TPSA | CANADA–INDONESIA TRADE AND PRIVATE SECTOR ASSISTANCE PROJECT

Identified Barriers to Indonesian Export Success

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Presentation Overview

- Previous presentations and working groups have outlined the production process and the linkages that connect Indonesian exporters to the rest of the world.

- Through that process, we identified specific areas that could potentially inhibit the global competitiveness of Indonesian firms and would be worthy of further study.

- This presentation is designed to summarize some of these identified barriers that Indonesian firms face, and to supplement that with direct consultation with firms and an assessment of policy research documents that are available.

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Coffee

Main Themes that Inhibit Coffee Exports

- Farm productivity and production levels
- Certifications and quality
- Government and institutional support

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Farm Productivity

The opportunity to increase backward and forward linkages in coffee's GVC are limited, creating a greater need to focus on production efficiency.

Main Themes from Industry Consultation Related to Productivity:

- Industry has the capacity to export more than it currently supplies.
- Uneven nature of coffee harvest and general distrust of financial institutions makes farmers less likely to invest in productivity-enhancing equipment and inputs.
- Farmers that did participate in government programs reported positive benefits. Other farmers didn't know of their existence.

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Certifications and Quality

Main Themes from Industry Consultation

- Most firms said that international certifications like organic certified or Fair Trade could be positive for their business. Unfortunately, many also they were unsure how to pursue them or how they would reap the benefits.
- Despite the belief by farmers and exporters that quality and certifications could help increase prices, several buyers of Indonesian coffee reported quality-related issues that affected the price they paid for Indonesian coffee.
  - One buyer said that Indonesian coffee had to be sorted twice upon arrival before additional processing and roasting could take place.
  - Another buyer said that the high presence of foreign materials in Indonesian economy created more wear and tear on their machinery.
  - Reliability issues tied to transportation and delivery.

Government Support and Institutions

Government can play a role in helping coffee producers

Productivity Issues

- Import duties on machinery and equipment make it costly for farmers to invest.
- Government training on modern farming practices was considered very beneficial by those that had previously participated and want it to continue. Furthermore, others were totally unaware of their availability.
- Programs to promote composting and organic fertilizers to boost yields
- New coffee trees

Quality Issues

- Ensuring adequate access to finance, even for small firms
- Access to information and training on international certifications
- Continue improving logistical infrastructure and improve the flow of information between government agencies and industry – particularly smaller firms
- Waste management and certifications

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Apparel

Main Themes that Inhibit Apparel Exports

- Lack of local production of key inputs that conform to the needs of Indonesian manufacturers
- High energy production costs
- Labour force productivity and workforce skill sets (regional)
- Market access & trade facilitation

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Key Inputs

- Lack of available domestic supply of high-value textiles gives Indonesia the international reputation that it is “good for basics” only.

- Some smaller firms lack the expertise to source their inputs internationally, inhibiting the quality of products they can produce.

- Ensuring that information can flow as efficiently as possible through the supply-chain is critical.

- Strategic support for backward linkages
  - We found that a major global producer of vegetable origin fiber producer is deciding whether or not to establish a new facility in Indonesia. Not only would this create jobs for Indonesians, but it would also provide apparel manufacturers with easy and efficient access to high-value Lyocell fibers which they can use to create high-value apparel.

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High Energy Costs

- Apparel manufacturers were particularly concerned about energy costs, despite the government's efforts to keep natural gas prices down.

- Manufacturing is a relatively energy-intensive process, but firms were found to be reluctant to invest in efficient machinery that would help them reduce consumption. Cost and import duties were often cited as a barrier.

- Self-generation is still very common. Almost every apparel manufacturer said energy costs were too high, but in many cases they reported that they generated virtually all of their power from diesel generators at the farm.
  - More costly
  - More difficult to pursue environmental certifications

Labour Force Productivity and Skills

- Firms are very reluctant to invest in machinery and equipment to improve labour productivity. Several said they want the return of the government program that helps share the cost of upgrading for new machinery and equipment.
- Regional wages are shifting production. Minimum wages in Jakarta have risen to a level that many apparel producers can no longer afford to locate there. They are moving for example to areas like Solo and Bandung where wages are considerably lower.
- But firms also said that workers in these areas lack the skill sets necessary, making it also difficult for firms to compete.

