agreement (European Commission, n.d.). These bilateral negotiations have already been completed with Singapore and Vietnam. Negotiations between the EU and Indonesia on a Comprehensive Economic Partnership Agreement (CEPA) to deepen their economic relations have been ongoing since 2016. Currently, Indonesia has access to the EU's Generalised Scheme of Preferences (GSP), which grants lower import tariffs to developing and less developed countries. However, as Indonesia catches up economically to become an upper-middle-income country, it will lose this access. This constellation could enhance Indonesia's incentives to conclude an FTA with the EU.

According to the European Commission's Sustainability Impact Assessment (SIA), the CEPA would have a significant effect on trade relations between the EU and Indonesia: CEPA is estimated to increase Indonesian imports from the EU by between 36 and 44 per cent and its exports to the EU by around 17 to 18 per cent by 2032 (European Commission, 2019), depending on the scenario. The upper bound represents the results for the scenario with more ambitious trade liberalisation. This translates into an increase in the level of GDP of EUR 2.5 billion to EUR 5 billion for the EU and between EUR 4.6 billion and EUR 5.2 billion for Indonesia by 2032 compared to a scenario without CEPA.

On the sectoral level, both countries are projected to export more to the partner country in the sectors in which they have comparative advantages. For the EU, this is the case for industrial goods, such as motor vehicles, machinery and chemicals. Indonesia is projected to export more textiles, apparel and footwear as well as processed foods and palm oil. In the course of an increase in trade and production specialisation, both the EU and Indonesia are expected to experience increases (declines) in output and exports in those goods and sectors where they have (or do not have) a comparative advantage. Due to the expected positive welfare effects of more trade specialisation, the overall impact of CEPA is projected to be positive for both partners. However, the SIA concludes that the positive impact of CEPA depend significantly on the extent to which non-tariff barriers (NTBs) are removed.

Despite the prospective benefits of CEPA, the negotiations between the EU and Indonesia are held up by some obstacles. Sustainability issues are at the centre of the dispute between the two sides:

- In particular, the **EU's deforestation regulation** represents a major issue for Indonesia. The regulation prohibits the import of goods into the EU that are associated with deforestation or forest degradation and will come into effect at the end of 2024. It is argued that this regulation would harm the small-scale agriculture industry in Indonesia, as it would be difficult for them to comply with the burdensome bureaucratic requirements (Hutt, 2023a).
- Another very important obstacle from an Indonesian point of view is the European Commission's plan to phase out palm oil-based biofuels by 2030 according to its Renewable Energy Directive II (RED II). However, **palm-oil** is one of Indonesia's main export goods. Together with Malaysia, another major producer of palm-oil, Indonesia therefore filed a complaint against the EU with the World Trade Organization (WTO) in 2019. So far, the WTO has not yet decided on this case.
- Moreover, in November 2023, the WTO Dispute Settlement Body agreed to set up a panel to review the EU's countervailing duties on imports of biodiesel (WTO, 2023). These countervailing duties of between 8 and 18 per cent were imposed by the European Commission in 2019 with the argument that Indonesian biodiesel producers benefit from grants, tax benefits and access to raw materials below market prices (EEAS, 2019).
- Besides these legal measures, Indonesia temporarily banned the export of palm oil in April 2022 and February 2023, allegedly to secure domestic demand amid rising prices. From the Malaysian side, there has even been the threat of a complete stop of palm oil exports to the EU (Hutt, 2023a).
- For the EU, on the other hand, **Indonesia's export ban on nickel**, which is intended to boost domestic downstream processing of nickel products (see Section 3.2), is a controversial issue. The EU filed a complaint with the WTO over this ban, which it won in November 2022 (Wrede, 2023). So far, however, Indonesia has ignored the WTO decision. On the contrary, in June 2023 Indonesia expanded its export ban to bauxite in order to encourage the development of a domestic processing and refining industry, replicating the policy it pursued with nickel.

Tensions between the EU and Indonesia on trade-related issues are likely to persist after the national elections in February 2024. The current leading candidate, Prabowo Subianto, has recently criticised the EU's policy on palm oil and accused the West of applying double standards (Peer, 2023).

This is all the more disappointing as an analysis of the mutual trade barriers between Indonesia and the EU, and a look at the current trade underpin the SIA's conclusion and point to significant unused trade potential between the two partners.

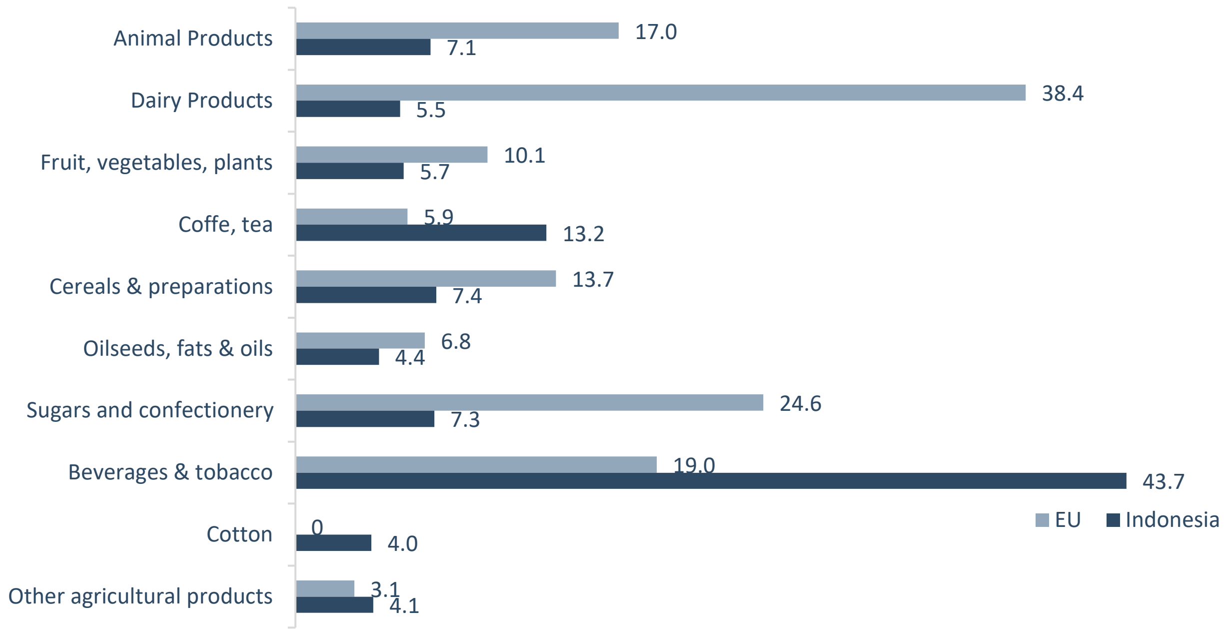
5.2 Trade barriers

Indonesia has been a member of the WTO since January 1995. This means that Indonesia is bound by the rules of the WTO, such as the Most-Favoured-Nation (MFN) clause. Regarding **tariff-related trade barriers**, Figure 5-1 shows the average MFN applied duties on agricultural products imported into Indonesia and the EU for the year 2022. The EU levies higher duties on most agricultural products than Indonesia. The European duty is about twice as high as in Indonesia in the case of animal products, fruit, vegetables, plants, cereals & preparations as well as oilseeds, fats & oils. For sugar and confectionery, the European duty is about three times higher and for dairy products even about six times higher than in Indonesia. For coffee, tea, beverages

& tobacco as well as cotton, on the other hand, Indonesia levies a higher duty. The higher duties on agricultural imports into the EU serve the purpose of protecting this sector. The agricultural sector traditionally enjoys a number of privileges in the EU, such as the subsidies under the Common Agricultural Policy, has a strong lobby and is also important in terms of strategic autonomy.

Figure 5-1: Tariff barriers on agricultural products and non-agricultural products

Average MFN applied duties* in Indonesia and the EU in 2022 in per cent



*MFN: most favoured nation duties are relevant for imports from WTO members that do not have an FTA with the respective country.
Source: WTO

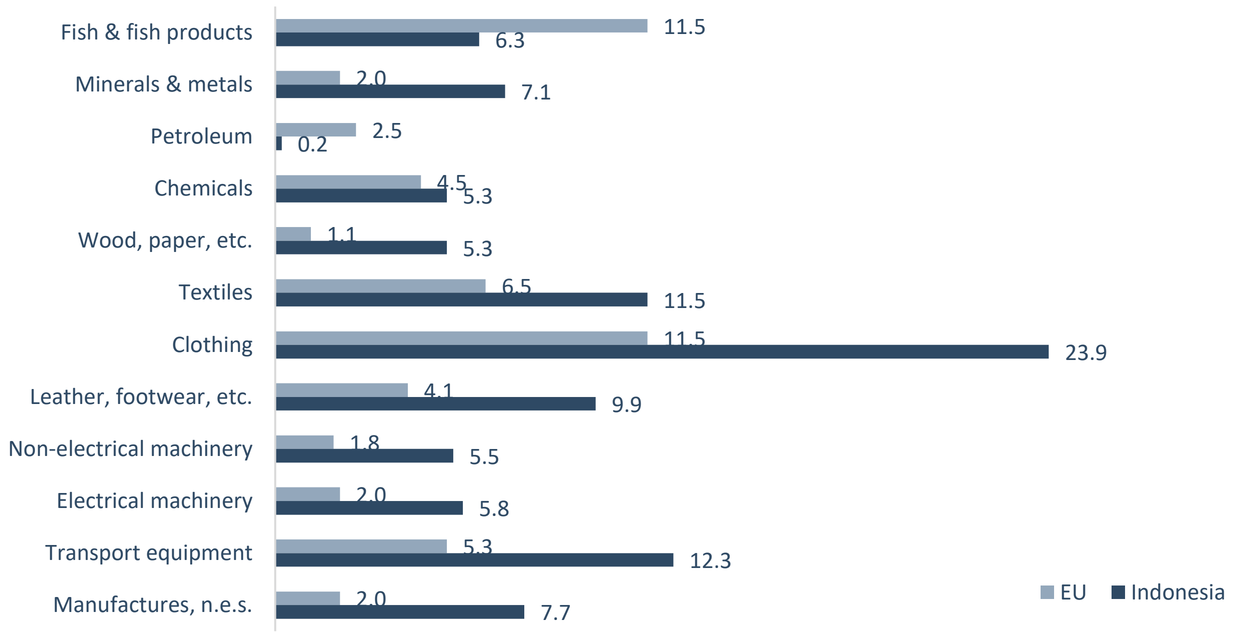
Figure 5-2 shows the average MFN applied duties on non-agricultural products imported into the EU and Indonesia. Unlike in the case of agricultural products, for non-agricultural products it is mostly Indonesia that levies higher duties. The only exceptions are fish & fish products, where the duty in the EU is about twice as high, and petroleum, where the duty in the EU is more than ten times as high. Indonesia levies a particularly high duty on clothing, which is among the most relevant industries in Indonesia (see Section 4). The high duty probably serves the purpose of protecting this existing domestic sector from international competition. Moreover, by levying a higher duty on machinery, the Indonesian government might intend to protect a sector in which the country is trying to gain a foothold in order to move up the value chain.

In view of this differentiated picture, greater trade liberalisation in both the agricultural and the non-agricultural sectors would benefit both sides. An FTA between Indonesia and the EU would enable both sides to export more in the respective sector with comparative advantages – as the European Commission's SIA simulations show (see Section 5.1)

Besides tariffs**, non-tariff measures** (NTMs), such as technical measures, also impede trade in Indonesia. Due to the fact that NTMs make trade policy less transparent, they are particularly harmful. Table 5-1 lists the top ten most imposed NTMs in Indonesia by coverage ratio. The coverage ratio is calculated by determining the value of imports of each commodity subject to NTMs, aggregating by applicable HS commodity group, and expressing the value of imports covered as a percentage of total imports in the HS (WITS, 2018a). Another way to quantify the effect of NTMs is the frequency ratio, which accounts for the presence or absence of a NTM and indicates the percentage of traded products to which one or more NTMs are applied (WITS, 2018a). Four of the top ten NTMs fall into Chapter B of UNCTAD's international classification of NTMs (UNCTAD, 2015). Chapter B collects technical barriers to trade (TBT), such as labelling, standards on technical specifications or certification. Pre-shipment inspection also falls into the category of technical measures. Five of the top ten NTMs fall into Chapter P, which collects export-related measures, such as export quotas or prohibitions.

Figure 5-2: Tariff barriers on agricultural products and non-agricultural products

Average MFN applied duties* in Indonesia and the EU in 2022 in per cent



*MFN: most favoured nation duties are relevant for imports from WTO members that do not have an FTA with the respective country.
Source: WTO

Even for the most frequently imposed NTMs in Indonesia, the registration requirements for importers, the coverage ratio is below 50 per cent. This is low compared to the EU, where the most commonly imposed NTM, labelling requirements, has a coverage ratio of over 70 per cent (WITS, 2018b). A noticeable difference to the NTMs imposed by the EU is that in Indonesia 50 per cent of the top ten most frequently imposed NTMs are export-related, while in the EU, not a single NTM is in the top ten.

For all imports, the coverage ratio in Indonesia is around 69 per cent, compared to around 94 per cent in the EU. On the export side, the coverage ratio in Indonesia across all sectors is around 60 per cent, compared to around 6 per cent in the EU. This corroborates the previous finding that Indonesia levies more NTMs on the export side compared to the EU.

Table 5-1: Top ten most imposed non-tariff measures by Indonesia

Coverage ratio and frequency ratio in per cent

Measure	NTM Coverage Ratio	NTM Frequency Ratio
Registration requirement for importers for TBT reasons (B150)	49.9	34.0
Traceability information requirements (B850)	47.9	27.5
Inspection requirement (P610)	44.4	8.3
Export Registration requirements (P140)	42.2	21.0
Pre-shipment inspection (C100)	39.9	24.5
Authorization requirement for TBT reasons (B140)	38.6	20.1
Export price control measures (P300)	38.5	18.8
Export technical measures, n.e.s. (P690)	34.8	9.8
Product quality or performance requirement (B700)	24.3	6.3
Licensing or permit requirements to export (P130)	20.0	4.1

NTM: Non-tariff measures.
Sorted by coverage ratio.
Coverage Ratio: The coverage ratio is calculated by determining the value of imports of each commodity subject to NTMs, aggregating by applicable HS commodity group, and expressing the value of imports covered as a percentage of total imports in the HS.
Frequency Ratio: The frequency ratio accounts for the presence or absence of a NTM and indicates the percentage of traded products to which one or more NTMs are applied.
Source: WITS, 2018a

Going into more detail, Table 5-2 lists the Indonesian NTMs by sector according to the HS classification, sorted by coverage ratio. Particularly food and food products are affected by NTMs. These are largely sanitary and phytosanitary measures (Chapter A). NTMs imposed on fuel are mostly export-related. Textiles and clothing are also particularly affected by export-related NTMs, such as measures to control export prices.

