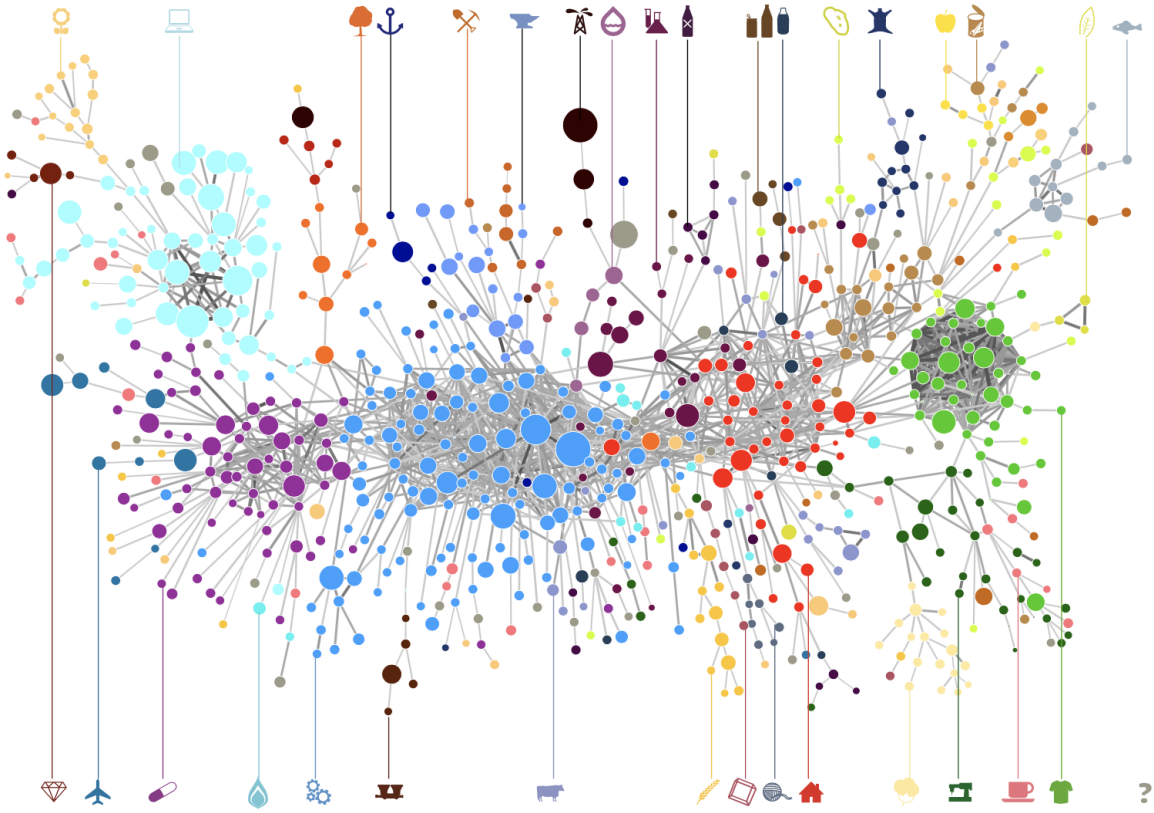

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Optimal Industry Development Strategy Using Economic and Product Complexity

Indonesia

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Optimal Industry Development Strategy for Indonesia

0. Executive Summary

In this report, we aim to uncover the economic path Indonesia went through during the period from 2013 to 2018. Specifically, we dive into the topic through a macroeconomic overview of Indonesia from the perspective of Gross Domestic Product (GDP) and Economic Complexity Index (ECI), which reflect countries' production capability and production structure, respectively. We find that during the period of our interest, Indonesia demonstrated a low level of economic growth with an annual GDP growth rate of 3.2%, concurrent with a decrease in economic complexity as compared with other major economies in Asia.

The level of economic progress during the period, we believe, can be partially explained through analysis of the economic and product complexity structure of Indonesia on the industry group level. The product classification system we adopt allows us to measure the realized industry development for various industry groups and to observe that Indonesia invested heavily in developing Precious Stones, Chemical Manufacturing, and Clothing and Accessories during the period, while its emerging peers and developed economies around the globe have adopted much more complex and progressive paths.

