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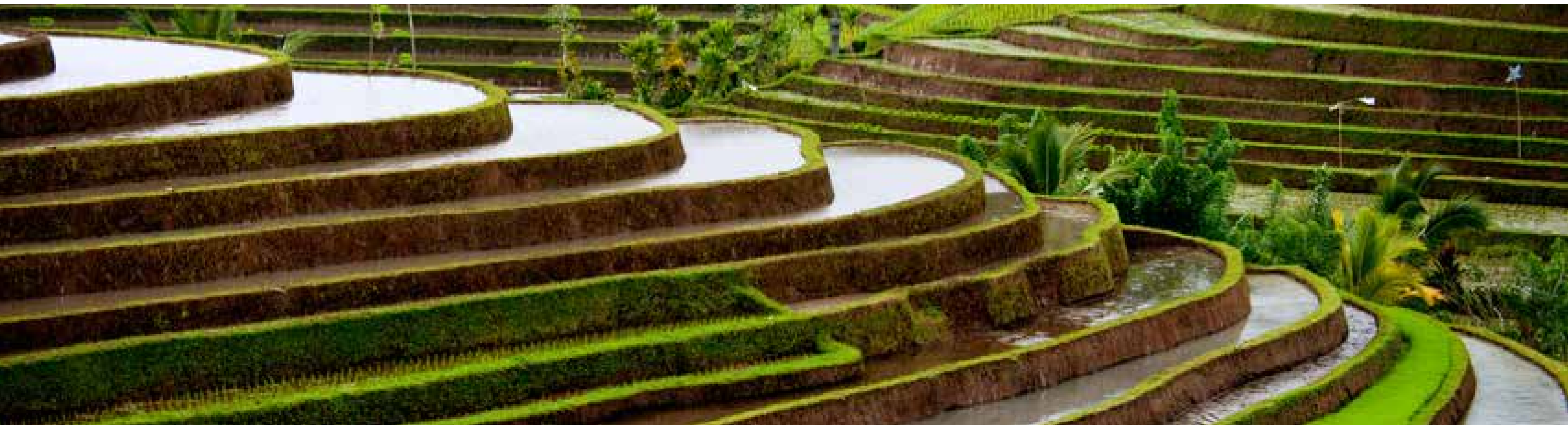
WENDY K. DOBSON



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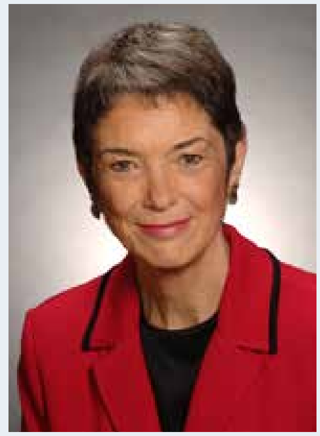
ABOUT THE FORGING A NEW INDONESIA-CANADA PARTNERSHIP PROJECT

Project Leader: **Leonard J. Edwards** is a CIGI Distinguished Fellow and former deputy minister of Foreign Affairs (2007–2010), of Agriculture and Agri-Food Canada (2004–2007) and of International Trade (2001–2004). He has also served as Canada's ambassador to Japan and Korea.

The Global Security & Politics Program at CIGI is undertaking a timely project to investigate the potential in strengthening and deepening Canada's relations with Indonesia. Researchers are exploring and building awareness of opportunities for closer bilateral ties in several areas, including business, diplomacy, security and governance. Indonesia represents by far the largest economy in the Southeast Asian region and it has been projected by the McKinsey Global Institute to be the seventh-largest economy in the world by 2030, making it an important partner for Canada in the region. The project aims to lay out a path toward sustainable engagement with one of the key countries in the Asia-Pacific region.