Institutions need to ensure they are providing the skill sets for the "next" jobs that Indonesians will do, not the ones they have done in the past. Many apparel manufacturers want to upgrade into design and development, but don't have the necessary training.

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Market Access & Trade Facilitation

- The most commonly identified barrier to export that Indonesian apparel manufacturers listed was "no international contacts".
  - If firms cannot understand what the end-user wants, this makes it difficult for them to upgrade their products.
  - Producers that had benefited from government-led trade facilitation were extremely satisfied with the results. Making these first connections for producers will not only secure contracts, but help them learn from foreign countries about the needs of the global market.

- Canadian retailers were hesitant to import from Indonesia because of the lack of free-trade arrangements
  - Canada, and many other high-income countries, pay a higher price to import from Indonesia
  - Indonesian producers receive a lower price as a result
  - International producers will often ask for rebates and tax concessions when trade agreements are not in place

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Footwear

Main Themes that Inhibit Footwear Exports

- Negative perceptions of local market and availability of key footwear inputs
- Market access & trade facilitation
- Confusion about government & institutional support and programs. Smaller firms felt that institutional support for them was lacking.

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Key Inputs and Local Supply

- Indonesian footwear makers said that finding good local supplies of value-adding inputs like poly-urethane (PU) and ethylene-vinyl acetate (EVA) was hard or impossible.
  - These types of inputs are critical in manufacturing many high-value types of footwear, particularly athletic shoes.
  - Firms are forced to import, which many smaller footwear manufacturers said was a challenge. This makes it difficult for them to produce higher quality shoes.
  - Polyvinyl chloride (PVC) is also a petroleum-based product, but is perceived as lower value and a poor substitute for PU.

- Many footwear producers had a negative perceptions of Indonesian quality themselves.
  - Even when local supply was available, producers perceived it to be of lower quality than international sources
  - Wholesaling network didn't provide the inputs that many producers needed. Only the largest firms sourced inputs directly. Lack of information on needs flowing between firms
  - Vertically integrated firms were sometimes directed by their clients to source their inputs from another country

Market Access & Trade Facilitation

As with apparel manufacturers, the most commonly identified barrier to export success was lack of international contacts and experience operating in international markets.

- Interviewed 8 firms, ranging from 20-2,400 employees. Larger firms were generally integrated with multinational firms and benefitted from these relationships. But smaller firms lacked the international connections to secure orders.

- Our industry consultation process revealed that firms that did export were able to do so because international buyers came to them. Those that were vertically integrated had no choice where their products were sold. Firms that didn't export were unsure how to break through the export barrier.