With regard to NTMs, a free trade agreement between the EU and Indonesia would be a good opportunity to reduce these barriers for EU exporters and importers.

Table 5-2: Non-tariff measures by sector in Indonesia

Sectors according to HS classification, sorted by coverage ratio, in per cent

Sector	NTM coverage ratio	NTM frequency ratio
Animal	100	100.0
Vegetable	99.3	91.8
Food Products	98.8	99.0
Fuels	96.6	28.2
Transportation	82.7	58.9
Textiles and Clothing	80.6	78.2
Hides and Skins	77.8	76.6
Chemicals	69.6	54.5
Footwear	63.3	53.2
Machinery and Electronics	61.9	46.0
Metals	40.5	30.5
Miscellaneous	37.5	36.7
Minerals	37.4	13.4
Stone and Glass	29.2	35.6
Wood	25.2	46.4
Plastic or Rubber	17.6	27.0

NTM: Non-tariff measures.
Coverage Ratio: The coverage ratio is calculated by determining the value of imports of each commodity subject to NTMs, aggregating by applicable HS commodity group, and expressing the value of imports covered as a percentage of total imports in the HS.
Frequency Ratio: The frequency ratio accounts for the presence or absence of a NTM, and indicates the percentage of traded products to which one or more NTMs are applied.
Source: WITS, 2018a

5.3 Indonesia's trade relations with the EU and China

Indonesia's global trade

On both the import and export side, the value of goods traded by Indonesia has increased in the last ten years. In 2022, the value of imported goods amounted to approximately USD 237 billion. This is an increase of nearly 24 per cent compared to 2012. On the export side, the development is even more positive. In 2022, the value of exported goods amounted to nearly USD 292 billion, which is an increase of approximately 54 per cent compared to 2012.

Indonesia's most important trading partner is China. Given the size and proximity of China, this seems logical. The EU is its fifth most important trading partner (EEAS, 2023). Other important trading partners of Indonesia are Japan, Singapore and South Korea. The US is a relevant export market for Indonesia.

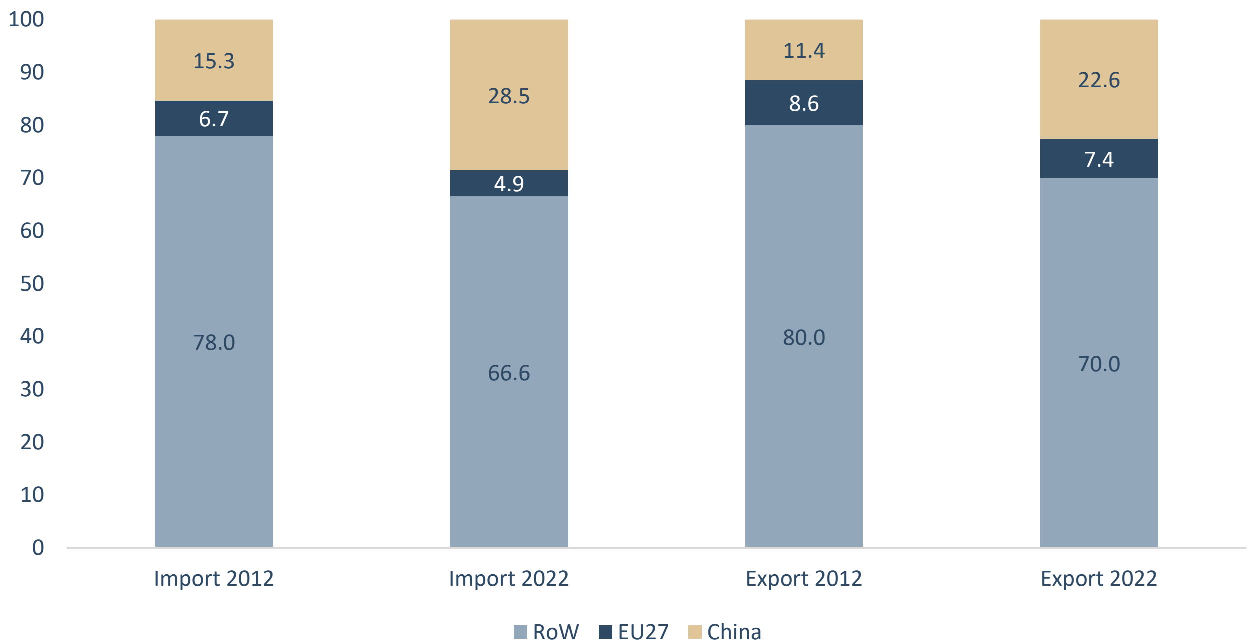
Figure 5-3 shows the share of China, the EU and the rest of the world in Indonesia's overall goods imports and exports:

- In 2012, 15.3 per cent of Indonesia's imports originated from China and 6.7 per cent from the EU. By 2022, the import share of China has nearly doubled to almost 29 per cent, while the EU's share has decreased to under 5 per cent.
- On the export side the picture looks similar: China's share has doubled from around 11 per cent in 2012 to more than 22 per cent in 2022. The export share to the EU has decreased from 8.6 per cent to 7.4 per cent.

Thus, on both the import and export side, the EU has lost relevance as Indonesia's trading partner, particularly in comparison to China. Also from this perspective, an FTA with Indonesia would be an important attempt to rebalance this growing imbalance between the EU and China as Indonesia's bilateral trading partners. An FTA between the EU and Indonesia would also be able to counter the trade diversion effects that result from Indonesia's existing FTAs with China and Indonesia's other FTA trade partners, as these FTAs tend to discriminate against trade with non-FTA partners such as the EU.

Figure 5-3: The EU and China as Indonesia's trading partners

Share of the respective country in Indonesia's overall exports and imports of goods in per cent



Sources: UN Comtrade; IW

Indonesia's top export commodity groups to the world are mineral fuels and oils (including in particular coal briquettes); animal, vegetable fats and oils (including in particular palm oil) as well as iron and steel. On the import side, the most important commodity groups are also mineral fuels (including in particular petroleum), machinery and mechanical appliances as well as electrical machinery and equipment.

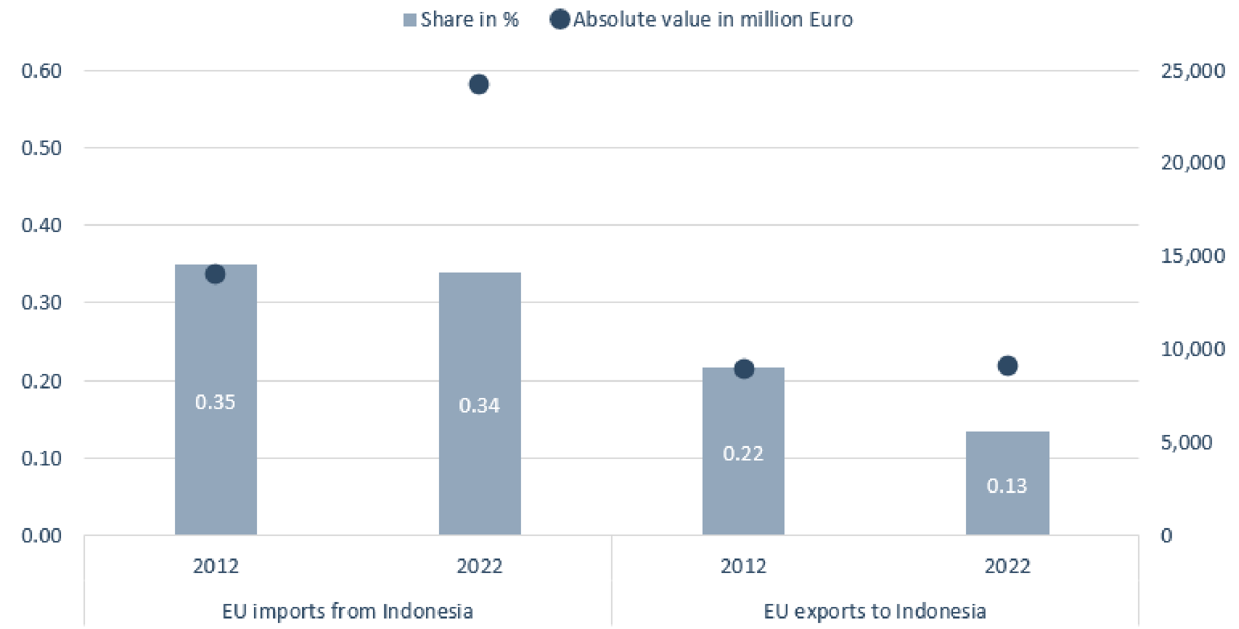
Indonesia's trade relationship with the EU

Figure 5-4 shows how trade with Indonesia has developed from the EU perspective:

- On the import side, Indonesia's share of the EU's overall imports has remained almost constant at roughly 0.35 per cent. In absolute terms, however, the value of imports from Indonesia has increased from around EUR 14 billion in 2012 to EUR 24 billion in 2022. However, as Indonesia's share stagnated, EU imports from Indonesia underperformed because they grew less dynamically than the EU's overall imports. Thus, there is still scope for improvement.
- On the export side, Indonesia's share decreased from around 0.22 per cent in 2012 to 0.13 per cent in 2022. In absolute terms, the value of exports from the EU to Indonesia has remained almost constant at around EUR 9 billion. In comparison to a considerable increase in EU's overall exports, exports to Indonesia have thus underperformed significantly in the last ten years.
- This clearly shows that there is potential for more trade between the two regions. Again, a remedy for this underperformance would be the conclusion of an FTA, which could help to advance the trade relationship, on both the import as well as on the export side.

Figure 5-4: EU trade with Indonesia

Share of Indonesia in overall EU trade in per cent (left-hand scale) and EU trade with Indonesia in million euro (right-hand scale)



Sources: Eurostat; IW

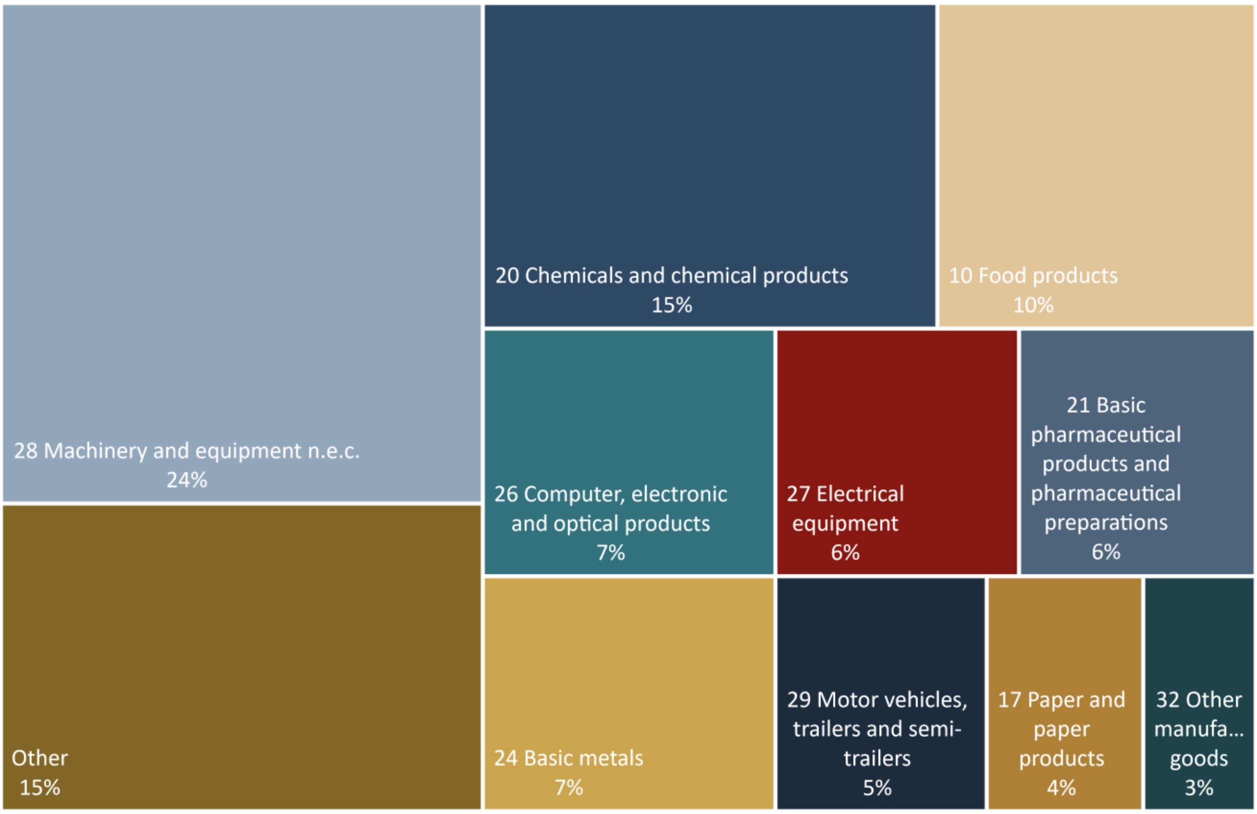
A closer look at the trade partnership between the EU-27 and Indonesia reveals a typical specialisation between an advanced country and an emerging country.

- Figure 5-5 shows the **top ten export goods** of the EU to Indonesia according to the two-digit classification of products (CPA) which are mostly sophisticated and technology-intensive industrial goods.

- **Machinery and equipment** (CPA code 28) is the EU's most important export good to Indonesia. They account for 24 per cent of the EU's overall exports to Indonesia.
- Other important exports goods of the EU to Indonesia are **chemicals and chemical products** (CPA code 20) with 15 per cent. These include, for instance, plastics in primary forms (CPA code 2016).
- Nearly all other product groups are sophisticated manufacturing products.
- One exception are **food products** (CPA code 10) which is in the third place with a share of 10 per cent. The result for food products is to a large part driven by dairy and cheese products, including milk powder. This increased demand for dairy products in Indonesia can be explained by the rising number of middle-class consumers and an evolving taste for Western diets. Indonesia also charges much lower duties on dairy products than the EU (see Figure 5-1).