ABOUT THE AUTHOR



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EXECUTIVE SUMMARY

This paper reviews Indonesia's economic prospects and what these imply for a closer relationship with Canada. By posing the question "Is Indonesia the next China?," the author suggests that Indonesia has the considerable economic potential envisaged by foreign investors, but conveys uncertainty as to whether Southeast Asia's most populous country can make the changes necessary to realize that potential. A review of the economic record and comparison of China's and Indonesia's economic structures, endowments and institutions show major differences between the two countries. The paper further questions what it will take to realize Indonesia's potential, finding the answers to be: human capital development; increased participation in the region's global value chains; meeting the growing middle-class demand for modern services; raising productivity in agriculture and fishing; and increasing use of the Internet. Failure to make these changes will increase the chances of Indonesia's growth in per capita incomes slowing and falling into the middle-income trap. Canada's role will be to monitor closely how Indonesia tackles its five priorities at the same time as it responds to the opportunities to exploit Indonesia's abundant natural resources, urbanization and its expanding consumer demand for modern services and educational opportunities.

INTRODUCTION

A Canadian newspaper reporter writing in early 2015 from Solo, Indonesia, asked if the country was "The Next China?" (Marlow 2015). He described global companies racing to invest in a country being compared to China in the 1980s, following national elections that installed a youthful new leader in a democratic country boasting the world's fourth-largest population (at 250 million, with a labour force numbering 126 million),[1] generous endowments of natural resources and a central location in the dynamic Asia-Pacific region.

Despite concerns about weak regulatory and legal institutions, endemic corruption and poor infrastructure, Indonesia's election of a political outsider is seen by many foreign investors as introducing new fundamentals that could substantially change Indonesia's future economic prospects. They are hoping that Joko Widodo ("Jokowi"), the new president, will clamp down on the misuse of privilege and power, and seriously pursue the goal of long-term sustainable growth.

There has been little mention of Indonesia's possible future role in the 10-member Association of Southeast Asian Nations (ASEAN), which, since the late 1960s, has pursued gradually deeper economic integration and security cooperation among its members. Indonesia, accounting for 40 percent of ASEAN's population, is in some ways the elephant in the room, sometimes providing leadership consistent with ASEAN's emphasis on reducing mistrust and promoting equality among its members. However, given its own preoccupations with its internal challenges, it has recently played a somewhat less prominent role in the regional organization.

In evaluating Indonesia's economic prospects, this paper takes into account the importance Indonesia's new leader might attach to ASEAN's goal of creating an economic community by the end of 2015 and to the plethora of "mega-regional" trade and integration initiatives, including the ASEAN-sponsored Regional Cooperative Economic Partnership (RCEP), the Trans-Pacific Partnership (TPP) and the Asia-Pacific Economic Cooperation's proposed 21-member Free Trade Area of the Asia-Pacific.

This paper begins with a review of Indonesia's economic record before examining five priorities for realizing the country's growth potential. While Indonesia's large population and location prompt the comparisons with China, the two countries differ substantially in their endowments and institutions. The next section summarizes the implications both of acting on these priorities and of failing to do so and falling into the middle-income trap. The penultimate section briefly examines the advantages of Indonesia providing more leadership within ASEAN, before turning to the implications for Canada. The conclusion explains why the prospects of Indonesia being another China of 30 years ago are, at best, mixed.

THE ECONOMIC RECORD

Indonesia's own economic record in the past three to four decades is a credible one. Early in this century, an ambitious restructuring program involved decentralizing administrative, financial and political authorities that were transferred to lower levels of government. Prior to the Asian financial crisis of 1997-1998, Indonesia had a record of good macroeconomic management and openness to trade and investment. Looking ahead, Indonesia's potential growth advantages include its relatively young population — now 52 percent urban — and a decade of modest but respectable five percent annual real economic growth. Natural resources account for 37 percent of GDP and 54 percent of exports, and produce a third of public revenues (World Bank 2015c). The service sectors are thriving and the middle class is growing; per capita income is now about half that in China. The Asian Development Bank predicts the middle class will number 220 million people by 2030, averaging $13,500 per capita incomes (on a purchasing-power parity basis) compared to $4,810 today (Asian Development Bank 2011).[2]