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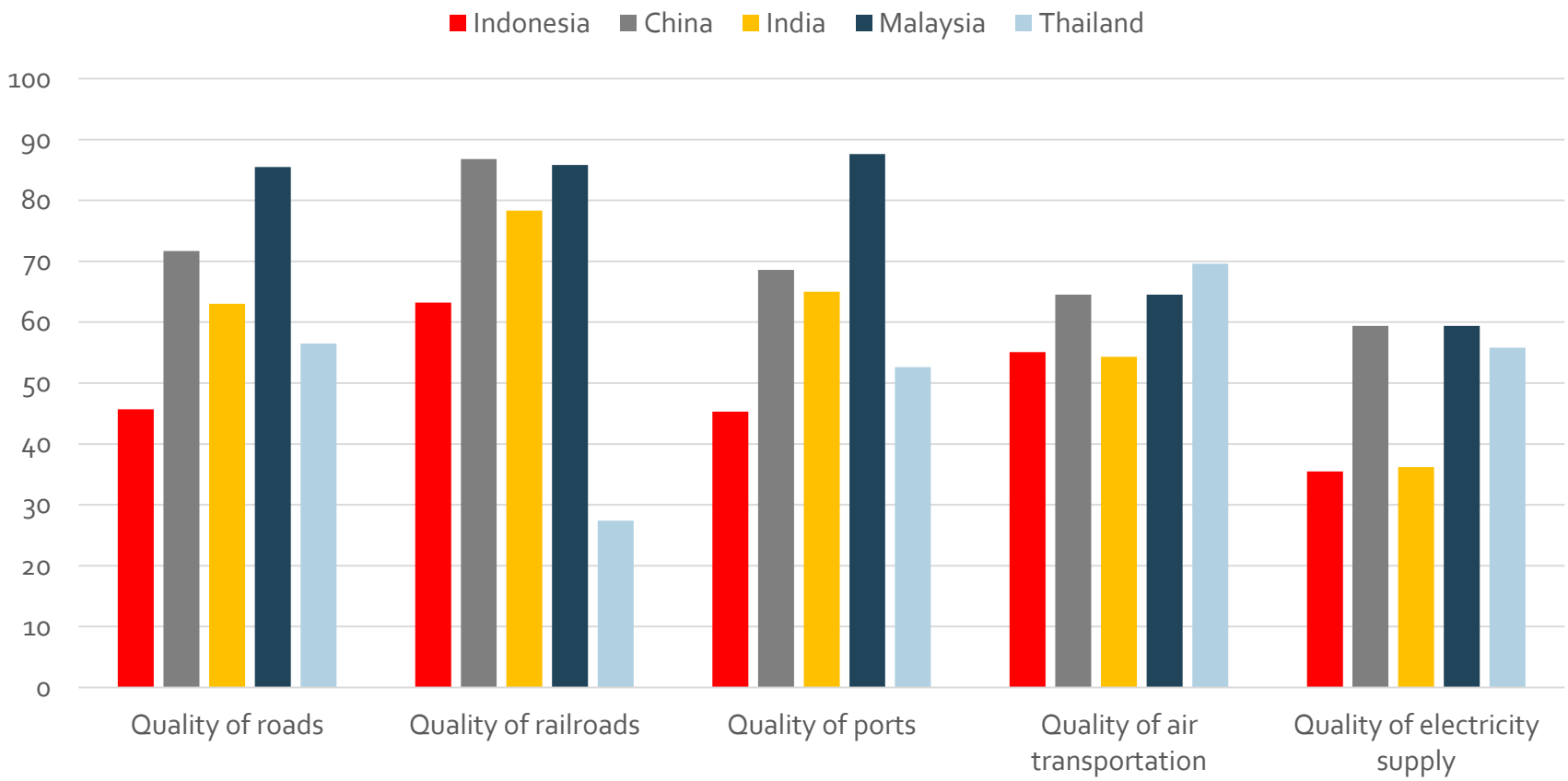
Government and Institutions

- Smaller firms in particular noted that institutional support and training programs were not necessarily targeted at their level.
- Only 2 firms were aware of the new footwear training institution in Central Java. Most firms reported that training institutions provided good basic skills, but did less well in higher value-added activities like purchasing, logistics, and design capabilities.
- Reliable access to key inputs was a key concern for some footwear manufacturers. 6 of the 8 manufacturers interviewed reported issues with energy and water. Diesel-generated electricity is common.
- Industry use of Special Economic Zones (SEZ) set by government is low and producers find that importation procedures sometimes slows the delivery of key leather inputs.
- Firms reported that labour was available, but that training institutions were not necessary providing workers with the skills they required to be successful in exporting their products.

Common Themes - Infrastructure



Source: World Economic Forum, Global Competitiveness Report 2016-17

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Common Themes – Market Access

- Lack of international contacts and trade knowledge was the #1 cited barrier to export success, particularly for small and medium-sized firms.

- About 1/3 of the firms we interviewed said they had benefited from government trade support or trade facilitation. All of them said it was extremely positive for their business.

- Apparel and Footwear manufacturers were particularly concerned with market access and freer trade.
  - Indonesian firms face high import duties in target markets
  - Indonesian firms face difficulties in importing key inputs in some cases, particularly productivity enhancing machinery and equipment.

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Common Themes – Productivity and Human Resources

Productivity-related issues and labour force skill shortages were noted by the majority of firms we interviewed.

Coffee farmers need a stronger focus on improving yields to a level more consistent with its competitors.

- Farmers, particularly small farms, need better access to high quality inputs
- Lack the skills to grade the quality themselves
- Lack knowledge on international standards

Apparel and Footwear manufacturers need a stronger focus on upgrading in the value-chain

- Rising wages means that Indonesian can no longer compete as a low-cost manufacturer. Higher wages have to be justified by higher quality products.
- Mid-sized firms face the greatest threat from international competition. They require assistance in integrating new machinery into their production processes.
- Labour force is available, but not enough experience in related activities like international purchasing or logistics. Training needs to focus on higher value jobs.