Figure 5-5: EU exports of goods to Indonesia

Share of the ten most important product groups in overall EU goods exports to Indonesia in 2022 in per cent



The category "Other" is the sum of the remaining goods (excluding the ten most important goods) according to the CPA classification.
Sources: Eurostat; IW

- Figure 5-6 shows the **top ten import goods** of the EU-27 from Indonesia according to the two-digit CPA classification. Here, the picture is more heterogeneous, but overall Indonesia's specialisation in less sophisticated products with lower technology intensity becomes obvious.
  - **Food products** (CPA code 10) are the EU's most important import good from Indonesia, accounting for 17 per cent of the EU's overall imports from Indonesia. Over 77 per cent of food product imports are oils and fats, including palm oil. This is despite the fact that the EU charges comparatively high

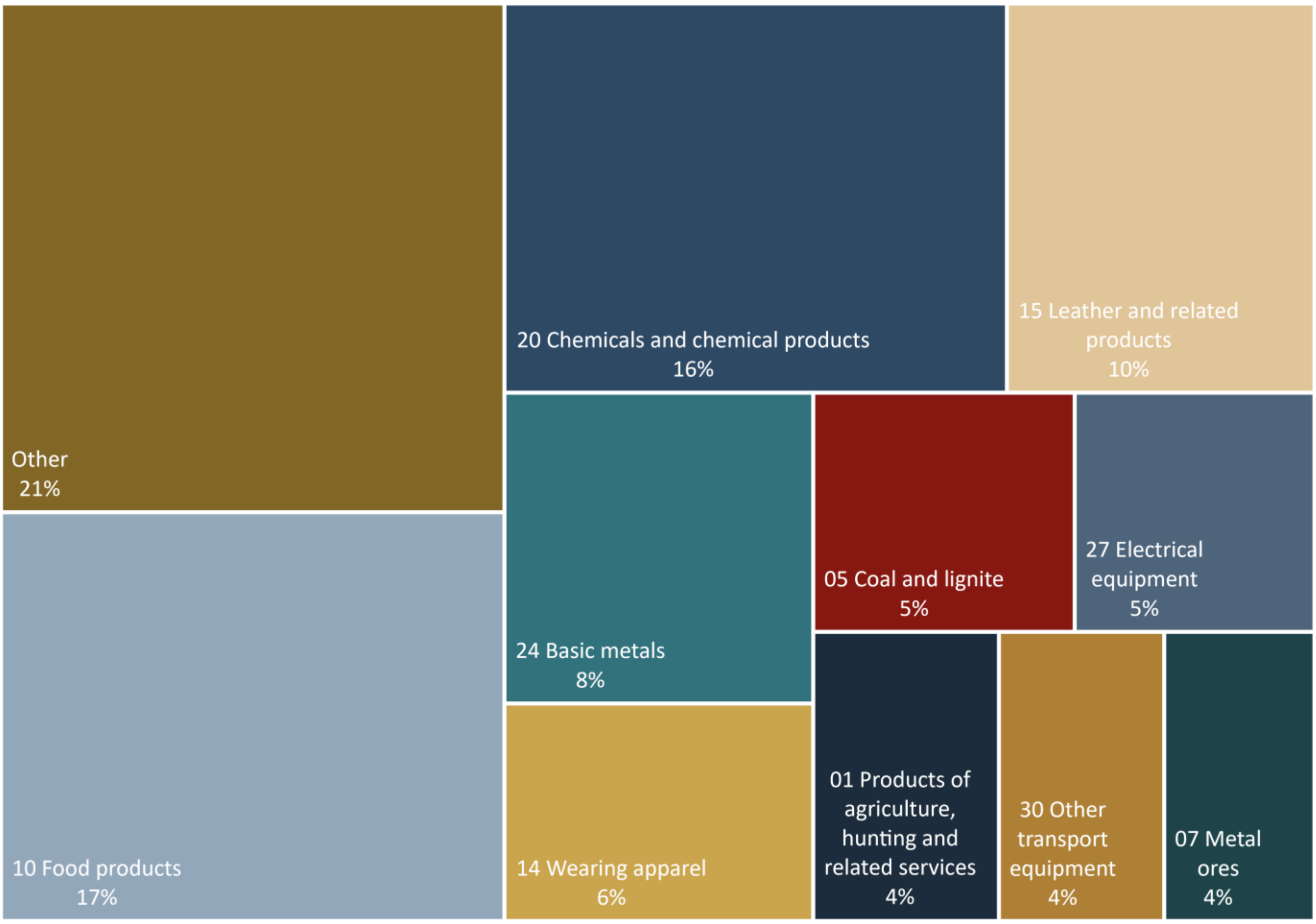
duties on agricultural products in general, although the duty on oilseeds, fats & oils is one of the lowest (see Figure 5-1).

- **Chemicals and chemical products** (CPA code 20) are another important EU import good from Indonesia. On the four-digit level according to CPA, these are for instance fertilisers and nitrogen compounds (CPA code 2015), which are relatively standardised products.
- The EU, moreover, imports **leather and related products** (10 per cent) from Indonesia as well as **basic metals** (8 per cent).

- Compared to the export side, more basic goods, such as food and raw materials, are imported to the EU from Indonesia. This reflects the different comparative advantages of the two regions.

Figure 5-6: EU imports of goods from Indonesia

Share of the ten most important product groups in overall EU goods imports from Indonesia in 2022 in per cent



The category "Other" is the sum of the remaining goods (excluding the ten most important goods) according to the CPA classification.
Sources: Eurostat; IW

Indonesia's trade relationship with China

As Figure 5-3 shows that Indonesia's most important trading partner is China, Table 5-3 and Table 5-4 focus in more detail on the trade relationship between these two countries. Table 5-3 shows Indonesia's imports from China for the top five commodity groups according to the two-digit HS classification. There is a noticeable concentration of Indonesian imports from China on machinery and mechanical appliances (HS code 84) with a share of overall imports of almost 24 per cent as well as electrical machinery and equipment (HS code 85) with around 21 per cent. All other commodity groups account for less than 5 per cent of overall imports. Though it is somewhat difficult to compare China's (Table 5-3) and the EU-27's (see Figure 5-5) exports to Indonesia due to the different systems of classification, it is apparent that both cater the Indonesian market with more complex goods, such as machinery. China therefore appears to be increasingly competing with the EU for sophisticated industrial goods, indicating that China's market share gains in Indonesia might tend to come at the expense of EU exports.

Table 5-3: Indonesia's imports from China

Absolute value in million USD and share in Indonesia's overall imports in per cent in 2022

Commodity group (2-digit HS)	Value in million US-dollars	Share of overall imports in per cent
Machinery and mechanical appliances, boilers, nuclear reactors; parts thereof (84)	16,162	23.9
Electrical machinery and equipment and parts thereof; sound recorders and reproducers; television image and sound recorders and reproducers, parts and accessories of such articles (85)	14,473	21.4
Iron and steel (72)	3,251	4.8
Plastics and articles thereof (39)	2,943	4.3
Organic chemicals (29)	2,607	3.9
Other	28,285	41.8

For readability the commodity group description is abbreviated for some categories.

The category "Other" is the sum of the remaining commodities (excluding the five most important commodities) according to the HS classification.

Sources: UN Comtrade; IW

Table 5-4 shows Indonesia's exports to China for the top five commodity groups according to the two-digit HS classification. As on the import side, there is a high degree of concentration on two commodity groups: iron and steel (HS code 72) with almost 29 per cent of overall exports as well as mineral fuels and oils and distillation (HS code 27) with around 27 per cent. Indonesia's other top five export commodity groups to China also fall into the category of agricultural products or raw materials in a broader sense. Here again, there is a similarity to what the EU-27 imports from Indonesia (see Figure 5-6) although the different systems of classification again make the direct comparison somewhat difficult. However, it can be concluded from this that China and the EU display relatively similar comparative advantages. Furthermore, both compete on the import side for Indonesia's agricultural products and raw materials.

Table 5-4: Indonesia's exports to China
Absolute value in million USD and share in Indonesia's overall exports in per cent in 2022

Commodity group (2-digit HS)	Value in million US-dollars	Share of overall exports in per cent
Iron and steel (72)	18,973	28.8
Mineral fuels, mineral oils and distillation (27)	17,867	27.1
Animal, vegetable or microbial fats and oils (15)	6,459	9.8
Nickel and articles thereof (75)	4,488	6.8
Pulp of wood or other fibrous cellulosic material (47)	2,828	4.3
Other	15,306	23.2

For readability the commodity group description is abbreviated for some categories.
The category "Other" is the sum of the remaining commodities (excluding the five most important commodities) according to the HS classification.
Sources: UN Comtrade; IW

Interim conclusion

In summary, the EU is leaving a large trade potential with Indonesia unused without a trade agreement. The picture of the existing bilateral trade relations underpins the view that both countries levy high trade barriers only for the products in which the respective partner is specialised. Moreover, the EU suffers from trade diversion as China and other countries do have concluded FTAs with Indonesia so that their goods enjoy trade preferences in Indonesia, while EU goods do not and are thus implicitly discriminated against. Thus, to exploit the EU's trade potential with Indonesia and to rebalance China's growing weight as Indonesia's trade partner, an FTA is indispensable.

6 Business environment and Foreign Direct Investment

6.1 Indonesia's attractiveness as business location and business climate

Indonesia as a business location

The following section discusses Indonesia's attractiveness as a business location as well as the business climate and again offers a comparison with the selected ASEAN peer countries. In order to shed light on central aspects of Indonesia as a business location, the IW Business Location Index of the IW Consult (2024) is used. It provides a standardised evaluation of central aspects determining the attractiveness of a **business location** and allows for international comparisons. The following dimensions are taken into account:

- **Governance** comprises indicators on the regulatory framework, regulation and bureaucracy.
- **Infrastructure** considers indicators on the distribution of internet and broadband access, transportation infrastructure as well as ports and airports.
- **Knowledge** summarises indicators on human capital and the innovation environment.
- **Resources** include access to resources and capital as well as energy efficiency.

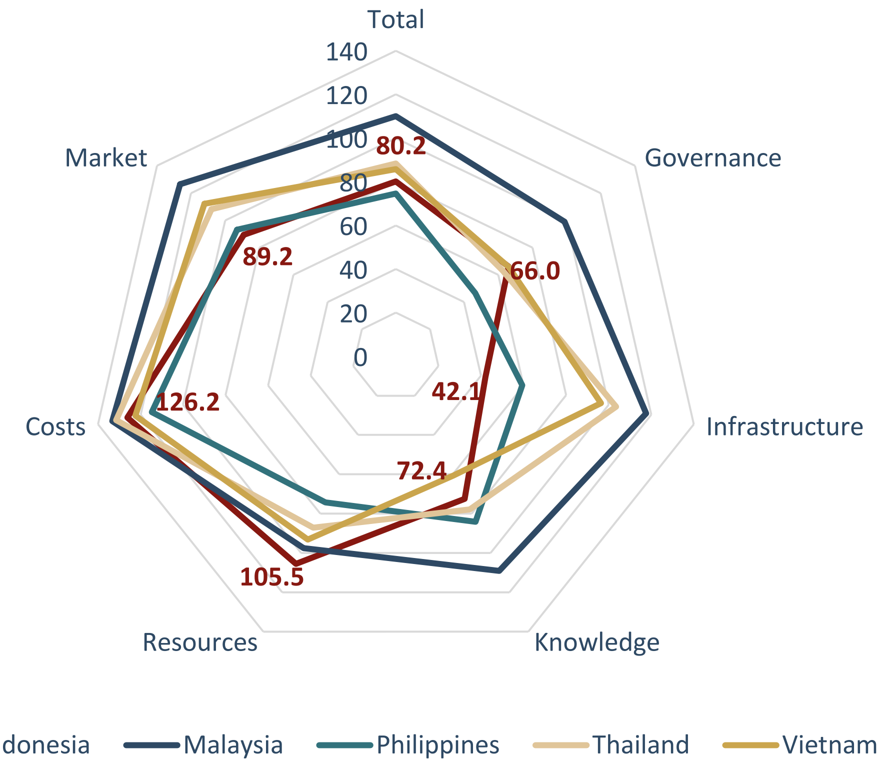
- **Costs** comprise export, energy, labour and interest costs as well as the tax burden.
- **Market** combines components such as the diversification and complexity of the economy, market size, the nature of value chains and the openness of the markets.

The above-mentioned dimensions are made up of 13 topic areas, which in turn are monitored by about 60 single indicators. The IW Business Location Index aggregates these single indicators and assigns an aggregated score as well as a score for each dimension between 0 and 200, whereby a higher value indicates a higher quality as an overall business location or better performance in the respective dimension. The following assessment of the Indonesian business climate uses the most recent data that is available for 2021 for most indicators.

The overall attractiveness of Indonesia as a business location falls behind that of other AESAN peer countries (see Figure 6-1). The IW Business Location Index ranks Indonesia 4th out of five ASEAN peer nations with a score of 80.2 and hence significantly lower than Vietnam (85.8), Thailand (88.4) and in particular Malaysia (110.1), but ahead of the Philippines (74.6).

Figure 6-1: IW business location indicators for selected ASEAN countries

IW Business Location Index, scores, scale 0–200



Source: IW Consult

Looking at the single dimensions, several relative strengths emerge in comparison with the ASEAN peer group:

- Indonesia's main advantage lies in its abundant **resources** which are unique not only in the ASEAN region, but also in a global context.

- Indonesia's **governance** performance is relatively on par with that of Thailand or Vietnam, but significantly behind that of Malaysia, ranking it at second place among ASEAN peer nations.

- The level of **costs** in Indonesia is another relative upside of the attractiveness as a business location, even though Malaysia and Thailand score somewhat better. Indonesia has recently made significant progress in reducing trade costs and takes a leading position among ASEAN countries regarding the implementation of trade facilitation measures (Southeast Asia Development Solutions, 2022). Labour costs remain highly competitive attracting among other businesses for low-cost contract manufacturing, despite recent reforms of the minimum wage level (AHK, n.d.c).

However, Indonesia falls behind ASEAN peer countries in critical aspects such as infrastructure, knowledge and market, where it ranks lowest. As previously outlined, while infrastructure development has been a key driver of economic development and has come a long way, the geographical structure of Indonesia is challenging and the distribution of transport, energy and internet infrastructure still leaves large potential for improvement. Moreover, the lack of a highly educated and trained workforce significantly hampers the development of sophisticated industries (see Section 3.2).