1 Data sources: World Bank (2013) unless otherwise noted.

2 All dollar figures in US dollars unless otherwise noted.

What is the likelihood that Indonesia, as it moves in a more progressive direction, will make the difficult reforms to restructure the economy and realize its potential long-term growth rate? Its large labour force will be a growth driver if workers have incentives to be productive, as has been the case in China since the 1980s, and a burden if they do not. They require appropriate labour market institutions that reward education, skills training and productive employment. Indonesia's rising savings will be another growth driver if financial institutions mobilize capital and allocate it efficiently for investment purposes. Endowments of natural resources and real estate can also be growth drivers if appropriate incentive frameworks to exploit them are created by national and local institutions. Outdated or inadequate incentive frameworks can instead become disincentives that cause an economy to stagnate or decline over time. Legal institutions should record and protect property rights, and policies and institutions are required to encourage and reward innovation and openness to trade, finance and new ideas.[3]

In China, changes in key economic institutions kick-started its 30-year growth sprint as central planning was replaced by authoritarian capitalism. Ad hoc experiments introduced market forces as a way to reward farmers, generating an explosion of rural production. Special zones that fostered industrialization using foreign capital and knowhow in the race to "catch up" with the neighbours stimulated the diffusion of knowledge and skills into the surrounding economies. The autocratic political regime is only now being made more accountable and, even so, the legal system remains under the supervision of the Communist Party of China. More changes are required as the population ages and the number of new entrants to the labour force continues to shrink (National Bureau of Statistics of China 2015). Clearly, the growth impetus from mobilizing labour by moving people out of low-productivity agriculture into more productive, higher-wage urban jobs has run its course. Popular concerns about corruption, environmental degradation and growing income inequality must be addressed by the party-state if it is to retain its legitimacy. After 30 years of investment in low-wage, export-oriented industry jobs, the economy is being rebalanced toward consumption and innovation as future sources of growth, and the financial system modernized and opened to cross-border financial flows. Exchange rate volatility — a predictable risk as the central bank allows greater market determination of interest rates — and a stock market mania inadvertently encouraged by the government's behaviour and moral hazard, have been significant bumps along the reform route.

Indonesia's current growth drivers remind one of China 30 years ago, insofar as the rural population is moving out of agriculture into more productive activities such as wholesale and retail trade, manufacturing, transportation and telecommunications. Labour productivity is growing at a three percent annual rate. Indonesia differs from China in significant ways. On the positive side, its plentiful natural resources include palm oil, of which Indonesia is the world's leading supplier; generous supplies of coal, cocoa and lime; major reserves of nickel, bauxite and petroleum; and potential geothermal sources. It has a growing and vibrant service sector, the political safety valve provided by democratic elections and a financial system that is more developed than China's. On the negative side, Indonesia's savings rate is relatively low; the education system produces near-universal primary school enrolment but rates of secondary and tertiary education completion are much lower. Labour market institutions do not reward skills training and productive employment. Property rights are not well protected and land use on the archipelago is a major problem when it comes to building the modern transportation infrastructure needed to participate in Asia's dynamic global value chains (GVCs).

Nearly half (45 percent) of Indonesia's employment is in the service sector, compared to 20 percent in industry. The World Bank estimates that these two sectors account for 40 percent and 46 percent of GDP, respectively. Agriculture still provides 35 percent of employment and accounts for a mere 14 percent of GDP. More than half (57 percent) of Indonesia's GDP is consumed and 36 percent of GDP is invested — a stark comparison to China's 35 percent consumption share, until recently, and nearly 50 percent investment rate (World Bank 2015c).

