Unleashing the Role of Services Sectors to Promote Growth and Competitiveness in Indonesia’s Economy
Services at a Glance
What are Services?

“Services are the result of a production activity that changes the conditions of the consuming units, or facilitates the exchange of products or financial assets”

Change effecting services (also referred to as “transformation services”) are outputs produced to order and typically consist of changes in the conditions of the consuming units realized by the activities of producers at the demand of the consumers. The change can take several forms:

a. Change in the condition of the goods (transport of the good, cleaning, repairing).

b. Change in the physical condition of persons (transport of the person, providing accommodation, medical treatment, improvement in appearance).

c. Change in the mental condition of persons (providing education, information, advice, entertainment in a face to face manner).

Margin services result when one institutional unit facilitates the change of ownership of goods, knowledge - capturing products, some services or financial assets between two other (institutional) units. Examples are the distribution services such as wholesalers and retailers and many types of financial services.
Classification of Services

1. BUSINESS
   A. Professional Services
   B. Computer and Related Services
   C. Research and Development Services
   D. Real Estate Services
   E. Rental and Leasing Services Without Operators
   F. Other Business Services

2. COMMUNICATION
   A. Postal Services
   B. Courier Services
   C. Telecommunication Services
   D. Audiovisual Services
   E. Other

3. CONSTRUCTION AND RELATED ENGINEERING
   A. General Construction Work for Buildings
   B. General Construction Work for Civil Engineering
   C. Installation and Assembly Work
   D. Building Completion and Finishing Work
   E. Other

4. DISTRIBUTION
   A. Commission Agents' Services
   B. Wholesale Trade Services
   C. Retailing Services
   D. Franchising
   E. Other

5. EDUCATIONAL
   A. Primary Education Services
   B. Secondary Education Services
   C. Higher Education Services
   D. Adult Education Services
   E. Other Education Services

6. ENVIRONMENTAL
   A. Sewage Services
   B. Refuse Disposal Services
   C. Sanitation and Similar Services
   D. Other
7. FINANCIAL
A. All Insurance and Insurance Related Services
B. Banking and Other Financial Services
C. Other

8. HEALTH RELATED AND SOCIAL
A. Hospital Services
B. Other Human Health Services
C. Social Services
D. Other

9. TOURISM AND TRAVEL RELATED
A. Hotels and Restaurants (including Catering)
B. Travel Agencies and Tour Operators Services
C. Tourist Guides Services
D. Other

10. RECREATIONAL, CULTURAL, AND SPORTING
A. Entertainment Services (including Theatre, Live Bands, and Circus Services)
B. News Agency Services
C. Libraries, Archives, Museums, and Other Cultural Services
D. Sporting and Other Recreational Services
E. Other

11. TRANSPORT
A. Maritime Transport Services
B. Internal Waterways Transport Services
C. Air Transport Services
D. Space Transport Services
E. Rail Transport Services
F. Road Transport Services
G. Pipeline Transport Services
H. Services auxiliary to all modes of transport
I. Other Transport Services

12. OTHER SERVICES NOT INCLUDED ELSEWHERE
Background: Why Services?

- Services are the main driver of Indonesia’s economic growth and job creation;
- Services have been instrumental in reducing poverty in Indonesia over the last decade;
- Services play an important role in enabling the growth and transformation of the economy through critical inter-sectoral linkages;
- Services restrictions are holding back growth and reducing competitiveness;
- Removing services restrictions is a proven strategy to boost growth in Indonesia;
- More open services trade and investment will lead to efficient services but the benefits are not automatic;
- Efficient and high quality services will boost exports of services creating a virtuous cycle;
- The Roadmap for Services Development in Indonesia comprises quick wins and longer term agenda focused on regulatory and institutional reform.
Services by Numbers
Services are the largest contributor of value added economy:

Services most important sector;
Direct contribution of services to GDP growth has increased over time.

