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Trade

STRENGTHENING INDONESIA'S PARTICIPATION IN GLOBAL VALUE CHAINS

- As Indonesia seeks to join and move up Global Value Chains (GVCs), a critical focus should be on improving the efficiency of its services sector which currently represents only 11% of gross exports.
- Indonesia's sourcing from GVCs is lower than would be expected given the country's economic characteristics, which deprives the country of potential productivity gains.
- Putting in place quality infrastructure that facilities international trade is crucial. This requires boosting investment in transport and logistics. In addition, more investment in knowledge-based capital (KBC) is needed.
- Were Indonesia to fully implement measures in the WTO Trade Facilitation Agreement, it could reduce trading costs by as much as 15%, and facilitate wider participation in GVCs.

What's the issue?

Global value chains have become a dominant feature of world trade. Goods and services are no longer produced by a firm in one country and sold to consumers in another; production is fragmented around the world and components are traded across borders multiple times.

GVCs are particularly sensitive to the quality and efficiency of services. The OECD-WTO initiative to measure trade in value-added (TiVA) shows that the contribution of services to exports in Indonesia remains quite low and is falling, accounting for only 19% of value-added exports in 2009, compared to 48% in the OECD on average. The OECD Services Trade Restrictiveness Index (STRI) further reveals that Indonesia has more restrictive regulations than the sample average in all 18 sectors covered by the index (see Figure) – a fact explained in part by general regulations applying to all sectors of the economy.

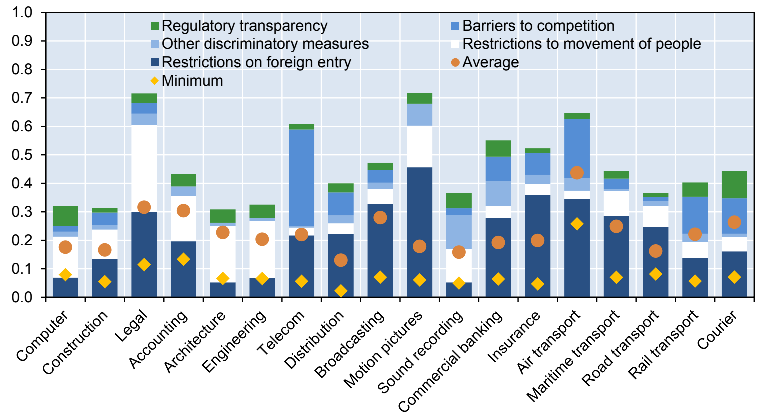
Over the past years, Indonesia has implemented a number of trade and investment measures to develop local industries and move its firms up the value chain, but these measures have raised concerns in many of its trading partners. Examples include export restrictions and taxes on raw materials, import licensing requirements, point-of-entry restrictions on imports, ownership limitations in a number of business sectors including banks (the "Negative Investment List"), and divestment requirements for foreign mining companies. OECD analysis suggests that such measures may be restricting Indonesia's wider integration into GVCs, which is lower than would be expected given the country's economic characteristics. This highlights the need for policymakers to be aware of the role imports play in facilitating participation in GVCs and to reduce tariffs as well as trade-restricting regulatory measures at and behind the border.

To better integrate into GVCs, Indonesia also needs to upgrade its transport and logistics infrastructure, where it performs badly in comparison to peer countries. Moreover, upgrading in GVCs requires more investment in KBC. The country has very low levels of public and private R&D, little collaborative research and poor skill levels; it consequently has little ability to generate patentable inventions and other intellectual property. Efforts are made to improve the innovation system: universities are mandated to develop research plans based on national priorities, a Centres of Excellence programme is attempting to improve research infrastructures, and a National Innovation Committee was established to improve governance. But much remains to be done to bring the large informal economy into the innovation system and leverage the country's rich resource endowment.

Why is this important for Indonesia?

Participation in GVCs is linked with desirable development outcomes, including a linkage to growing productivity and export sophistication and diversification. Trade-facilitating measures such as border bottlenecks are critical for facilitating wider participation in value chains. Openness to services is especially important as it not only ensures market access for foreign services suppliers, but also improves performance and export competitiveness of domestic players in the sectors concerned.

Indonesia applies quite restrictive regulations to services trade



Note: The STRI indices take values between 0 and 1, from least to most restrictive. The STRI database records measures applying on a most-favoured-nation basis; preferential trade agreements are not taken into account. The average and minimum scores take into account all countries included in the STRI database.
Source: OECD STRI Database (2014).

Preliminary OECD work indicates that Indonesia is increasingly relying on regional value chains, with its intra-ASEAN sourcing now representing 15% of all foreign value added used to produce exports (more than it sources from Korea and Japan combined), highlighting the importance of completing the ASEAN Economic Community. But Indonesia should also continue its process of multilateral liberalisation in order to access the most competitive intermediate products and technologies. OECD analysis shows that if Indonesia were to fully implement measures in the WTO Trade Facilitation Agreement, it could reduce its trading costs by as much as 15%.

What should policymakers do?

- Prioritise trade facilitation measures that have the greatest potential to increase bilateral trade flows and lower trade costs, such as simplifying trade documents, enhancing border process automation, and publishing trade information online.
- Accelerate regulatory reforms, particularly in services sectors where market restrictions have been shown to negatively affect trade in manufactured goods: distribution, telecommunication, transport, courier, commercial banking and insurance services.
- Increase investment in transportation and logistics infrastructure.
- Boost investment in innovation inputs, strengthen Indonesia's intellectual property policies to focus more on "quality" and provide bigger rewards for granted patents and commercialisation.
- Support shared Technology Transfer Offices to realise economies of scale and provide a better service in support of commercialisation by Indonesian institutions.

Further reading

OECD (2014), *Services Trade Restrictiveness Index (STRI): Indonesia.* http://www.oecd.org/tad/services-trade/STRI_IDN_BA.pdf

OECD (2013), *Trade Facilitation Indicators: Indonesia.* http://www.oecd.org/tad/facilitation/indonesia-oecd-trade-facilitation-indicators-april-2014.pdf

OECD (2015), *Developing Countries' Participation in Global Value Chains – Implications for Trade and Trade-Related Policies*, OECD Publishing, forthcoming.

OECD (2013), *Innovation in South-east Asia*, OECD Publishing. http://dx.doi.org/10.1787/9789264128712-8-en

OECD, WTO and World Bank (2014), *Global Value Chains: Challenges, Opportunities and Implications for Policy*, G20 report. http://www.oecd.org/tad/gvc_report_g20_july_2014.pdf