What will it take to realize Indonesia's full economic potential and attract investors? In addressing this question, Raoul Oberman et al. (2012) contend that, by 2030, Indonesia will have grown from its current rank as the world's sixteenth-largest economy (GDP in 2014 totalled $889 billion at current exchange rates) to become the seventh-largest economy. Such estimates are based on projections of four aspects of growth: the anticipated dynamic and demanding consumer sector that is 90 million strong; associated growth in demand for private education; realizing the fuller potential of agriculture and fishing industries; and marketing Indonesia's robust supplies of minerals and energy sources, in particular coal, oil and gas.

FIVE PRIORITIES FOR REALIZING INDONESIA'S GROWTH POTENTIAL

Five priorities stand out to realize these projections: better development of human capital; modernization of trade policy and regulatory systems to encourage, rather than inhibit, participation in GVCs; raising productivity in agriculture, in particular through more intensive use of land and maritime resources; meeting growing middle-class demand for modern services in telecommunications,

3 For a discussion of this framework applied to China and India, see Dobson (2009, ix–xiv).

Internet commerce and finance, and retail trade; and last, but not least, investing in greater access to the Internet to expedite and enhance achievement of the other four priorities.

Develop Human Capital

It is widely recognized that an important factor in South Korea's steady growth in living standards in the past half-century was the priority accorded education. As the Korean economy developed, public investment in education shifted from its initial emphasis on primary education to secondary and then tertiary education. Indonesia has taken only the first step and has had difficulty moving further. Only 10 percent of the labour force has attained tertiary education, largely in economics, education and law. The low enrolment rates in secondary and tertiary institutions reflect the perceptions by parents and students that the returns are low, relative to the costs. Private institutions are the main suppliers of higher education and school grants from government apply only to primary and junior secondary students. Employers criticize lack of skills, which are a better measure of educational attainment than enrolment; they complain about lack of mathematics skills and English-language proficiency. Seventy percent of public spending on education is for teacher salaries. The low quality and limited access to education constrain Indonesia's ability to adapt and produce innovations needed to realize its growth potential. Major changes are needed to improve teacher quality, make schools more accountable and improve the relevance of what is taught, particularly in vocational institutions (Raya and Suryadarma 2013).

Increase Participation in GVCs through Services and Developing Modern Regulatory Systems

As GVCs become more widely diffused in international trade and investment, the role of services as growth and growth-supporting industries is becoming more prominent. GVCs and global supply chains were pioneered in East Asia to capitalize on differing comparative advantages among economies located in proximity to each other. By 2014, the Organisation for Economic Co-operation and Development (OECD) estimated that 70 percent of global trade is now in inputs — parts, components, services and capital goods — rather than in final products (OECD, World Trade Organization and World Bank Group 2014). This trend implies the rising significance of "behind the border" policies, of new standards and disciplines for investment, services, competition policy and property rights that are being negotiated as enterprises extend production facilities across borders through investments, alliances and joint ventures. Yet the OECD's Services Trade Restrictiveness Index shows that some of the highest restrictions on services remain in the BRICS (Brazil, Russia, India, China and South Africa) and Indonesia. Restrictions apply to air and maritime transportation, legal services, accounting, broadcasting, courier services, architecture and telecommunications, with transportation and professional services the most restricted.

Maintaining public sector monopolies in these activities denies the economy new growth impetus from more efficient delivery of such services. Despite this grouping of China and Indonesia among those countries restricting services trade, in the past 15 years income associated with GVCs in China has increased sixfold. In Indonesia, in contrast, there are growing concerns that trade is moving in the opposite direction, with continued, even enhanced, restrictiveness. Recent changes in trade policies favouring import substitution industrialization will reduce global competitiveness in these industries by, for example, attracting investment in industries depending on local inputs. Such a fundamental policy choice, together with an associated lack of clarity around the regulatory treatment of imports and poor infrastructure, will likely reduce foreign investment in GVCs in Indonesia. In effect, this policy choice protects domestic suppliers from the winds of foreign competition and reduces incentives to produce internationally competitive products (Wihardja 2014). In mid-2015, there were reports of greater reliance by the president on the military to enhance local development and a decision to produce a national car, which magnified concerns about inward-looking, even autarchic, domestic policies.