Weighing these aspects against each other leads to the conclusion that the attractiveness of Indonesia as a business location is characterised by huge potential in specific areas such as resources and to a smaller degree governance and costs as well as significant challenges in critical areas such as infrastructure and knowledge.

Indonesia's business climate

The business climate is evaluated using selected Ease of Doing Business indicators (EoDB) provided by the World Bank (2024) and augmented with a hiring and firing subindicator of the Economic Freedom Index provided by the Fraser Institute. Even though the EoDB has been heavily disputed, its unique, detailed and comprehensive measurement of relevant aspects of operational activities of enterprises renders it outstanding. As there are currently no comparable alternatives, the usage of the EoDB appears still justified– at least until its successor index B-Ready is published.

The EoDB provides rankings of countries according to their economic framework conditions for businesses. The indicators measure several critical aspects of the operational activities of enterprises and hence allow for a detailed assessment of up- and downsides of the **business climate** in Indonesia. The rank denotes the relative position of a country within the set of 190 countries. The indicators are assigned scores on a scale from 0 to 100, whereby a higher value indicates a higher ease of doing business in the respective aspect. The latest data is available is for 2020.

Regarding for its overall ease of doing business measure, Indonesia ranks at a 73th place among the 190 countries – placing it in neighbourhood of Vietnam and ahead of the Philippines but dramatically behind its other ASEAN peer nations. Malaysia takes a strong 12th place in the ranking followed by Thailand on the 21st place (World Bank, 2024).

Looking at selected subindicators in Figure 6-2 underlines the overall mediocre business climate in Indonesia. The following EoDB subindicators are considered:

- **Starting a business** measures the bureaucratic hurdles of starting a business such as the number of procedures, time and costs as well as minimum capital requirements for small- and medium-sized enterprises in the respective economy's largest business city.

- **Registering property** captures the steps, time and costs required for registering property using a standardized case of purchasing already registered and juristically undisputed land and a building.

- **Protecting minority investors** measure the protection of minority shareholders against abuse of corporate assets for private gain as well as related rights and regulations and is an indicator of how equity capital is protected.

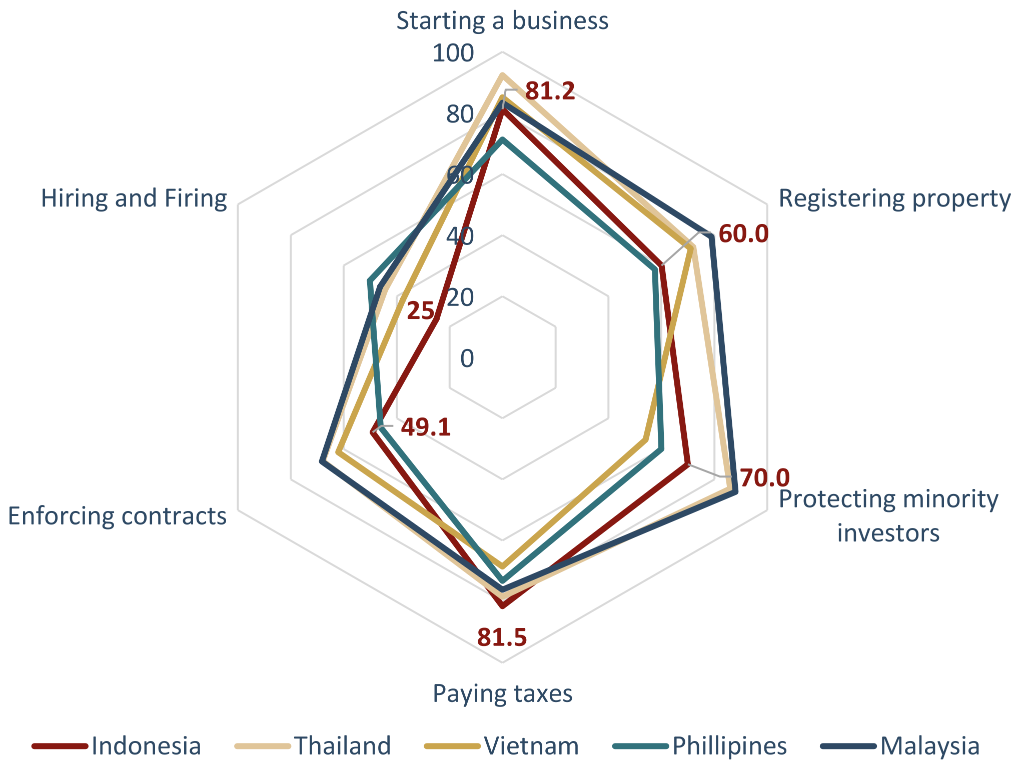
- **Paying taxes** measure the tax and mandatory contributions burden carried by a medium-sized company as well as the associated administrative burden.

- **Enforcing contracts** capture the time and costs required to resolve a commercial dispute through a local first-instance court as well as the quality of the judicial framework.

Figure 6-2 is augmented with a **hiring and firing** subindicator of the Economic Freedom Index that captures regulations on the ease of employing and laying off workers which are not included in the EoDB. Data for 2020 is used for comparability. The subindicator is measured on a scale from 0 to 10, whereby a higher value indicates a higher freedom of hiring and firing regulations. Original values are multiplied by 10 to adapt them to the scale to the EoDB indicators.

Figure 6-2: Business climate indicators for selected ASEAN countries

Selected indicators on the Ease of Doing Business, scores, scale 0–100



Note: All indicators except the "Hiring and Firing" indicator are taken from World Bank (2024). The "Hiring and firing" indicator is taken from the Fraser Institute; its original score of 0-10 was multiplied by a factor of ten to adapt it to the same scale.
Sources: World Bank; Fraser Institute; IW

Mirroring the attractiveness of Indonesia as a business location, the business climate performance is mediocre relative to ASEAN peer nations in most aspects:

- However, Indonesia can set it itself ahead of other ASEAN nations only regarding the payment of taxes. The baseline corporate income tax rate is 25 per cent in comparison to an average corporate income tax rate of close to 29 per cent in Germany (ZEW, 2023). Several exemptions from the baseline tax rate are granted in particular for large businesses whose shares are traded on the Indonesian stock market as well as for small and medium-sized businesses whose turnovers fall below certain thresholds (Indonesia Investments, n.d.c).
- Indonesia scores reasonably well regarding the ease of starting a business, albeit not exceptional and in close neighbourhood to Vietnam and Malaysia and behind Thailand.
- Indonesia scores particularly low in critical dimensions such as registering property and enforcement of contracts, where it positions itself only slightly ahead of the Philippines but markedly behind other ASEAN nations.
- Indonesia's outstanding weakness is its very rigid labour market regulation which significantly hampers employment, as companies shy away from hiring new employees if they cannot make them redundant, even though a deteriorating business situation would require this. Indonesia ranks last on the hiring and firing indicator with a particularly low score of 25 – far behind its ASEAN peer nations. The Indonesian government has demonstrated its awareness of the problem by passing the controversial Omnibus Law on Job Creation in 2020, which besides making Indonesia an attractive business location for international investors, is particularly aimed at adapting the previously very strict Indonesian labour market regulations to those of other ASEAN peer nations.

Omnibus Law on Job Creation

The heavily disputed legislation aims to make Indonesia an attractive economic hub for international investors by significantly reducing the number of industries closed to foreign investment and easing operational hurdles for businesses by reforming labour market regulations and streamlining bureaucratic and other regulatory hurdles (U.S. Department of State, n.d.).

The Omnibus Law on Job Creation was first passed in late 2020. It included amendments to more than 75 laws and required the Indonesian government to issue more than 30 government regulations (UNCTAD, 2020). The legislation was praised from businesses as a major breakthrough. However, it faced a heavy backlash in particular from trade unions who protested against the weakening of worker rights and took the legislation to the Indonesian Constitutional Court shortly after it was passed. The court declared the Omnibus Law as conditionally unconstitutional as certain procedural standards had not been met. It decided that the Indonesian government would have to restart the legislative process within two years. However, although it prohibited the implementation of new regulations, in particular those of broad impact and strategic impact, regulations that had already been implemented remained in full force and effect. In late 2022, the Indonesian government passed a slightly altered version of the initial 2020 Omnibus Law that finally came into effect in March 2023 (IR Global, 2023). Once again, labour unions heavily protested against the law and filed another case at the Constitutional Court, claiming procedural flaws such as the neglect of public participation. However, this time the court ruled in favour of the legislators and rejected the petitions in late 2023. Nonetheless, the law is still not fully in force, as the substance of the legislations remains under investigation, pending a further ruling of the Constitutional Court (Reuters, 2023d).

Notwithstanding this uncertainty about its full application, the 2023 Omnibus Law on Job Creation, which largely builds on its predecessor, comprises provisions in the following key areas.

Labour regulations

The reform of labour market regulations is the core of the Omnibus Law on Job Creation. The legislation comprises several measures to make the labour market more flexible in order to induce job creation and expand formal sector employment. It reinstated a previous legislation that enables companies to subcontract and outsource parts of their business activities, and introduced new working hour regulations have been introduced that extend overtime allowance. Moreover, it reformed the calculation of the minimum wage and implemented local minimum wages at provincial or regency level instead of sectoral ones (U.S. Department of State, 2023). The Omnibus Law also significantly curtailed worker rights in multiple areas to make the Indonesian labour regulation competitive with that of other ASEAN peer nations, including the reduction of severance payments and mandatory rest days as well easing hiring and firing processes (Simatupang et al., 2023).

Dismantling bureaucratic hurdles and business facilitation

The Indonesian government intends to implement a risk-based approach for the issuance of business licenses and has overall streamlined the process for almost all sectors. Businesses are classified into low, medium and high risk categories depending on the potential hazard of their business activities and are subject to different business licensing requirements based on their risk profile. While low-risk businesses only need a business identity number (BIN) for commercial or production activities, medium-risk companies need a BIN as well as additional certificates, and high-risk businesses face additional requirements, such as an environmental impact assessment (U.S. Department of State, 2023).

(Foreign) Investment regulations

The legislation replaces the 2016 negative list of investments and opens up nearly all sectors to foreign investments. Relevant sectors that were previously out of reach for foreign investors will be opened include manufacturing, capital- and labour-intensive industries, transport and energy as well as digital infrastructure and healthcare. However, despite the de jure full opening to foreign investment, technical and sectoral regulations may nonetheless pose significant challenges (U.S. Department of State, 2023). Only seven highly specific sectors remain closed for international investors, such as the cultivation and processing of narcotics, gambling, or fishing of endangered species.

In addition to these regulations, the Omnibus Law instated the Indonesia Investment Authority – a sovereign wealth fund designed to attract foreign investment, in particular for the large-scale government infrastructure projects in sectors such as transportation, energy, construction as well as digital technologies (U.S. Department of State, 2023).

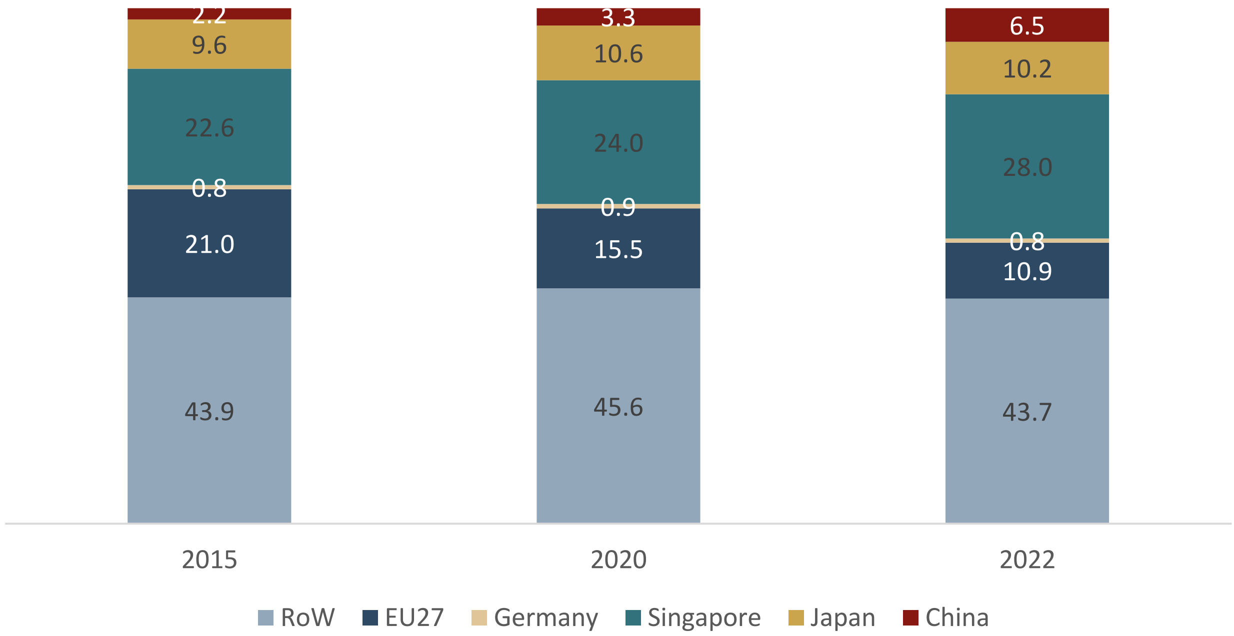
In sum, the Indonesian business landscape used to display significant weaknesses, such as non-transparent regulations and procedures as well as vested interests in political decisions. The Omnibus Law on Job Creation addresses many of these pressing issues and puts in place regulations that could benefit domestic businesses and attract foreign investors. However, there is still a great deal of legal uncertainty surrounding the legislation currently. Nonetheless, the law marks a decisive first step in the right direction towards making the Indonesian economy more competitive and further open it up to further to international investors.

6.2 Indonesia's FDI relations globally and with the EU

Over the last years, Indonesia has not only expanded its trade relations, but has also become more attractive to foreign investors. The stock of inwards foreign direct investment (FDI) has increased by nearly 19 per cent since 2015, from around USD 222 billion in 2015 to nearly USD 264 billion in 2022. Figure 6-3 displays the stock of inward FDI to Indonesia by source country as precent of total stock of inward FDI.[1] In 2015, the EU-27 accounted for 21 per cent of total inward FDI to Indonesia, and Germany for 0.8 per cent. This is similar to the amount of investment by Singapore in Indonesia, which accounted for 22.6 per cent. Japan's share was nearly 10 per cent. Meanwhile, in 2015 China only stood for a share of 2.2 per cent.