Source: Duggan, Rahardja, Varela “Services Sector Reform and Manufacturing Productivity Evidence from Indonesia” (WB, 2013)
Services as a share of GDP

Source: World Trade Organization, Time Series on International Trade, adapted from Pasadilla and Chanda 2011
Between 1984-2008 the growth of Services Sector manifested into about 80% of rural poverty reduction and 86% of urban poverty reduction. Thus, services sector support:

1. 8 out of 10 people who are successful to move out from poverty line in the rural level
2. 9 out of 10 people who are successful to move out from poverty line in the urban level

Source: SMERU 2010
Services is the engine of job creation

Services employment share to other sector has increased over time – from 39% in 2000 to 45% in 2010.

- During 2000-2010, services has contributed highest provider in creating new employment and created far more jobs than other sectors:
  - Services: 21.7 million jobs
  - Manufacturing: 2.2 million jobs
  - Mining: 750,000 jobs
  - Agriculture, Hunting & Forestry: 650,000 jobs
  - Public Administration: 600,000 jobs
  - Others: 400,000 jobs
  - Fishing: 300,000 jobs

- Since the start of the 21st century, 3 out of every 4 new jobs that were created in Indonesia were in services and service related sectors.

Source: International Labour Organization, Key Indicators of the Labour Market downloaded via APEC Statistics
Distribution of Employment and Occupation in Services

Sources: (ILO 2013)
4 The Connectivity between services and other elements in the Economy

- Services are purchased for two uses:
  - To use by itself
  - To use an input into making something else.

- In Indonesia $\frac{2}{3}$ of services are purchased for direct use. For eg, if you go to the hospital, you are there to use their services to get better.

- The other $\frac{1}{3}$ of services are purchased to be used to do something else. For example most of road transportation is being purchased to facilitate some other business to happen.

Demand for services: 66% of the total demand for services is use for final consumption, 34% comes from producer (intermediate demand). About 34% of services sector production is intermediate demand from other production sectors. Only 66% final product from services sectors is directly consumed by end consumers.
5 The most FDI now in Services

Inward FDI by Sector

Source: Duggan, Rahardja, Varela “Services Sector Reform and Manufacturing Productivity Evidence from Indonesia” (WB, 2013)

FDI in Communication Services as a Percent of all Services (2000-2012)

Note: Excluding oil&gas, Non-Bank Financial Institution, Insurance, Leasing, Investment, Source: BKPM (accessed on 8 March 2013)
The true picture on services exports

- In the traditional measure of exports, services constitute only 10% of Indonesia’s exports.
- However, if we take into account these embedded services, Indonesia’s services exports rise to USD 28 Billion.
- In other words, ratio of services in exports doubles from 10% to 21.5% of total exports (in value added terms).

Source: OECD-WTO Trade in Value added
Sample Cases:
services for other sectors
The Ipod Example

Source: Constructed from Linden et al (2007)
Example Inputs into the Automotive Sector

Source: Based on Table 2. Total Transaction based on producer prices (BPS 2009)
Example Inputs into the Electronic Sector

Source: Based on Table 2. Total Transaction based on producer prices (BPS 2009)
Services input into Other Sector

Example Inputs into the Mining Sector

Source: Constructed from OECD STAN database, Indonesia IO Table, ITS Global (2010)
Services Content of various Indonesian Products

Example Content in Top Indonesian Products

- Food products, beverage & tobacco: 10.71%
- Textile, textile products, leather & footwear: 14.14%
- Pulp, paper, paper products, printing & publishing: 15.97%
- Chemicals: 11.39%
- Machinery & equipment: 14.97%

Source: Constructed from OECD STAN database, Indonesia IO Table
Services in the ASEAN Context
Increased Role of Services ASEA
Source of Growth –
Everywhere, especially in advance economic

Source: WDI Data
Services as a key input

% per capita income increase associated with 1% increase in service productivity

<table>
<thead>
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<th>MIC</th>
<th>HIC</th>
<th>ASEAN MIC</th>
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<td>0.1</td>
<td>0.45</td>
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<td>0.65</td>
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% industrial labor productivity increase associated with 1% increase in service productivity

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<th>MIC</th>
<th>HIC</th>
<th>ASEAN MIC</th>
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<td>0.2</td>
<td>0.9</td>
<td>0.6</td>
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Source: WDI Data
Services Trade as a Key Input

Services Trade and Income

Services Trade and Industrial Productivity
Services Play a Significant Role as input to other export activities

Source: World Bank *Value Added Database*.