Raise Productivity in Agriculture and Fishing

At the same time, one of Indonesia's unique features is its economic diversity. It is increasingly urbanized, yet has a large land and natural resources base with which to meet the domestic demands of the more affluent population expected by 2030. Oberman et al. (2012) estimate that a 60 percent improvement in productivity of farmers will be required to supply estimated domestic demand. Moves to reduce the costly externalities of historical reliance on extensive agriculture are needed; it is estimated that land-intensive agriculture has a major responsibility for deforestation and other practices that account for 75 percent of Indonesia's greenhouse gas emissions. Oberman et al. recommend boosting yields, shifting production to higher-value crops and reducing waste in the value chain to help Indonesia to become a net agricultural goods exporter.

Meet Growing Middle-class Demand for Modern Services

GVC-related concerns also raise questions about whether and how Indonesia will address the demands from its growing middle class for more sophisticated services, including in telecommunications, education, finance, health care and the environment. The World Bank ranks Indonesia at 163 out of 189 countries in terms of the ease of doing business (World Bank 2015a), indicating a plethora of significant barriers to meeting middle-class demand in the forms of regulatory issues, particularly related to contract enforcement, taxation, dealing with construction permits and registering property, where Indonesia ranks low on the global scale.

Increase Internet Use to Expand Markets, Raise the Efficiency of Economic Transactions, Create Economies of Scale and Boost Citizen Engagement and Social Inclusion

Indonesia's telecommunications sector was privatized in 2000. Available statistics show that mobile telecom penetration increased eightfold between 1997 and 2005. Access has become cheaper and fixed broadband accounts have been growing at a 40 percent annual rate in the past four years. The World Bank (2015b) estimates that around 40 million of Indonesia's 250 million people (16 percent) access the Internet regularly. Many others lack digital literacy, are budget-constrained or are not attracted by the available content. Internet penetration is far behind that of neighbouring Malaysia. Clearly, there is still a distance to travel for the Internet to become a significant driver of productivity growth (although mobile phones are now in widespread use in agricultural markets). There are a number of obstacles to overcome in making access universal, affordable and safe, beginning with the lack of infrastructure (fixed lines and wireless towers), although such facilities are becoming more numerous in and around major cities. Public and private investment in networks is required, as well as increased competition and tax incentives to businesses to subsidize employee access and attract consumers to online retailing, which has tremendous potential.

IMPLICATIONS FOR INDONESIA

Attention to these five priorities, taken together, would help realize Indonesia's full growth potential in the next decade or two. Carrying them out will require high-level political commitment, since they entail political risks of pushback by powerful interests, both civilian and military, vested in the status quo.

By mid-2015, a series of political developments raised concerns about the president's ability and commitment to fight endemic corruption and make the economy more competitive. Faced with political opposition in Parliament and bureaucratic sluggishness, the president has appointed a number of military and former military figures to civilian posts and is reported to be cooperating with the military to make progress on his nation-building goals, including achieving food self-sufficiency by 2017. As a result, new agricultural initiatives are not market-driven but organized by the military. In another example, infrastructure spending has increased but is channelled through state-owned firms. And while state subsidies of petroleum have been officially reduced, these reductions are only partially carried out and in some cases have been partially reversed.

This is not the first time President Jokowi has resorted to cooperation with the military. As governor of Jakarta from 2012 to 2014, he called upon military personnel to aid in flood prevention, clean up trash and help relocate households away from flood-prone areas. This time, calling upon the military is a pragmatic way to work around bureaucratic obstacles in achieving objectives. But can the risks be managed, particularly with respect to control and accountability, in order to get things done more quickly in a country that has only recently achieved hard-fought democratic reforms? One in which the first civilian government following a series of military dictatorships is still developing its ability to govern the country?