Figure 6-3: Stock of inward FDI to Indonesia by source country

Share of selected partner country/region at year-end in total inward FDI stock in Indonesia in per cent



Sources: ASEANStats DataPortal; IW

By 2022, Singapore managed to expand its strong investment position in Indonesia to 28 per cent. Japan still accounted for around 10 per cent. Thus, these two advanced countries seem to regard Indonesia as a relatively attractive investment location. However, it also shows that Indonesia relies on only two countries for nearly 40 per cent of its FDI. This makes it vulnerable to the macroeconomic conditions in these countries. At the same time, the share of the EU-27 halved to 10.9 per cent. This decline has been particularly steep in the two years since 2020. The German share remained constant at 0.8 per cent. China's share, by contrast, has tripled to 6.5 per cent. Indonesia is also part of China's Belt and Road Initiative (BRI). This has spurred Chinese investment in Indonesia, particularly directed toward infrastructure development and the mining industry (Busbarat et al., 2023).

[1] The data source for the inward stock of FDI by source country is ASEANStats. To verify the quality of the data it was crosschecked with the data from UNCTAD, which provides only total stock of FDI, but no bilateral data. The total amount of inward stock of FDI provided by ASEANStats equals the amount provided by UNCTAD. Furthermore, the amount of German investment into Indonesia was crosschecked using data from the German Central Bank (Deutsche Bundesbank). Taking into account the euro/dollar exchange rate, the order of magnitude and the trend of the German FDI stock in Indonesia from both sources is similar.

In general, it seems that foreign investment in Indonesia is largely resource-oriented and to a large extent goes into the mining sector, instead of more high-tech sectors, such as manufacturing (Russell/Ruehl, 2023). However, foreign investment could become an opportunity for Indonesia to climb the technology ladder by further expanding into refining mining products. In fact, in-line with Indonesia's aim to build an electronic vehicle (EV) ecosystem on the back of its nickel reserves, BYD, a Chinese carmaker, is reported to invest USD 1.3 billion in an EV factory (Campbell et al., 2024). Construction is to begin this year.

Similar to the trend observed for exports and imports to Indonesia, the EU is increasingly losing ground to China also regarding FDI. Within the EU, the Netherlands are the largest European investor in Indonesia, which could be a legacy of the colonial past, but could also be due to tax reasons because many holding companies are located in the Netherlands. In 2022, the Netherlands accounted for nearly three quarters of the total EU-27 inward FDI stock in Indonesia. However, since 2015 the stock of Dutch investment in Indonesia has decreased from nearly USD 33 billion to around USD 21 billion in 2022. The stock of FDI from Belgium, France and Luxembourg in Indonesia has also decreased significantly since 2015. This explains the large reduction in overall EU inward FDI stock in Indonesia.

Interim conclusion

The decline in the EU's FDI stocks in Indonesia is remarkable and surprising as the EU's FDI outward stocks tend to increase globally. While the business climate in Indonesia used to lag behind that of other ASEAN countries (see Section 6.1), this was a known fact when former FDI stocks had been established. Thus, one might have expected a stagnation or a smaller increase of the Eu's FDI stocks in Indonesia than the global average, but not such a clear decline. What is more, the clear reform orientation of the Indonesian government and recent improvements in the business climate should have the potential to reverse the declining tendency as they should offer new potentials for investment engagement in Indonesia. Particularly, the recently introduced Omnibus Law, when fully implemented, will make investment in Indonesia more attractive, for instance by simplifying processes and opening up more sectors to foreign investors. One obstacle for foreign manufacturing firms is certainly the low quality of the education system and vocational training in Indonesia (see Section 3.2). However, this is not unusual for multinational companies when investing in emerging and developing countries. As European firms install relatively modern equipment in these countries, it is a given fact that they always have to intensively train their employees for their particular needs.

One starting point for more EU investment in Indonesia could be the green transition. In 2022, the EU and international partners launched the Just Energy Transition Partnership (JETP) with Indonesia. Part of the JETP is for Indonesia to develop an investment plan to achieve its climate targets and reduce greenhouse gas emissions. Given that Indonesia still heavily relies on fossil fuels for energy production (see Section 3.2), investment in this area is urgently needed. The EU has committed to mobilise around EUR 2.5 billion for the partnership (European Commission, 2022). European firms could use this opportunity to expand their presence in Indonesia in this sector, which is of strategic importance to the country in the longer run. Another sector that would profit from more European investment and in which China does not yet dominate, is manufacturing. This would be in-line with the aim of Indonesia's long-term development plan, the 2025-2045 RPJPN, to foster the manufacturing sector (see Section 3.1).

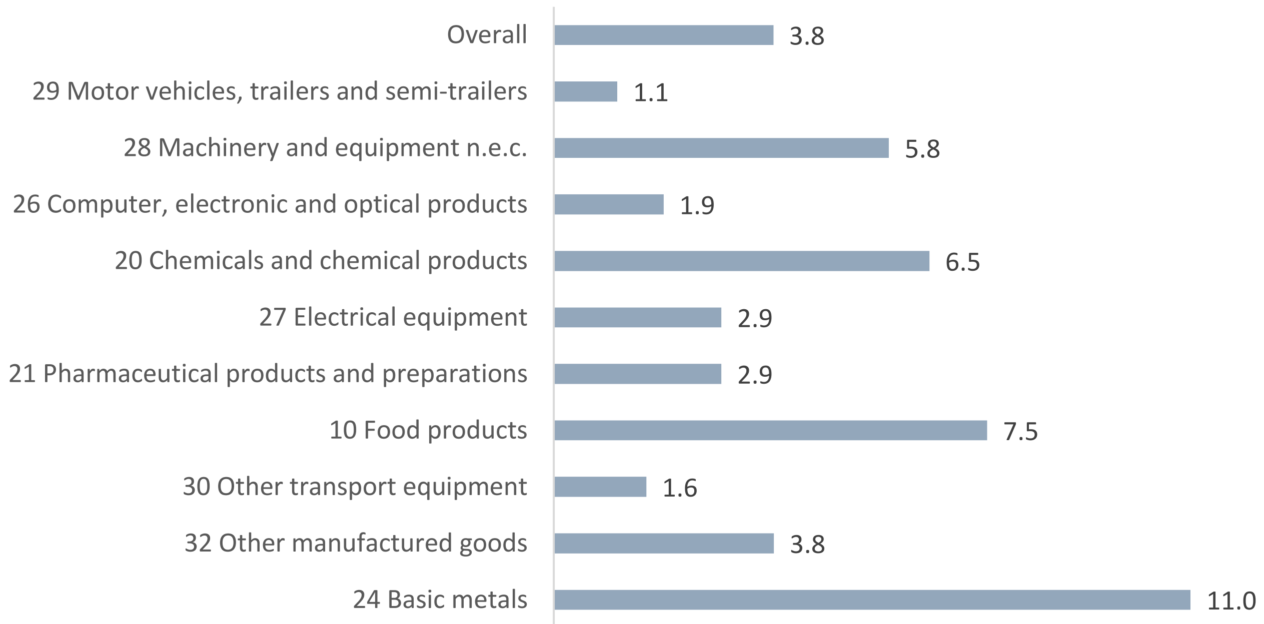
7 Conclusion: Potential for diversification for the EU

The aim of this study is to analyse whether Indonesia offers the EU potentials to diversify trade away from China. To be clear, diversification does not imply that trade with China should be completely substituted. Decoupling from China is not needed and would not be reasonable. Instead, de-risking critical dependencies on the export and import side could imply that the EU might trade less with China to a limited extent or only that trade with China might not grow as dynamically as it would without de-risking. The question therefore is whether an increase in economic exchanges with Indonesia can support the EU's diversification strategy in a meaningful way.

The potential of Indonesia to replace China is clearly limited. First, while China is approaching the status of an advanced economy, Indonesia is still an emerging economy with a less broad and less sophisticated industrial portfolio. Second, Indonesia's economic size is much smaller than China's. Figures 7-1 and 7-2 show that EU trade with Indonesia represented less than 4 per cent of total EU exports to and imports from China in 2022. In basic metals, chemical and food products the current relevance of Indonesia is somewhat larger on the export side, on the import side, this is true for chemical products and leather products. However, these figures indicate the current status quo and not the potential.

Figure 7-1: Indonesia's relevance as an export partner relative to China

Share of EU exports to Indonesia relative to EU exports to China in 2022 in per cent
Overall trade and top ten product groups ranked by value of EU exports to China

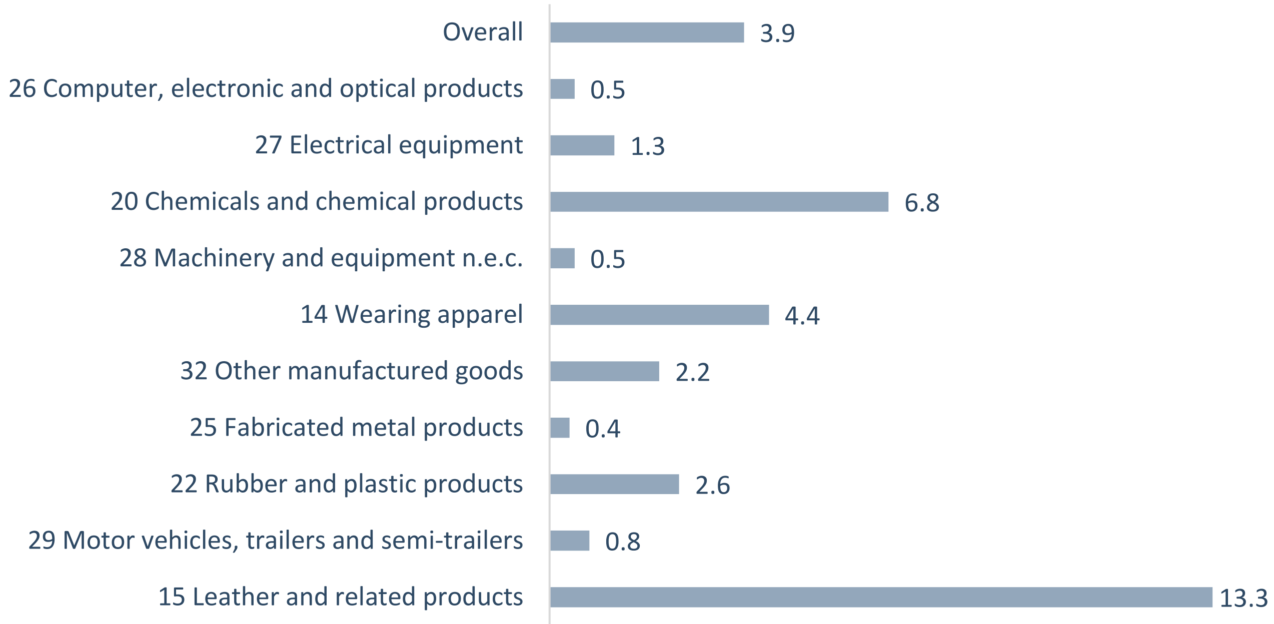


Product groups based on CPA classification.
Sources: Eurostat; IW

However, a static thought experiment shows that Indonesia can play a sizeable role in de-risking from China. When theoretically assuming that trade with China was to be reduced by a possible 5 per cent in the medium term as a result of de-risking, an assumed increase of trade with Indonesia by 25 per cent (from 4 per cent to 5 per cent of Chinas relevance) would be able to compensate for roughly one fifth (1 out of 5 percentage points) of the assumed shortfall in trade with China. However, it is also clear that compensating for a potentially limited decline of trade with China would require the EU to seek a broader set of diversification partners than just Indonesia, including for example India and other ASEAN countries and also countries in Latin America and Africa.

Figure 7-2: Indonesia's relevance as an import partner relative to China

Share of EU imports from Indonesia relative to EU imports from China in 2022 in per cent
Overall trade and top ten product groups ranked by value of EU imports from China



Sources: Eurostat; IW

An increase in trade with Indonesia in the range of 25 per cent or more appears to be realistic in the medium term. In fact, the SIA estimates that in an ambitious scenario of trade liberalisation as part of an EU-Indonesia FTA, EU exports to Indonesia could increase by up to 44 per cent, while EU imports from Indonesia could increase by 18 per cent in the medium term.

Putting these results into perspective, Indonesia does indeed appear to be an attractive trading partner for the EU. Several arguments support this view.

Relatively positive perspectives for economic growth

- The Indonesian economy has grown steadily and at a significant average pace of 5 per cent over the last two decades and has mastered the various crises relatively well. Moreover, Indonesia is also considered one of the most stable democracies in the region with relatively reliable economic and political institutions. In addition, other drivers of development like population growth, public infrastructure, and industrial development are likely to further contribute to Indonesia's relatively strong growth performance. The potential demand for EU exports has therefore grown over time and is likely to continue growing considerably in the future.

- The reform orientation of the new Indonesian government has further improved the perspectives for growth, investment and employment. Ambitious objectives such as the Golden Indonesia 2045 Vision and reforms like the Omnibus Law on Job Creation or programmes such as the manufacturing initiative 'Making Indonesia 4.0' illustrate the serious strive for a better future, even though public funds tend to fall short of the high ambitions. Nevertheless, due to the recent economic success of Indonesia, the new government, which will be elected on 14 February 2024, has an incentive not to unwind the reforms and might potentially continue the reform process.

- In order to maintain this positive momentum in economic perspectives, it is important that the quality of the education and training system is rapidly improved. Moreover, the relatively good governance performance must not be blunted by a further surge in corruption.

Comparative advantages offer potentials but are hindered by trade barriers

- The EU and Indonesia are good trading partners, as the comparative advantages are rather different, which points to a large trade potential. The EU is specialised in sophisticated industrial goods, while Indonesia is specialised in goods with lower technological intensity such as food and textiles. In particular, Indonesia is a resource-rich country and the EU needs many of Indonesia's raw materials.

- Moreover, Indonesia's development objectives tend to benefit the interests of EU exporters. The aim of Indonesia's government to expand the manufacturing sector and to build downstream industries that complement Indonesia's raw material production will increase the demand for capital goods. The EU and particularly Germany are specialised in sectors producing capital goods, so that European producers could benefit from supplying the very goods needed for Indonesia's industrialisation.

- However, trade barriers are strongly impeding trade between the EU and Indonesia as they tend to be levied in both countries exactly on those goods, in which the respective partner enjoys a comparative advantage.