Based on our analysis of the opportunity gain and a sensitivity analysis of major industry groups, Indonesia can further its gains by prioritizing Services and Utilities. We further note that Indonesia has a slightly mismatched development strategy that indicates a low level of structural optimality on the complexity level, having an adjusted R-square of around -5.8%. Since a significant positive correlation exists between five-year GDP growth and the structural optimality index of an economy as we define and calculate, Indonesia indeed has a suboptimal growth experience as compared with fast-growing economies both on a regional scale and on a global scale, and has the potential to further its economic gains through industrial structure optimization as suggested in the paper.

1. Report Overview

In this report, we aim to uncover the economic path Brazil went through during the period from 2013 to 2018. Specifically, we dive into the topic through a macroeconomic overview of Brazil from the perspective of Gross Domestic Product (GDP) and Economic Complexity Index (ECI), which reflect countries' production capability and production structure, respectively. We then analyze the industrial framework and changes of Brazil during the period based on quantitative measures such as Product Complexity Index (PCI) and Product Family Complexity Index (PfCI), followed by a detailed analysis of how such changes have matched with development strategies as quantitatively measured by opportunity gains on an industry-level. We conclude our report with macro-level results and predictions of Brazil, as deduced from regression models we have established on a global scale, which take into account countries' stances in their product space.

2. Macroeconomic Results

2.1 GDP Ranking and Changes

As the 16th largest economy in the world ranked by GDP, Indonesia has a GDP of 912 billion USD in 2013 and 1042 billion USD in 2018, exhibiting an extraordinary level of economic output. Figure 1 illustrates the time-series GDP results for major asian economies from 1999-2018, and Indonesia ranks among its peers as a small but growing economy in terms of both GDP and GDP growth. During the period from 2013 to 2018, Malaysia achieved an average annual growth of 2.2% in GDP. This number is almost at the same level as the annual growth rate of the other four leading asian economies, which have a geometric average growth rate of 3.0% and an arithmetic average growth rates of 3.2%. Compared with more developed economies on a global scale, the annual growth rate of 2.2% is comparable to countries such as the USA which has an average annual GDP increase of around 4% during the period. The rapid economic growth, we believe, can be reflected through changes in ECI and PCI, and can be further explained by a well-chosen set of production strategies adopted by Malaysia from 2013 to 2018, which we will expand at the later stage of the report.