These uncertainties and challenges about Indonesia's institutions raise a larger question about the related and significant risks to Indonesia's growth that some of its neighbours have experienced (and indeed is a current question about China's future). The "middle-income trap" refers to many cases of developing countries in which economic growth accelerates as the country industrializes using abundant low-cost labour and/or natural resources, but then slows down or stagnates when per capita incomes reach middle-income levels. A 2008 report by the World Bank studied 13 developing economies that sustained high growth rates in the 1965–2000 period (including Indonesia, where annual per capita income grew from $200 in 1966 to $900 in 1997, prior to the Asian financial crisis) and saw per capita incomes rise to middle- and high-income levels in the period. In the most successful cases, such as South Korea (where per capita incomes grew from $1,100 in 1960 to $13,900 in 2001), institutions and policies were changed to encourage productivity-driven, rather than factor inputs-driven, growth. Looking ahead in Indonesia, the World Bank estimates that to achieve high-income status by 2030 (implying a per capita income of $12,000), Indonesia's growth rate in the 16 years after 2014 will have to average nine percent annually.

As several recent studies have pointed out, however, such a projection is subject to significant risks. One is public sentiment, which currently tends to be supportive of economic nationalism and trade protectionism. Another is the slow development of Indonesia's institutions for higher education, and labour market problems that trap people in the informal sector. Lack of physical infrastructure, particularly transportation infrastructure, is another obstacle holding back the integration of remote areas. While these weaknesses are widely identified, there are lengthy processes required to achieve consensus around modernizing key institutions that provide the "software" of growth in an innovative, open and competitive economy such as an independent, impartial and independent legal system (Aswicahyono and Hill 2015).

The changes required will be difficult. A significant example can be found in the trade and investment regime. Indonesia's participation in GVCs is minor compared to that of other ASEAN economies where GVCs account for half of total trade within the group. Participation will require a more open trade and investment regime, as well as efficient logistics, infrastructure and competitive labour inputs, all areas in which Indonesia lags behind its neighbours. While Indonesia is close to universal literacy among the school-aged population, dropout rates remain high. Evidence of weak formal-sector employment growth and serious skills mismatches further complicate the picture. Government spending lags in higher education, where public expenditures on universities total only 0.3 percent of GDP. Indeed, it has been estimated that prior to the recent reforms, energy subsidies claimed 10 times more government spending than research-and-development and education. The education system also remains heavily regulated and is not internationalized. These weaknesses are partly explained by strong pro-labour sentiments that tend to dominate competitiveness concerns.

Indonesia's infrastructure challenges are extensively studied and seen as a political priority, but logistical weaknesses persist because of, for example, inter-island transportation costs, which push up producer costs in remote areas. Infrastructure is also an area of under-investment, despite its importance. These problems are compounded by outdated regulations and inefficient services. The magnitude of Indonesia's infrastructure challenge became apparent when the *Bappenas* (the Planning Ministry), released estimates of requirements to bring Indonesia up to a middle-income country benchmark; it estimates that 2,650 km of roads, 1,000 km of toll roads, 15 airports, 24 seaports, 3,258 km of rail networks and 35,000 MW of power plants are required. A similar estimate of social infrastructure needs (schools, health facilities and social housing) would require more than $300 billion funding in the 2015–2019 period. Delays have occurred in the past — even when funding was available — due to poor coordination among levels of government, permit delays and land acquisition problems; all of these factors also inhibit public-private partnerships (Morris and Tsjin 2015).

In summary, to continue on its upward growth path, Indonesia should address significant institutional challenges needed to support an open, prosperous and equitable economy. Conclusions and recommendations of the Commission on Growth and Development (World Bank 2008) and lessons from studies of the middle-income trap strongly suggest that government (and its use of the military) should withdraw from production and ownership to roles that produce public goods and foster competition by private firms. Land and public finance reforms will help reduce income inequality. Regulatory monopolies in services need to be removed and services deregulated to encourage more sophisticated health, education, environmental and financial services demanded by the middle class. As the Asian Development Bank has argued, the emergence of the middle class changes the structure of demand toward increased consumption which, in turn, encourages more intra-Asian exports.