Trade diversion to the detriment of the EU

- The EU suffers from trade diversion compared to other Asian countries that have free trade agreements with Indonesia. A free trade agreement between the EU and Indonesia would counterbalance this grave disadvantage.

- Especially China benefits from trade diversion in its favour and to the detriment of the EU. This is because China displays a similar trade specialisation on industrial goods as the EU. This has contributed to China's large gains in exports and imports with Indonesia. China's share of Indonesia's total exports has risen from 11.4 per cent in 2012 to 22.6 per cent in 2022. On the import side, China's share accounted for 15.3 per cent in 2012 and 29 per cent in 2022. Moreover, as part of China's Belt and Road Initiative China's investments in Indonesia further contribute to rising trade with Indonesia.

Moderate potentials for more EU investment in Indonesia

- Indonesia's attractiveness as an investment location is moderate compared to its ASEAN peers, as indicated by the IW Business Location Index. Also, Indonesia's business climate has relative strengths and weaknesses.

- The Indonesian governments' Omnibus reform law is meant to tackle several shortcomings regarding the investment climate. It is mainly intended to open up many Indonesian investment sectors for FDI, to lower corporate taxes and to liberalise strict employment protection regulations. The reform effort behind this initiative is remarkable. However, due to court proceedings initiated by Indonesian trade unions, the law has been implemented only to a small and uncertain degree.

Declining relevance of Indonesia as a trade and investment partner of the EU

- The EU's relevance as a trading partner for Indonesia decreased further in the last decade. Also from the EU's perspective, Indonesia has lost relevance: Between 2012 and 2022, Indonesia's share in total EU imports stagnated at around 0.35 per cent, because imports from Indonesia grew less dynamically than overall EU imports. On the export side, the picture is even starker: While Indonesia stood for 0.22 per cent of the EU's total exports in 2012, this share declined to only 0.13 per cent in 2022. During this period, the absolute value of EU exports to Indonesia hardly increased at all. Germany's exports to Indonesia even declined by around 5 per cent between 2012 and 2022.

- As far as the investment dimension is concerned, the stock of FDI from the EU in Indonesia declined in absolute terms from around EUR 47 billion to around EUR 29 billion between 2015 and 2022. This contributed to a significant decline in the EU's share in Indonesia's inward FDI stock. On the contrary, China managed to expand its share over this period from 2.2 per cent to 6.5 per cent.

- Considering Indonesia's moderate performance as a business location, it might appear understandable that there has been no large surge of FDI from the EU in Indonesia. However, it is surprising that there was even a marked decline, despite major reform efforts of the Indonesian government in recent years.

In summary, there is a considerable potential for the EU to increase economic relations with Indonesia in the course of diversifying away from China. This pertains to trade and investment. However, the EU has recently left this potential completely untapped, as shown by the stagnating exports and the declining FDI stock. The open question is whether this is due only to the economic framework conditions, i.e. mainly the lack of a free trade agreement to open up the Indonesian market and mitigate the clear trade diversion. Or is it also due to a lack of attention that European firms are paying to Indonesia? In other words: Would a considerably larger economic exchange be possible, if European companies were more aware of and willing to seize upon the opportunities that Indonesia offers as a trade and investment partner? If this is the case, then it is right to redirect public schemes for the promotion of exports and investment away from China towards Indonesia and other emerging markets. The German government, for example, is already doing this.

Regardless of these initiatives, it is clear that a free trade agreement with Indonesia is a decisive precondition for removing the roadblocks and thus for achieving major progress in in the expansion of economic relations between the EU and Indonesia. However, the EU's approach to the CEPA negotiations is highly problematic in some aspects. The EU's unilateral trade measures, such as the deforestation regulation, are a major obstacle in the trade negotiations with Indonesia. This is also true on a more general level, as the recent failure of the negotiations with the MERCOSUR or Australia demonstrate. This kind of behaviour is perceived as neocolonial by the partner countries. Instead, the EU should try to involve its trading partners more and formulate a joint approach towards reaching the sustainability goals. The EU should reprioritise its objectives in trade negotiations and should put geostrategic considerations first. Moreover, the EU has to recognise that its negotiating position has become weaker in the last years – especially in relation to alternative trading partners such as China. On the other hand, Indonesia will also have to make compromises. Its current policy of strict export bans on raw materials such as nickel has been ruled inconsistent with WTO rules. It is important that both partners recognise that by giving up on some of their maximum demands, they will have a lot to gain by reaching a joint agreement in the near future.

The CEPA negotiations could also be supported if the EU offering Indonesia a clear perspective to benefit from more free trade with the EU. To this aim, the EU and also individual EU countries should offer to increase FDI in Indonesia in order to support employment in the country – and to mitigate Indonesia's increasing dependence on China. It goes without saying that this necessitates the Indonesian government to be open and cooperative towards EU investment. Once implemented, the Omnibus Law would be a large step in this direction. However, export processing zones with more liberal regulation regimes can also play a role in providing solid and reliable economic conditions for EU investors.

The key aspect behind this is a clear alignment of interests between the EU and Indonesia. The EU has an interest in supporting industrial and technological development in Indonesia in order to foster Indonesia's role as a growing trade and investment partner, both for exports and for imports. For example, the EU could work together with Indonesia in the course of derisking by supporting Indonesia in developing a large-scale battery production for electric vehicles and potentially also a production of solar modules. It is obvious that these efforts would also be in the interest of Indonesia.

To support these common interests, EU governments should pay more high-level political visits to Indonesia and take large business delegations with them – as they did with China some decades ago when China opened up to foreign investment. In short, it is the task of the EU to help Indonesia copy China's way of climbing the development ladder.

Zusammenfassung

Am 14. Februar wählt Indonesien einen neuen Präsidenten. Nach zehn erfolgreichen Jahren im Amt darf Joko Widodo nicht erneut antreten. Er hat eine Reformära in dem Land eingeläutet. Auch deshalb ist Indonesien seit zwei Dekaden mit jahresdurchschnittlich rund 5 Prozent gewachsen und hat selbst die Krisen der vergangenen Jahre erstaunlich gut gemeistert. Die Infrastruktur wie Straßen und das Eisenbahnnetz, aber auch der digitale Bereich wurde stark ausgebaut. Widodo hat wirtschaftliche Interessen nach vorn gestellt und viel Reformeifer gezeigt, was das Wachstum gestützt hat, auch wenn verschiedene Herausforderungen, etwa im Bildungsbereich oder bei der Korruption, bleiben.

Indonesien ist mit einer Bevölkerung von gut 277 Millionen Menschen ein wichtiges Land im Indo-Pazifik. Diese Region spielt für die EU eine wichtige Rolle, wenn es darum geht, kritische Abhängigkeiten von China zu vermindern durch eine Diversifizierung der Handelsbeziehungen. Allerdings kann Indonesien China wegen seiner begrenzten wirtschaftlichen Bedeutung bei Weitem nicht ersetzen. Denn der Handel der EU mit Indonesien macht nur rund 4 Prozent des EU-Handels mit China aus. Trotzdem ist mehr wirtschaftlicher Austausch mit Indonesien ein wichtiger Baustein für das von der Europäischen Union (EU) angestrebte De-Risking von China, bei dem umso mehr auch andere Länder der Indo-Pazifik-Region einbezogen werden müssen sowie Lateinamerika und Afrika.

Im gegenseitigen Handel der EU mit Indonesien bestehen große Potenziale. Denn die komparativen Vorteile zwischen Indonesien und der EU sind stark unterschiedlich: Im Fall von Indonesien liegen sie besonders bei Agrargütern und Rohstoffen, im Fall von der EU bei anspruchsvollen Industriegütern. Auch aus diesem Grund zeigen Schätzungen der Europäischen Kommission, dass durch ein Freihandelsabkommen zwischen der EU und Indonesien die EU-Ausfuhren nach Indonesien mittelfristig um bis zu 44 Prozent steigen könnten, während die EU-Einfuhren aus Indonesien um 18 Prozent zunehmen könnten. Ein Anstieg des Handels mit Indonesien in der Größenordnung von beispielsweise 25 Prozent, könnte damit ein Fünftel eines angenommenen Rückgangs im EU-Handel mit China von 5 Prozent kompensieren, der sich möglicherweise aus einem De-Risking gegenüber China ergeben mag.

Derzeit lassen sich diese Potenziale aber kaum heben, weil

- Indonesien und die EU jeweils gerade diejenigen Güter mit relativ hohen Zöllen belegen, bei denen der andere Partner komparative Vorteile hat.
- Indonesien bereits Freihandelsabkommen mit anderen asiatischen Staaten – und China – hat, sodass die EU unter starken Handelsumlenkungseffekten leidet, weil EU-Akteure im Handel diskriminiert werden.

Vor allem China profitiert von der Handelsumlenkung zu seinen Gunsten und zum Nachteil der EU. So weist China eine ähnliche Handelsspezialisierung auf Industriegüter auf wie die EU und steht daher in enger Konkurrenz zu europäischen Firmen. Dies trug zu den großen Gewinnen Chinas bei den Ausfuhren und Einfuhren mit Indonesien bei. Der Anteil Chinas an den gesamten Exporten Indonesiens ist von 11,4 Prozent im Jahr 2012 auf 22,6 Prozent im Jahr 2022 gestiegen. Auf der Importseite betrug der Anteil Chinas 15,3 Prozent im Jahr 2012 und 29 Prozent im Jahr 2022. Darüber hinaus tragen Chinas Investitionen in Indonesien als Teil der chinesischen Neuen Seidenstraße Initiative zu einem weiteren Anstieg des Handels mit Indonesien bei.

Hingegen hat die Bedeutung der EU als Handelspartner für Indonesien im letzten Jahrzehnt weiter abgenommen. Auch aus Sicht der EU hat Indonesien an Relevanz verloren: Zwischen 2012 und 2022 stagnierte der Anteil Indonesiens an den gesamten EU-Importen bei rund 0,35 Prozent, weil die Importe aus Indonesien weniger dynamisch wuchsen als die EU-Importe insgesamt. Auf der Exportseite ist das Bild noch deutlicher: Während der Anteil Indonesiens an den Gesamtausfuhren der EU im Jahr 2012 noch bei 0,22 Prozent lag, sank dieser Anteil bis 2022 auf nur noch 0,13 Prozent. In diesem Zeitraum ist der absolute Wert der EU-Ausfuhren nach Indonesien kaum gestiegen. Die deutschen Exporte nach Indonesien sind zwischen 2012 und 2022 sogar um rund 5 Prozent zurückgegangen.

Bei den Direktinvestitionen ergibt sich ein ähnliches Bild. So ist der Bestand an ausländischen Direktinvestitionen aus der EU in Indonesien zwischen 2015 und 2022 in absoluten Zahlen von rund 47 Milliarden Euro auf rund 29 Milliarden Euro zurückgegangen. Dies trug zu einem erheblichen Rückgang des Anteils der EU an den ausländischen Direktinvestitionen in Indonesien bei. China hingegen konnte seinen Anteil in diesem Zeitraum von 2,2 Prozent auf 6,5 Prozent ausbauen.

Bei Handel und Direktinvestitionen erfolgte damit in der letzten Dekade das Gegenteil von Diversifizierung mit Indonesien. Denn dafür hätten die Anteile Indonesiens aus Sicht der EU zunehmen müssen. Bildlich gesprochen fährt der Zug der Diversifizierung mit Indonesien demnach nicht vorwärts, sondern sogar rückwärts.

Die EU sollte daher dringend ein Freihandelsabkommen mit Indonesien anstreben, welches ermöglicht,

- die jeweiligen komparativen Vorteile wirklich nutzen zu können,
- die Handelsumlenkung zulasten der EU zu stoppen,
- Chinas Vordringen zumindest zu bremsen durch deutlich mehr EU-Handel mit Indonesien.

Daneben sollten die europäischen Unternehmen Indonesien und den Chancen, die sich ihnen dort bieten, mehr Aufmerksamkeit schenken. Das ist zu flankieren mit handels- und investitionspolitischen Übereinkommen, um die Investitionsbedingungen vor Ort attraktiv genug zu gestalten. Dazu braucht es auch ein Wirtschaftspartnerschaftsabkommen, das Ansiedelungen von EU-Firmen in Indonesien vorsieht. Hier ist beispielsweise an sogenannte Exportfreizonen (‚export processing zones‘) zu denken, also weniger regulierte Regionen, in denen sich multinationale Firmen ansiedeln können.

Um solche Übereinkommen umzusetzen, ist es wichtig zu verstehen, dass es eine klare Interessenübereinstimmung zwischen der EU und Indonesien gibt: Die EU hat ein Interesse daran, die industrielle und technologische Entwicklung in Indonesien zu unterstützen, um Indonesiens Rolle als wachsender Handels- und Investitionspartner zu fördern, sowohl für Exporte als auch für Importe. So könnte die EU beispielsweise im Zuge des De-Risking mit Indonesien zusammenarbeiten, indem sie Indonesien beim Aufbau einer umfangreichen Batterieproduktion für E-Fahrzeuge und möglicherweise einer Produktion von Solarmodulen unterstützt. Diese Bemühungen sind ebenfalls ganz im Interesse Indonesiens.