Note: Due to data limitations we work on the basis of two broad categories. The first category corresponds to transport, distribution, and tourism activities, broadly speaking. The second category ("Other private services") corresponds to activities such as professional services, business services, financial, entertainment services, and others.
The ASEAN Experiences

Share of Services in GDP Value Added and Employment (in %)

Opportunities and Challenges

Trade is Growing Rapidly
Services exports as share of total exports: Gross, Value Added, and Total

Source: WDI and World Bank Export of Value Added Database.
Note: GXshare = Gross Exports Share, DXshare = Direct Exports Share, VXshsrefwd = Total Exports Share.
Key Messages of Services in ASEAN

1. Services Growth and Trade are Closely Linked to Productivity Growth, especially in middle income countries

2. Services trade have grown rapidly. When measured in terms of value-added, services contribution to total exports increases significantly

3. In ASEAN countries also services are a fundamental input to other activities and therefore a key determinant of the region’s competitiveness

4. Services’ role in ASEAN countries is below what would be expected from a dynamic region as East Asia

5. Data suggests that there is scope for greater regional integration in services in ASEAN that can help to achieve gains from economies of scale from a market of 600 million people and USD 2.3 trillion GDP
Services in Country Studies
Advanced Economies:

- Most of 2000s European growth (80 percent) and US (70 percent) Productivity growth attributed to Services sector’s contribution.
- Research suggests that differences in aggregate productivity levels and growth rates among seven advanced economies countries were largely explained by differences of the performance in the service sector.

Middle Income Economies:

- In Chile FDI in services closely linked to manufacturing productivity, especially helpful for small firms.
- In Indonesia relaxing equity restrictions in both the transport, and the electricity, gas, and water sectors led to significant productivity gains of manufacturing firms.
Key elements of the reforms include:

• Permitting up to 100% foreign ownership of companies engaged in telecommunications services, including satellite communications.
• Up to 49% ownership will be allowed in radio and television broadcasting, subject to a requirement of reciprocity.
• Empowering a new regulatory authority to identify dominant market participants and to force those participants to remove barriers to entry.
• Launching new broadband infrastructure
• Removing barriers to effective enforcement, simplifying the concession/administrative structure, and resolving disputes efficiently.
Country Studies - India

Services reform boosts not only productivity and exports in services, but also the performance of downstream manufacturing industries.

- Study based on panel data for 4,000 Indian firms for the 1990-2005 period finds that
- **banking, telecommunications** and **transport** reforms all have significant positive effects on the productivity of manufacturing firms.
- Similar studies on the Czech Republic, Chile and African countries present robust empirical evidence.

Source: Arnold, Javorcik, Lipscomb and Mattoo (2010).
The Challenges
Sector Modernization for Growth

- Low productivity in Asia’s service sector, Indonesia in particular reflects the dominant role of traditional services industries, such as: wholesale retail, hotels and restaurants, real estate, transportation services.

- Advanced economies, in contrast, have shifted toward modern services, such as: ICT, finance and professional business services, which tend to enjoy higher productivity.
Since the Global Financial Crisis, the Services Sector is in Decline

Source: BPS accessed 27 March 2014
When services coughs, the whole economy catches a cold

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Services and Services related</th>
<th>Other sectors</th>
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<tr>
<td>2001</td>
<td>3.64</td>
<td>2.18</td>
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<td>2002</td>
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<td>2008</td>
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<tr>
<td>2010</td>
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<tr>
<td>2012</td>
<td>6.23</td>
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<tr>
<td>2013</td>
<td>5.81</td>
<td>3.8</td>
<td>2.02</td>
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</tbody>
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Source: BPS accessed 27 March 2014
The Recommendations
To create higher value added, services need to be improved

- Better service links support communication and exchange of knowledge
- Service links also reduce cost and increase incentives to acquire knowledge

Even more important when talking about industrial upgrading

- Moving up the value chain involves higher services embodied in production
- Business services is the key
Modern services as key to improve services sector

- **Eichengreen and Gupta (2009)**: Modern services enjoy the highest productivity growth among service industries and their share of output tends to rise rapidly as high income is achieved.

- Key to improving Indonesia’s services sector productivity overall lies in shifting from traditional services industries with add value to modern service industries with **high value addition**.