WILL INDONESIA LEAD IN ASEAN?

Indonesia's domestic challenges and uncertainties, and the need for the new leader to consolidate his power base in order to push reforms, suggests some parallels with modern China. Despite — or because of — China's 30-year growth sprint, its own leader faces major domestic challenges and preoccupations that shape his view of the Chinese role in the Asia-Pacific region and the world. Nevertheless, China is an active player in RCEP discussions and is a prominent member, along with the United States and Japan, in the East Asia Summit.

Initial expectations of President Jokowi were for energetic institutional reforms to improve Indonesia's growth performance. In late 2015, however, reports of progress were disappointing.[4] ASEAN neighbours also expected some restoration of a leadership role by their largest member in helping to push along the reforms promised before the launch of the ASEAN Economic Community (AEC). They too were disappointed as the AEC reached its 2015 launch date with many of the reform and integration measures promised by its members remaining unfulfilled. Indonesia did not apply to join the TPP because the standards required of negotiating partners were considered too high. China has made the same argument. Yet, in late 2015, officials in both countries are signalling new interest in eventual membership. This is a hopeful sign since, as noted earlier, President Jokowi has shown tendencies in domestic policies of turning inward rather than creating more economic openness and playing a more prominent role in foreign affairs.

IMPLICATIONS FOR CANADA

Indonesia and Canada are not yet major trading partners, but flows of trade and investment are growing. Indonesia imports nearly $2 billion in Canadian goods each year, double the value of imports five years ago (Global Affairs Canada 2015), and almost double the value of Canada's imports from Indonesia. Large Canadian players in the services and natural resources industries are already present, including Manulife, Sun Life, Bombardier and BlackBerry. In 2013, the stock of Canadian foreign direct investment in the country totalled CDN$3.2 billion. Indonesian investment in Canada is negligible (ibid.).

Canadian resource-management companies have made inroads in the Indonesian market. North Vancouver-based

4 See, for example, *The Economist* (2015).

Hatfield Consultants has developed a well-regarded reputation for work on improving environmental standards. Smaller companies with expertise in education and medical services could find business there, especially if more were done to link their expertise with the advantages and access already achieved by larger Canadian firms. Some, such as Export Development Canada's regional vice-president for Asia, have argued that Indonesia can be a base for accessing other markets such as those in Thailand, in light of the nascent ASEAN economic community launched in 2015. This estimate of timing may be overly optimistic, given the wide consensus that many more years will pass before the community is a reality, but the direction is clear. At present, Canadian producers face other obstacles, such as the high cost of goods and services that lead to being underbid by Korean and Chinese competitors (Smith 2014). Existing intergovernmental agreements apply to air transport, double taxation and nuclear cooperation. A Foreign Investment Promotion and Protection Agreement is under negotiation.

Returning to the title of this paper, will Indonesia turn into a dynamic open economy like China, affording major trade and investment opportunities? There is cause for pessimism for at least two reasons. One relates to those aspects of President Jokowi's economic strategy that are autarchic and inward-looking, with emphasis on self-sufficiency rather than being competitive and open to world markets. The second reason relates to his relatively unsuccessful struggle with entrenched political and military elites for more authority on his own (at least so far). Without such authority, his commitments to large-scale restructuring and infrastructure investments are lagging. By some estimates, only 11 percent of a $22-billion budget for infrastructure projects had been allocated in the first six months of 2015 (Chilkoti 2015). His reliance on the military for nation-building activities also raises questions about the importance he accords transparency and accountability — problems, it is important to note, that are shared by businesses in China in dealing with the party-state. Much of the opposition the president faces comes from within his own political party, with Chairperson Megawati Sukarnoputri taking such measures as recommending the dissolution of the Corruption Eradication Commission (KPK), the central institution in President Jokowi's anti-corruption campaign. It is too early in his mandate to draw final conclusions, but these are disquieting choices because of their negative implications for improving the business environment that is essential to attract more private investment.