List of Tables

List of Figures

References

Acemoglu, Daron / Robinson, James A., 2012, Why Nations fail: The Origins of Power, Prosperity and Poverty, London

AHK – Auslandshandelskammer, n.d.a, Indonesia continues infrastructure offensive, https://indonesien.ahk.de/infothek/indonesia-continues-infrastructure-offensive [28.12.2023]

AHK, n.d.b, Indonesia launched strategic infrastructure projects, https://indonesien.ahk.de/en/infocenter/translate-to-english-indonesia-launched-strategic-infrastructure-projects [16.1.2024]

AHK, n.d.c, Minimum wages in Indonesia will rise moderately in 2022, https://indonesien.ahk.de/infothek/minimum-wages-in-indonesia-will-rise-moderately-in-2022 [19.1.2024]

Amenan, Amrozi / Murti, Tri / Subagyo, Totok / Nuky, Ester, 2022, Jokowi Builds 1,700 km Toll Roads, 2.1 Times the Length of the Previous Era, 28.9.2022, https://www.pwc.com/id/en/media-centre/infrastructure-news/september-2022/jokowi-builds-1700-km-toll-roads-2-1-times-the-length-of-the-previous-era.html [28.12.2023]

ASEAN – Association of South East Asian Nations, 2010, ASEAN Trade in Goods Agreement, https://asean.org/asean2020/wp-content/uploads/2020/12/ASEAN-Trade-in-Goods-Agreement.pdf [19.12.2023]

ASEAN, 2021, ASEAN's Free Trade Agreements: An Overview, https://www.aseanbriefing.com/news/aseans-free-trade-agreements-an-overview/ [10.1.2024]

ASEAN Briefing, n.d., Indonesia's Manufacturing Sector: Practical Information for Investors, https://www.aseanbriefing.com/doing-business-guide/indonesia/sector-insights/indonesia-s-manufacturing-sector-practical-information-for-investors [15.12.2023]

Bagaskara, Mirza / Setyarso, Budi, 2023, Jokowi to Meddle in 2024 Presidential Election; Democrat Reacts, 30.5.2023, https://en.tempo.co/read/1731400/jokowi-to-meddle-in-2024-presidential-election-democrat-reacts [12.12.2023]

Bank Indonesia, 2024, Government Debt to GDP at Current Price, retrieved from Macrobond [7.2.2024]

Basri, Chatib M., 2018, Chapter 2: Twenty Years after the Asian Financial Crisis, in: Breuer, Luis E. / Guajardo, Jaime / Kinda, Tidiane (Eds.), Realizing Indonesia's Economic Potential, Washington, D.C., https://www.elibrary.imf.org/display/book/9781484337141/ch002.xml [12.1.2024]

Bauer, Friederike, 2023, Interview: 'An amazing change', 20.9.2023, https://akzente.giz.de/en/interview-martin-hansen-indonesia [22.1.2024]

BPS – Badan Pusat Statistik, 2023, Statistics by Subject, https://www.bps.go.id/en/statistics-table?subject=520 [22.12.2023]

Busbarat, Pongphisoot et al., 2023, How Has China's Belt and Road Initiative Impacted Southeast Asian Countries?, 5.12.2023, https://carnegieendowment.org/2023/12/05/how-has-china-s-belt-and-road-initiative-impacted-southeast-asian-countries-pub-91170 [10.1.2024]

Business Indonesia, n.d.a, Food & Beverage Overview, https://business-indonesia.org/food_beverage [18.12.2023]

Business Indonesia, n.d.b, Pharmaceuticals, https://business-indonesia.org/pharmaceuticals [21.12.2023]

Cabinet Secretariat of Indonesia, 2019, Indonesia to Become World's 4th Biggest Economy by 2045, President Jokowi Says, https://setkab.go.id/en/indonesia-to-become-worlds-4th-biggest-economy-by-2045-president-jokowi-says/ [7.12.2023]

Cabinet Secretariat of the Republic of Indonesia, 2021, President Jokowi: I Have No Intention to Run for Third Term, https://setkab.go.id/en/president-jokowi-i-have-no-intention-to-run-for-third-term/

Cabinet Secretariat of the Republic of Indonesia, 2022, IMF Praises Indonesia's Economic Stability Amid Pandemic, https://setkab.go.id/en/imf-praises-indonesias-economic-stability-amid-pandemic/ [4.1.2024]

Cai, Derek, 2023a, Indonesia opens Whoosh high-speed railway, https://www.bbc.com/news/world-asia-66979810 [18.1.2024]

Cai, Derek, 2023b, China Belt and Road: Indonesia opens Whoosh high-speed railway, 2.10.2023, https://www.bbc.com/news/world-asia-66979810 [28.12.2023]

Campbell, Peter / Lakshmi, Anantha A. / White, Edward, 2024, China's BYD to build electric vehicle plant in Indonesia, https://www.ft.com/content/219eaeba-4eb2-4041-ac4c-725b6eab9fdb [19.01.2024]

Climate Change Knowledge Portal, 2024, Climate Risk Country Profile, https://climateknowledgeportal.worldbank.org/sites/default/files/2021-05/15504-Indonesia%20Country%20Profile-WEB_0.pdf [30.1.2024]

Consensus Economics, 2024, Asia Pacific Consensus Forecasts, January 2024, London

DataIndonesia.id, 2023, Mayoritas Penduduk Indonesia Beragama Islam pada 2022, 28.3.2023, https://dataindonesia.id/varia/detail/mayoritas-penduduk-indonesia-beragama-islam-pada-2022 [3.1.2024]

East Asia Forum, 2021, AUKUS mixed reception a symptom of strategic fault-lines in Southeast Asia, 17.10.2021, https://www.eastasiaforum.org/2021/10/17/aukus-mixed-reception-a-symptom-of-strategic-fault-lines-in-southeast-asia/ [18.1.2024]

Eddyono, Luthfi Widagdo, 2018, The Constitutional Court and Consolidation of Democracy in Indonesia, https://jurnalkonstitusi.mkri.id/index.php/jk/article/view/1511 [18.1.2024]

Edwards, Ryan B., 2019, Export agriculture and rural poverty: evidence from Indonesian palm oil, 19.2.2019, https://static1.squarespace.com/static/57d5edcf197aea51693538dc/t/5c6cbb1aa4222f75067de956/1550629671736/eard_v9_1901-merged.pdf [18.12.2023]

EEAS – European Union External Action, 2019, European Commission imposes a provisional countervailing duty on imports of Indonesian biodiesel, 13.8.2019, https://www.eeas.europa.eu/node/66399_en#:~:text=European%20Commission%20imposes%20a%20provisional%20countervailing%20duty%20on%20imports%20of%20Indonesian%20biodiesel,-13.08.2019&text=The%20European%20Commission%20%2D%20the%20executive,of%20subsidised%20biodiesel%20from%20Indonesia. [29.01.2024]

EEAS, 2023, EU Trade and Investment with Indonesia 2023, Press and information of the Delegation to Indonesia and Brunei Darussalam, 25.10.2023, https://www.eeas.europa.eu/delegations/indonesia/eu-trade-and-investment-indonesia-2023_en#:~:text=The%20EU%20was%20Indonesia's%205th,the%20rest%20of%20the%20world [18.12.2023]

EIU – Economist Intelligence Unit, 2023, Asia elections monitor 2024: Incumbents have the upper hand in the region, https://www.eiu.com/n/campaigns/asia-elections-monitor-2024/ [18.1.2024]

Embassy of the Federal Republic of Germany Jakarta, 2023, Joint Statement: Indonesia Just Energy Transition Comprehensive Investment and Policy Plan Launched, 22.11.2023, https://jakarta.diplo.de/id-en/joint-statement/2632552#:~:text=The%20Just%20Energy%20Transition%20Partnership,inclusive%20global%20economies%20and%20societies. [29.12.2023]

European Commission, 2019, Sustainability Impact Assessment (SIA) in support of Free Trade Agreement (FTA) negotiations between the European Union and Republic of Indonesia – Final Report, https://circabc.europa.eu/ui/group/09242a36-a438-40fd-a7af-fe32e36cbd0e/library/76dcefc4-692c-421d-8a5e-54955bb486aa/details [21.12.2023]

European Commission, 2021, The EU strategy for cooperation in the Indo-Pacific, 16.9.2021, https://www.eeas.europa.eu/sites/default/files/jointcommunication_2021_24_1_en.pdf [16.1.2024]

European Commission, 2022, The EU and International Partners launch ground-breaking Just Energy Transition Partnership with Indonesia, 15.11.2022, https://ec.europa.eu/commission/presscorner/detail/en/ip_22_6926 [15.1.2024]

European Commission, n.d., Association of South East Asian Nations (ASEAN), https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/association-south-east-asian-nations-asean_en [19.12.2023]

Fernyhough, James, 2022, BHP Sees Nickel Demand Rising Fourfold by 2050 on EV Boom, 2.11.2022, https://www.bloomberg.com/news/articles/2022-11-02/bhp-sees-nickel-demand-rising-fourfold-by-2050-on-ev-boom#xj4y7vzkg [29.11.2023]

Fraser Institute, 2022, Annual Survey of Mining Companies, 2021, 12.4.2021, https://www.fraserinstitute.org/studies/annual-survey-of-mining-companies-2021 [29.11.2023]

Goodman, Peter S., 2023, China's Nickel Plants in Indonesia Created Needed Jobs, and Pollution, https://www.nytimes.com/2023/08/18/business/indonesia-nickel-sulawesi-china.html [29.11.2023]

Harding, Robin / Reed, John, 2020, Asia-Pacific countries sign one of the largest free trade deals in history, https://www.ft.com/content/2dff91bd-ceeb-4567-9f9f-c50b7876adce [2.1.2024]

Harinck, Christiaan / Horn, Nico van / Luttikhuis, Bart, 2017, Do the Indonesians count? Calculating the number of Indonesian victims during the Dutch-Indonesian decolonization war, 1945-1949, 14.8.2017, https://imperialglobalexeter.com/2017/08/14/do-the-indonesians-count-calculating-the-number-of-indonesian-victims-during-the-dutch-indonesian-decolonization-war-1945-1949/ [18.1.2024]

Hendrix, Cullen S., 2023, The US should consider a critical minerals trade agreement with Indonesia, 16.11.2023, https://www.piie.com/blogs/realtime-economics/us-should-consider-critical-minerals-trade-agreement-indonesia [29.11.2023]

Humas, Oleh, 2023, Balancing Indonesia's Economic Growth: Balancing Progress and Sustainability, 14.8.2023, https://setkab.go.id/navigating-indonesias-economic-growth-balancing-progress-and-sustainability/ [21.12.2023]

Hutt, David, 2023a, Malaysia, Indonesia seek allies in EU deforestation row, 27.11.2023, https://www.dw.com/en/malaysia-indonesia-seek-allies-in-eu-deforestation-row/a-67564595 [18.12.2023]

Hutt, David, 2023b, Can the EU succeed on closing Indonesia trade deal?, 2.8.2023, https://www.dw.com/en/can-the-eu-succeed-on-closing-indonesia-trade-deal/a-64640224 [29.11.2023]

ICTJ – International Center for Transnational Justice / KontraS, 2011, Derailed: Transitional Justice in Indonesia since the fall of Soeharto, https://www.ictj.org/publication/derailed-transitional-justice-indonesia-fall-soeharto-report [18.1.2024]

Ilman, Assyifa Szami / Hapsari, Indira Maulani, 2023, Bucking the global trend: Insights on inflation in Indonesia, 17.10.2023, https://blogs.worldbank.org/developmenttalk/bucking-global-trend-insights-inflation-indonesia [4.1.2024]

IMF – International Monetary Fund, 2023, World Economic Outlook Database: October 2023, https://www.imf.org/en/Publications/WEO/weo-database/2023/April, [18.1.2024]

Indonesia Investments, n.d.a, National Long-Term Development Plan (RPJPN 2005-2025), https://www.indonesia-investments.com/projects/government-development-plans/national-long-term-development-plan-rpjpn-2005-2025/item308 [29.12.2023]

Indonesia Investments, n.d.b, Agricultural Sector of Indonesia, https://www.indonesia-investments.com/culture/economy/general-economic-outline/agriculture/item378 [17.1.2024]

Indonesia Investments, n.d.c, Tax system of Indonesia, https://www.indonesia-investments.com/finance/tax-system/item277 [25.1.2024]

Indonesian Ministry of National Development Planning, 2023, Golden Indonesia Vision 2045, https://indonesia2045.go.id/ [7.12.2023]

International Tin Association, 2023, Indonesia classifies tin as a critical mineral for strategic development, 13.10.2023, https://www.internationaltin.org/indonesia-classifies-tin-as-a-critical-mineral-for-strategic-development/ [12.1.2024]

IR Global, 2023, The Omnibus Law: The latest amendment and its impact, https://irglobal.com/article/the-omnibus-law-the-latest-amendment-and-its-impact/ [25.1.2024]

ISN Magazine, 2023, Unveiling Indosia's Thriving Retail Industry: A Western Perspective, https://internationalsupermarketnews.com/archives/13772 [16.1.2024]

Iswara, Made Anthony, n.d., A Land Without Farmers: Indonesia's Agricultural Conundrum, https://www.thejakartapost.com/longform/2020/08/13/a-land-without-farmers-indonesias-agricultural-conundrum.html [17.1.2024]

ITA – International Trade Administration, 2024, Information and Telecommunications Technology, https://www.trade.gov/country-commercial-guides/indonesia-information-and-telecommunications-technology [16.1.2024]

ITA, n.d., Healthcare – Indonesia, https://www.trade.gov/healthcare-resource-guide-indonesia [5.1.2024]

IW Consult, 2024, data supplied on the basis of: IW Consult GmbH, 2023, Industrielle Standortqualität Bayern im internationalen Vergleich – Niveauranking, Gutachten im Auftrag der Vereinigung der Bayerischen Wirtschaft e.V. (vbw), Cologne

Jacob, Charmaine, 2023, Indonesia is moving its capital from Jakarta to Nusantara. Here's why it won't be so easy, https://www.cnbc.com/2023/08/28/indonesia-to-move-capital-from-jakarta-to-nusantara-but-it-wont-be-easy.html [27.12.2023]

Jaffrey, Sana, 2023, Indonesia's 2024 Presidential Election Could Be the Last Battle of the Titans, 5.10.2023, https://carnegieendowment.org/2023/10/05/indonesia-s-2024-presidential-election-could-be-last-battle-of-titans-pub-90711 [18.01.2024]

Jazuli, Muhamad Rosyid, 2021, Never become dead mice in the rice barn: the quest for turning nutritious local food into fuel for Indonesia's HR development, https://www.researchgate.net/publication/355978596_Never_become_dead_mice_in_the_rice_barn_the_quest_for_turning_nutritious_local_food_into_fuel_for_Indonesia's_HR_development/link/6187a29407be5f31b753a18a/download?_tp=eyJjb250ZXh0Ijp7ImZpcnN0UGFnZSI6Il9kaXJlY3QiLCJwYWdlIjoicHVibGljYXRpb24iLCJwcmV2aW91c1BhZ2UiOiJfZGlyZWN0In19 [5.1.2024]

Jiwa Muda Indonesia, 2022, Strategy to Improve Indonesia's Human Capital Index, 28.4.2022, https://www.jiwamudaindo.com/strategy-to-improve-indonesias-human-capital-index/ [5.1.2024]

Junifta, Dhenny Yuartha, 2023, The trap of infrastructure development, 16.8.2023, https://www.pwc.com/id/en/media-centre/infrastructure-news/august-2023/the-trap-of-infrastructure-development.html [28.12.2023]

Malerius, Frank, 2022, Nationale Stromverteilung hat in Indonesien Vorrang, https://www.gtai.de/de/trade/indonesien/specials/nationale-stromverteilung-hat-in-indonesien-vorrang-861426 [27.12.2023]