Other Key Factors

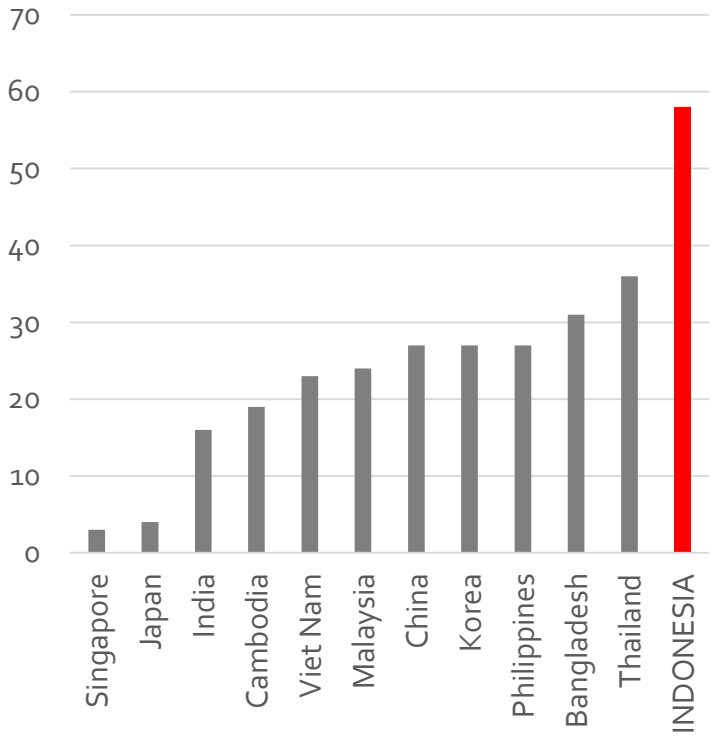
- **Labour market distortions**
  - Recent minimum wage changes are welcome. Limited to GDP growth plus inflation. This creates policy stability and makes planning easier.
  - Cost of dismissal is far beyond nearly every country in the world. This makes it harder for firms to hire workers

- **High cost of opening a business, and registering land.**
  - Land ownership costs are very high. This acts as a disincentive on new investment.
  - Pushes firms into the informal sector

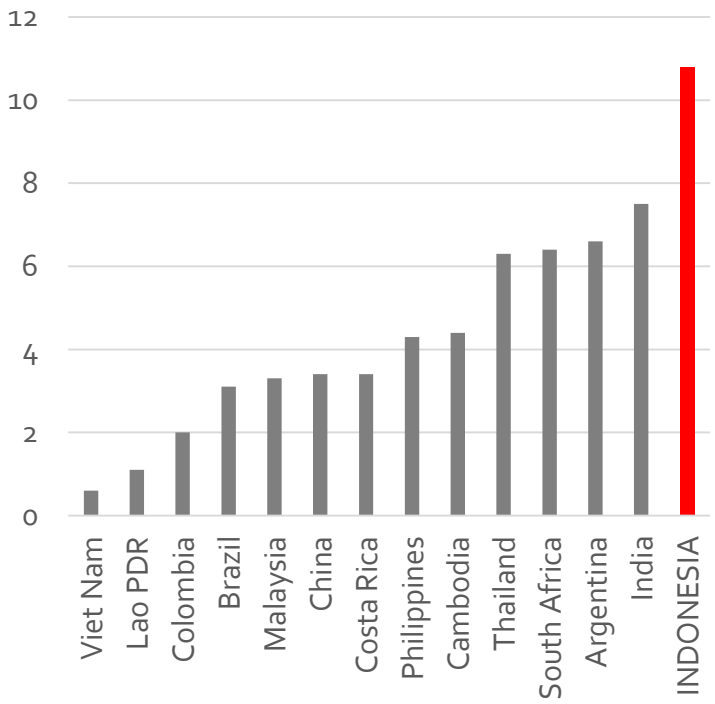
- **Regulatory inconsistency**
  - The growing number of provinces, regencies/cities, and districts can result in drastically different policies depending on where firms are. Public employment shares are well above norms.
  - Leads to a “race to the bottom” between Indonesian jurisdictions

Examples

Cost of dismissal (weeks of salary)



Cost of registering land (% of value)



Sources: World Bank, OECD, WEF

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Next Steps

Break off into groups and assess the barriers to competitiveness that have been identified through the IO, TiVA, and Industry Consultation process

Do you agree with the assessments that firms have provided when it comes to exporting potential?

What are some potential solutions to overcoming these barriers?

What are the main difficulties associated with these solutions?

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