While Canadian businesses should be aware of these political and institutional weaknesses that will be drags on restructuring Indonesia's economy, they should not ignore the opportunities related to Indonesia's economic strengths. Country strategies should extend their geographic reach beyond the traditional focus on Java. As Indonesia urbanizes and its middle class grows, smaller cities on Indonesia's 17,000 other islands will present new business opportunities. The anticipated expansion of the consumer base provides a number of opportunities for services, most prominently in financial services, where demand will grow for wealth management and capital market services. Canadian businesses will have to build knowledge about the diverse location of the customer base as well as build their own talent bases. Mobile banking and other means of using the expanding Internet will clearly be sources of brand advantage. Demand for services will prominently include private educational institutions. Oberman et al. (2012) see the possibility of entire new markets opening up for privately provided education services, as Indonesia addresses its serious skills mismatch problems. The market today for such services is estimated at $10 billion. It could grow to $40 billion by 2030 (ibid.).

Agricultural and marine products, as well as natural resources, are industries in which both Canada and Indonesia have strengths. Indonesia has suffered from the decline in its terms of trade, and growth has slowed with the recent declines in global commodity prices. But Indonesia clearly would benefit from technologies and advice about developing and extending supply chains in agriculture and fisheries to meet its own future domestic demand. Despite the earlier caveat, Java is probably the location furthest along in creating the connectivity and access to dense populations, making it the logical initial focus for such businesses.

Natural resources are the other major focus. Oberman et al. (2012) estimate the energy market alone will be worth as much as $270 billion, taking into account new energy sources and conservation measures. While oil and natural gas and coal will continue to dominate the market, geothermal and biofuels are also expected to grow rapidly.

In each of these areas of opportunity, businesses will have to understand and find ways to work with governments at different levels of the economy. Relationships have to be built, but public-private partnerships should be pursued with caution until the signals are clearer about President Jokowi's ability to tackle corruption more seriously.

CONCLUSIONS

The prospects for Indonesia to be another China of 30 years ago are at best mixed, as this paper has demonstrated, but not hopeless. Recent policy developments and institutional reforms have shown some promise of moving in the right direction, but progress has been halting. It is useful, however, to bear in mind the country's history of strong economic growth prior to the Asian financial crisis. After many years of moderate but respectable growth rates, Indonesia's endowments of labour, land and natural resources, efficiently developed in a more open economic environment, could still provide the basis for the country to become one of the world's large and dynamic emerging economies. But the importance of reform cannot be overemphasized, given Indonesia's challenges in geography (the archipelago), its demographic structure (large and youthful population without adequate education), its political institutions (a populist democracy and rising nationalism), and the serious deficiencies in key economic institutions and policies. Topping the list are poor local governance, the underdeveloped legal system and deeply entrenched bureaucratic inefficiencies. The Jokowi government's choice of import substitution trade policies, and its slow progress in tackling Indonesia's infrastructure deficiencies, have introduced further uncertainty about Indonesia as a location for the region's dynamic GVCs.

Unless these challenges are addressed, Indonesia's performance may not match that of China of 30 years ago. Recent decisions at the highest political level do not encourage optimism, but there are still several years remaining in the president's mandate. The danger is that if Indonesia does not meet these institutional challenges it could languish in the middle-income trap, lacking the "software" of growth — those institutions that encourage an open and competitive economy driven by innovation, competition and protection of property rights that would set it on the path of sustained long-term growth.

If the challenges are addressed and the leadership adopts an international outlook, Indonesia's location, endowments and capabilities all point to an emerging power with the economic clout and potential political ambition to help balance the growing strategic tensions in East Asia.

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