Malerius, Frank, 2023a, Rückkehr zur Upper-Middle-Income Economy, 13.7.2023, https://www.gtai.de/de/trade/indonesien/wirtschaftsumfeld/rueckkehr-zur-upper-middle-income-economy-1016846 [9.11.2023]

Malerius, Frank, 2023b, Löhne und Inflation steigen stark, 19.6.2023, https://www.gtai.de/de/trade/indonesien/wirtschaftsumfeld/loehne-und-inflation-steigen-stark-227180 [15.1.2024]

Malerius, Frank, 2023c, Importbedarf und Ausbau von Produktionskapazitäten steigen, 11.8.2023, Importbedarf und Ausbau von Produktionskapazitäten steigen | Branche kompakt | Indonesien | Chemische Industrie (gtai.de) [5.2.2023]

Maulia, Erwida, 2023a, Nickel surplus seen widening in 2023 as Indonesian output soars, 12.6.2023, https://asia.nikkei.com/Spotlight/Market-Spotlight/Nickel-surplus-seen-widening-in-2023-as-Indonesian-output-soars [29.11.2023]

Maulia, Erwida, 2023b, Indonesia bets on critical mineral export bans as deadline nears, 23.5.2023, https://asia.nikkei.com/Spotlight/Asia-Insight/Indonesia-bets-on-critical-mineral-export-bans-as-deadline-nears [31.1.2024]

Medina, Ayman Falak, 2020, Indonesia Launches National Economic Recovery Program, 20.5.2020, https://www.aseanbriefing.com/news/indonesia-launches-national-economic-recovery-program/ [4.1.2.024]

Mining Technology, 2023, Nickel production in Indonesia and major projects, https://www.mining-technology.com/data-insights/nickel-in-indonesia/?cf-view [12.1.2024]

Ministry of Energy and Mineral Resources Republic of Indonesia, 2022, Handbook of Energy & Economic Statistics of Indonesia 2022, https://www.esdm.go.id/assets/media/content/content-handbook-of-energy-and-economic-statistics-of-indonesia-2022.pdf [12.1.2024]

Moors, Camellia, 2023, Batteries: EVs to use silicon, solid state for next-generation batteries, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/batteries-evs-to-use-silicon-solid-state-for-next-generation-batteries-75864189 [30.1.2024]

Nangoy, Fransiska, 2023, Bauxite miners urge Indonesia to rethink export ban as deadline looms, 6.6.2023, https://www.reuters.com/article/idUSL1N37Y0QC/ [30.1.2024]

Natahadibrata, Nadya, 2013, RI kicks off 12-year compulsory education program, 26.6.2013, https://www.thejakartapost.com/news/2013/06/26/ri-kicks-12-year-compulsory-education-program.html [8.1.2024]

Natural Earth, 2022, Free vector and raster map data, https://www.naturalearthdata.com/downloads/50m-cultural-vectors/ [25.1.2024]

OECD – Organisation for Economic Co-operation and Development, 2023a, Working Age Population, OECD Labour Force Statistics, https://data.oecd.org/pop/working-age-population.htm [18.1.2024]

OECD, 2023b, PISA 2022 Results (Volume I): The State of Learning and Equity in Education, https://www.oecd-ilibrary.org/docserver/53f23881-en.pdf?expires=1705314575&id=id&accname=guest&checksum=BC1B445F9318244DF6920C49097B79BF [15.1.2024]

Peer, Mathias, 2023, Favorit um Präsidentenamt in Indonesien teilt gegen EU aus, 28.11.2023, https://www.handelsblatt.com/politik/wahlkampfbeginn-in-indonesien-favorit-um-praesidentenamt-in-indonesien-teilt-gegen-eu-aus/100001572.html [2.1.2024]

Politico, 2023, EU trade deals risk affordability of generic medicines for Global South, https://www.politico.eu/article/eu-trade-deal-risk-affordability-generic-medicine-global-south/ [21.12.2023]

Prihadi, Cahyo, 2023, How workforce training is helping Indonesia modernise its economy, https://www.eastasiaforum.org/2023/12/15/how-workforce-training-is-helping-indonesia-modernise-its-economy/ [4.1.2024]

Pwc, 2023, Oil and Gas in Indonesia, https://www.pwc.com/id/en/energy-utilities-mining/assets/oil-and-gas/oil-gas-guide-2023.pdf [10.1.2024]

QS, 2024, World University Rankings 2024: Top global universities, https://www.topuniversities.com/world-university-rankings?countries=my [15.1.2024]

Rachman, Joseph, 2023, China Has Sewn Up a Critical Metals Market, https://foreignpolicy.com/2023/04/17/china-indonesia-nickel-metals-inflation-reduction-act/ [29.11.2023]

Rayos, Marc, 2023, Indonesia – Mining by the numbers, 2023, 13.9.2023, https://www.spglobal.com/marketintelligence/en/news-insights/research/indonesia-mining-by-the-numbers-2023#:~:text=Mining%20is%20an%20integral%20pillar,the%20total%20GDP%20in%202022. [31.1.2024]

Redaski, Tim, 2024, Hasil 11 Survei Terbaru Pilpres 2024: Anies Vs Prabowo Vs Ganjar, https://www.cnbcindonesia.com/news/20240117000354-4-506416/hasil-11-survei-terbaru-pilpres-2024-anies-vs-prabowo-vs-ganjar [22.01.2024]

Reuters, 2023a, Indonesia president inaugurates $108 million floating solar plant, 9.11.2023, https://www.reuters.com/sustainability/indonesia-president-inaugurates-108-million-floating-solar-plant-2023-11-09/ [29.12.2023]

Reuters, 2023b, Indonesia launches $20 billion renewable energy investment plan, 21.11.2023, https://www.reuters.com/sustainability/climate-energy/indonesia-launches-20-bln-renewable-energy-investment-plan-2023-11-21/ [29.12.2023]

Reuters, 2023c, Coal miners group expects Indonesia’s 2023 coal output to surpass target, 29.11.2023, https://www.reuters.com/markets/commodities/coal-miners-group-expects-indonesias-2023-coal-output-surpass-target-2023-11-29/ [10.1.2024]

Reuters, 2023d, Indonesia court rejects petitions to review pro-investment law, 2.10.2023, https://www.reuters.com/world/asia-pacific/indonesia-court-rejects-petition-review-pro-investment-law-2023-10-02/ [25.1.2024]

Rosser, Andrew, 2018, Beyond access: Making Indonesia’s education system work, Indonesia’s education system is low in quality and the underlying causes are political, 21.2.2018, https://www.lowyinstitute.org/publications/beyond-access-making-indonesia-s-education-system-work [8.1.2024]

Russell, Alec / Ruehl, Mercedes, 2023, Is Indonesia finally set to become an economic superpower?, https://www.ft.com/content/4e442979-36c7-47c3-9682-46a5d199a752 [10.1.2024]

Simatupang, Renata / Dachlan, Akbar/ Maharani, Galuh, 2023, Indonesia’s Controversial Omnibus Law on Job Creation, 14.8.2023, https://devtechsys.com/insights/2023/08/14/indonesias-controversial-omnibus-law-on-job-creation/ [26.1.2024]

SJR – Scimago Journal & Country Rank, 2023, Country Rankings, https://www.scimagojr.com/countryrank.php?order=itp&ord=desc&year=2022 [15.1.2024]

Southeast Asia Development Solutions, 2022, ASEAN Makes Good Progress in Reducing Trade Costs, Says UN Survey, 4.4.2022, https://seads.adb.org/news/asean-makes-good-progress-reducing-trade-costs-says-un-survey [19.1.2024]

Statista, 2024, Mine production of nickel in Indonesia from 2010 to 2023, https://www.statista.com/statistics/260757/indonesian-mine-production-of-nickel-since-2006/#:~:text=Indonesia%27s%20production%20of%20nickel%20amounted,million%20metric%20tons%20in%202022. [7.2.2024]

Suhanda, Nopriyanto Hady / Swasono, Dwinanda Ardhi, 2023, A strong middle class is the backbone of Indonesia’s economy, 17.3.2023, https://www.eastasiaforum.org/2023/03/17/a-strong-middle-class-is-the-backbone-of-indonesias-economy/ [9.1.2024]

Syebubakar, Abdurrahman, 2020, Corruption in Jokowi’s Indonesia, 4.9.2020, https://www.bangkokpost.com/opinion/opinion/1979635/corruption-in-jokowis-indonesia [18.1.2024]

Tan, Isabella, n.d., Education in Indonesia: What Should Have Been, https://www.warwickaseanconference.com/sociocultural/education-in-indonesia-what-should-have-been [9.1.2024]

The Economist, 2023a, What will Indonesia look like after Jokowi leaves?, 7.9.2023, https://www.economist.com/asia/2023/09/07/what-will-indonesia-look-like-after-jokowi-leaves [18.1.2024]

The Economist, 2023b, Indonesia embraces resource nationalism, 26.1.2023, https://www.economist.com/asia/2023/01/26/indonesia-embraces-resource-nationalism [29.11.2023]

The White House, 2023, FACT SHEET: President Joseph R. Biden and President Joko Widodo Announce the U.S.-Indonesia Comprehensive Strategic Partnership, 13.11.2023, https://www.whitehouse.gov/briefing-room/statements-releases/2023/11/13/fact-sheet-president-joseph-r-biden-and-president-joko-widodo-announce-the-u-s-indonesia-comprehensive-strategic-partnership/ [18.1.2024]

Tritto, Angela, 2023, How Indonesia Used Chinese Industrial Investments to Turn Nickel into the New Gold, 11.4.2023, https://carnegieendowment.org/2023/04/11/how-indonesia-used-chinese-industrial-investments-to-turn-nickel-into-new-gold-pub-89500 [29.11.2023]

Ulum, Muhammad Bahrul, 2020, Indonesian Democracy and Political Parties after twenty years of Reformation: A contextual Analysis, in: Indonesia Law Review, Vol. 10, No. 1, https://scholarhub.ui.ac.id/ilrev/vol10/iss1/3/ [18.1.2024]

UN – United Nations, 2022, World Population Prospects 2022, https://population.un.org/wpp/ [18.1.2024]

UNCTAD – United Nations Conference on Trade and Development, 2015, International Classification of Non-Tariff Measures, 2012 Version, https://unctad.org/system/files/official-document/ditctab20122_en.pdf [5.1.2024]

UNCTAD, 2017, Using trade policy to drive value addition: Lessons from Indonesia's ban on nickel exports, https://unctad.org/system/files/non-official-document/suc2017d8_en.pdf [29.11.2023]

UNCTAD, 2020, "Omnibus Law" on job creation has been enacted, 2.11.2020, https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3567/indonesia-omnibus-law-on-job-creation-has-been-enacted [25.1.2024]

USAID, n.d., Indonesia High Priority Plan, Global Water Strategy 2022-2027, https://www.globalwaters.org/sites/default/files/indonesia_global_water_strategy_2023.pdf [22.12.2023]

U.S. Census Bureau, 2024, International Database, https://www.census.gov/data-tools/demo/idb/#/dashboard?COUNTRY_YEAR=2024&COUNTRY_YR_ANIM=2024 [7.2.2024]

USDA – U.S. Department of Agriculture, 2023, Production - Palm Oil, https://fas.usda.gov/data/production/commodity/4243000 [18.12.2023]

U.S. Department of State, n.d., 2023 Investment Climate Statements: Indonesia, https://www.state.gov/reports/2023-investment-climate-statements/indonesia/ [25.1.2024}

VOI, 2023, National Strategic Projects Need To Be Continued For the Development Of Indonesia Gold 2045, 27.10.2023, https://voi.id/en/economy/324075 [16.1.2023]

Wibisana, Putu Sanjiwacika / Pape, Utz / Tiwari, Sailesh / Beschorner, Natasha, 2022, How can Indonesia improve the quality of its internet services and universalize access?, 3.6.2022, https://blogs.worldbank.org/eastasiapacific/how-can-indonesia-improve-quality-its-internet-services-and-universalize-access [12.1.2024]

Wiradji, Sudibyo, 2023, President Jokowi launches final phase of RPJPN 2025-2045, 19.6.2023, https://www.thejakartapost.com/business/2023/06/19/president-jokowi-launches-final-phase-of-rpjpn-2025-2045.html [29.12.2023]

WITS – World Integrated Trade Solution, 2018a, Indonesia Non-Tariff Measure (NTM) Summary, https://wits.worldbank.org/tariff/non-tariff-measures/en/country/IDN [10.1.2024]

WITS, 2018b, European Union Non-Tariff Measure (NTM) Summary, https://wits.worldbank.org/tariff/non-tariff-measures/en/country/EUN# [10.1.2024]

World Bank, 2014, Indonesia's Higher Education System: How Responsive is it to the Labor Market?, June, https://documents1.worldbank.org/curated/en/596601468268792237/pdf/893000WP0P12940arket0Paper0June2014.pdf [15.1.2024]

World Bank, 2020, Aspiring Indonesia: Expanding the Middle Class, https://www.worldbank.org/en/country/indonesia/publication/aspiring-indonesia-expanding-the-middle-class [27.11.2023]

World Bank, 2023a, World Development Indicators, https://databank.worldbank.org/source/world-development-indicators [18.1.2024]

World Bank, 2023b, Indonesia Economic Prospects: The Invisible Toll of COVID-19 on Learning, 26.6.2023, https://elibrary.worldbank.org/doi/epdf/10.1596/39921 [9.1.2024]

Wrede, Insa, 2023, Export bans boost Indonesia's onshoring policy, 2.7.2023, https://www.dw.com/en/how-export-bans-boost-indonesias-industrial-policy/a-64626030#:~:text=The%20South%20Asian%20country%20is,palm%20oil%20and%20refined%20tin. [29.11.2023]

WTO – World Trade Organization, 2023, Dispute panel established to review EU duties on imports of biodiesel from Indonesia, 27.11.2023, https://www.wto.org/english/news_e/news23_e/dsb_27nov23_e.htm [2.1.2024]

ZEW – ZEW Leibniz-Zentrum für Europäische Wirtschaftsforschung, 2023, Mannheim Tax Index, https://www.zew.de/mannheim-tax-index [31.1.2024]

Zielonka, Juliane, 2023, Altech Advanced Materials, Volkswagen AG, Byd-Electric Drive Solutions Fuel the Share Rally, 2.6.2023, https://news.financial/comments/altech-advanced-materials-volkswagen-ag-byd-electric-drive-solutions-fuel-the-share-rally [29.11.2023]