JC Economics: A Level Revision

Macroeconomics CSQ

Economic Development in Indonesia and South Korea

Table 1: Gross Domestic Product per capita (at 2018 US$ constant prices) for Indonesia and South Korea, selected years

	2000	2005	2010	2015	2018
Indonesia	781	1263	3122	3331	3893
South Korea	11948	18640	22087	27105	21363

Source: World Bank

Table 2: Indonesia's Selected Economic Indicators, 2015 – 2018

	2015	2016	2017	2018
Real Economic Growth (%)	4.9	5.0	5.1	5.2
Unemployment (%)	4.5	4.3	4.2	4.5
Change in General Price Levels (%)	6.4	3.5	3.8	3.3
Net Exports in goods and services (current US$billion)	7.7	9.5	11.8	-8.7

Source: World Bank

Extract 4: Opportunities and Challenges for Indonesia's burgeoning middle class

Indonesia is the world's fourth largest consumer market, trailing only China, India, and the United States. The economy is now worth US$900 billion per annum, fuelling a large consumer base, second to none in South East Asia, and a burgeoning middle class and retail sector to match drawing in significant capital investment from domestic and international sources.

Key factors driving Indonesia's explosive growth include its strikingly young population with 60% of its people below 30 years of age, expanding at a rate of 2.9 million a year. It is one of the fastest- growing consumer markets in the world, undergoing a rapid period of urbanisation which is expected to reach 71% of the total population by 2030, fuelled by a rise in incomes and a consumerist lifestyle. It is thus essential that any company wishing to operate there interpret and understand the characteristics of the Indonesian domestic market and its needs. Equally critical is being conscious of the considerable challenges for companies seeking to capture a share of this large commercial opportunity, including its fragmented geography, spread across 6,000 inhabited islands, and the heterogeneous nature of its people.

Indonesia is not Jakarta (the capital city), nor is it Java (the most important island); Indonesia is a complex country composed of many villages, smaller towns and cities who can only be served via proper operations and distribution networks. Indonesians have a strong preference for trusted local brands and take particular, even nationalistic, pride in supporting local businesses. The perception of being "Indonesian" has a strong bearing on purchasing decisions. Compounding the regional disparities are the logistical challenges inherent by extending supply chains across a country that remains poorly served due to insufficient transport infrastructure which are usually dominated by domestic firms with the long-established connections.

Source: FDISpotlight (accessed 24 July 2020)

Extract 5: Two Sides of Economic Success

Indonesia's air quality has deteriorated from among the cleanest in the world to one of the most polluted over the past two decades, shaving five years from life expectancy in some regions, researchers say.

The study by the Energy Policy Institute at the University of Chicago says an increase in coal- fired power stations, burning of land for plantation agriculture and rising car ownership are responsible for the worsening pollution in the world's fourth-most populous country. Sustained high concentrations of particulate matter in the air people breath will cut 2.3 years from lifespans in Jakarta. Indonesia's annual dry season fires were particularly disastrous in 2015, burning 2.6 million hectares of land and spreading health-damaging haze across Indonesia, Singapore, southern Thailand and Malaysia. The World Bank estimated the fires cost Indonesia $16 billion and a study estimated the haze hastened 100,000 deaths in the region.

Citing the experience of cities such as London, Osaka and Los Angeles in reducing disastrous air pollution and China's more recent progress, the researchers said Indonesia's pollution problem is "solvable" through stricter regulation and stronger enforcement, which is sorely missing now.

Meanwhile, a World Bank report in 2015 rang alarm bells for Indonesia. Despite managing to more than halve its poverty rate since 1999, inequality has been rising fast since 2000. That’s because the richest 20% have enjoyed much higher growth in incomes and consumption than others. World Bank estimates reveal that Indonesia’s Gini index increased from 0.30 in the 1990s to 0.41 in 2015. Indonesia’s consumer class has grown stronger thanks to two decades of economic growth. Their incomes are rising as their high educational qualifications meet the increasing demand for skilled workers. On the other side, Indonesia is largely still an agrarian country with a low-skilled manufacturing sector. A significant number of people with lower education struggle to find productive employment. They are trapped in low-paying jobs. Some work in farming and fisheries in rural areas, others work in the informal sectors – market coolies, domestic workers, drivers, etc. As their wages increase more slowly than for skilled workers, the income gap widens.

Indonesia also faces different income gaps between different provinces, ranging from the richer Jakarta metropolitan area to the poorer agriculture-based Sumatra and Sulawesi islands.

Source: Associated Press, 29 March 2019 and The Conversation, 28 August 2018

Extract 6: Can Asian countries learn from South Korea?

The "middle–income trap", in general terms, are middle–income countries which have lost their competitiveness against other low-wage economies but at the same time are unable to compete against developed economies to transition to high-income countries. As Ejaz Ghani from the World Bank says, it is a "development stage that characterizes countries that are squeezed between low- wage producers and highly skilled and fast-moving innovators." Typically, its real GDP per capita would remain in the region of US$3,000 to US$10,000. Certainly, many developing countries have enjoyed the benefits of transitioning, some rapidly, from a low-income country to a middle–income country but only a handful of countries have seemed to manage to escape the middle–income trap. This is a sad situation, where the GDP of a country can possibly decrease if it remains in the middle- income level for a very long time and has little hope of seeing it reach high–income in the near future.

South Korea began its economic take-off from 1960s to 1980s, during which rapid economic growth was fuelled mainly by investment and exports. Beyond a certain threshold, more focus had been shifted to the quality rather than the quantity of growth. Today, South Korea's firms such as Samsung, Hyundai and LG are among the world leaders in capital-intensive manufacturing in areas such as consumer electronics, biotechnology and alternative energy.

For countries to leave the middle–income trap, encouraging private investment and innovation, high levels of efficient government system and leadership, and highly educated workforce must be achieved. These are areas that South Korea has certainly achieved which developing middle-income countries can emulate. Considering the rather similar conditions most of these Asian countries stuck in a middle–income trap have with South Korea's initial economic development experience, the country offers important lessons on how to fill those gaps.

Source: Daniel Kasenda, Global Development Network (accessed 12 July 2020)

Questions

(a) With reference to Table 1, explain why real GDP per capita in US$ might not be a good indicator to compare material wellbeing of an average person living in South Korea to another living in Indonesia and suggest a more appropriate indicator. [3]

(b) Explain whether the net exports indicator could help you to conclude that Indonesia is an open economy. [2]

(c) Using information from Extract 4, explain why would a rational foreign retailer make the decision to invest in Indonesia. [3]

(d) Extract 6 mentions that 'the GDP of a country can possibly decrease if it remains in the middle-income level for a very long time'.

Explain how the above would impact on unemployment and net exports of Indonesia as shown in Table 2. [4]

(e) Discuss the extent to which economic growth is beneficial to the standard of living in Indonesia. [8]

(f) Given Indonesia's burgeoning middle class, discuss whether Indonesia could escape the middle-income trap by following the example of South Korea. [10]

[Total:30 marks]