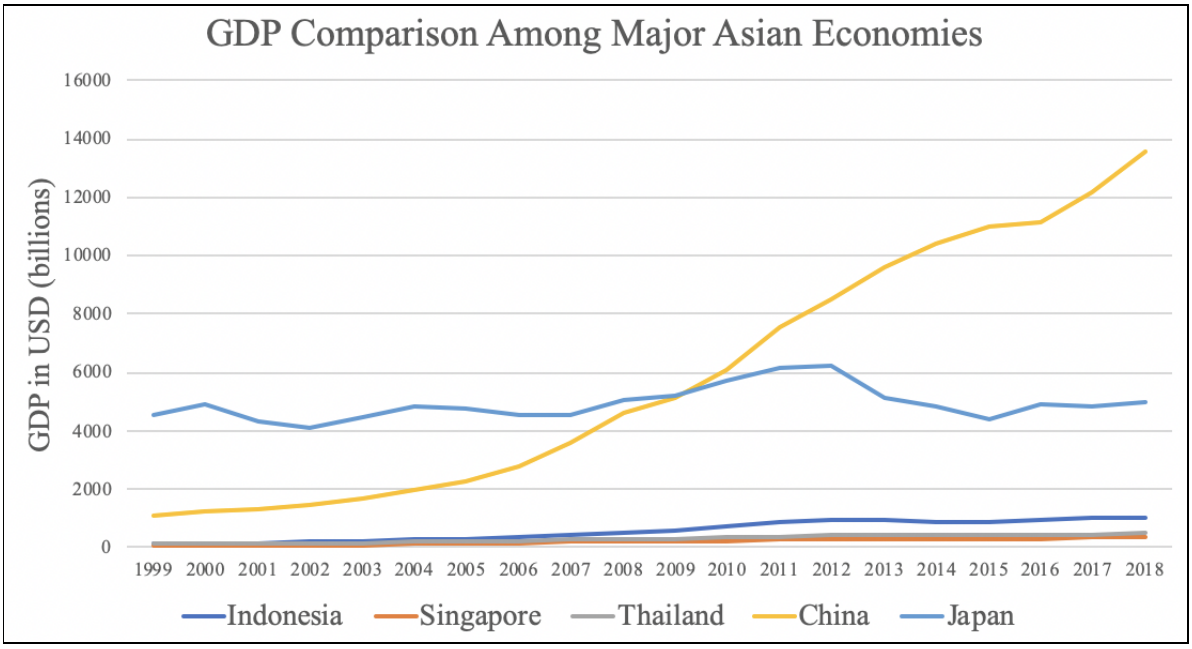


Figure 1: GDP Comparison Among Major Asian Economies

2.2 ECI Ranking and Changes

The Economic Complexity Index (ECI), as defined by Ricardo Hausmann and Cesar Hidalgo in 2009 to explain the knowledge accumulated in a country's population, exhibits a similar pattern for Indonesia. As illustrated in Figure 2 below, Indonesia exhibits a stably low production capability from 2013 to 2018, as measured by ECI. This is in direct contrast to the other four major asian economies such as China, which demonstrates a huge advantage in both ECI growth rate and GDP growth rate.

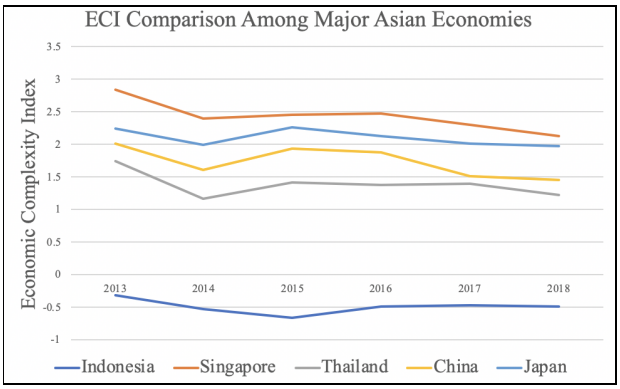


Figure 2: ECI Comparison

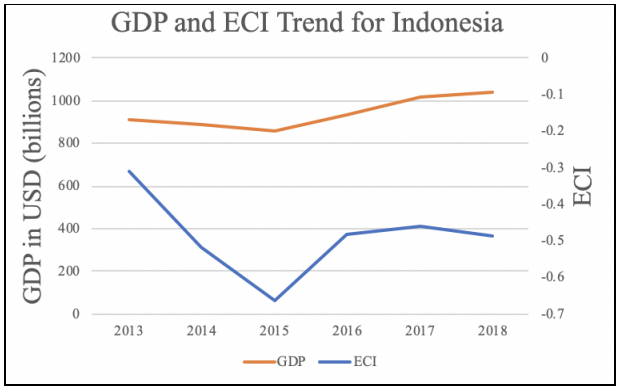


Figure 3: GDP and ECI (Indonesia)

Figure 3 offers a further comparison of GDP and ECI over the entire time span from 2013 to 2018 for Indonesia. The slight increase in GDP during the period from 2015 to 2018 is accompanied by a small improvement in ECI, indicting the potential that the mild economic growth experienced by Indonesia during this period might be attributed to its improving ECI, or the effectiveness of the country in developing a competitive product space that helps to accumulate complicated knowledge and technology. In order to provide a more concrete answer to why this has happened, we will dive into an analysis of Indonesia's production structure and its product space designs in the next few chapters.

3. Production Analysis

3.1 Product Categorization

Our main data source in this research is the UN Comtrade Website (https://comtrade.un.org), which provides us with valuable information on countries' export values on an annual basis, including highly specific export data for more than 5000 categories of products. In order to have a holistic vision of the product space of a country, however, a level of categorization is required. Products in our data source are labelled from 010000-999999, with the first two-digits representing a general category to which the product belongs. Based on the 99 categories as extracted from the label, we further group the products into 18 most widely-accepted industries, as summarized in Table 1.

Note that the High-complexity Products industry group is not a distinct industry but rather an aggregated industry that encompasses the most complicated products from the most technologically-advanced industries (as measured by PCI). This industry serves as an indicator for us to quantitatively evaluate how well a country has performed in developing cutting-edge technologies and closing its technical gap with advanced economies, which has become a topic of wide concern today. Indeed, when we rank the 18 categories based on PfCI (an equivalent concept of PCI as calculated based on the 18 categorized product groups), the High-complexity Products industry has the highest PfCI among all industry groups.

Category	Description
Animals and By-products	All kinds of meat, livestock and related by-products
Vegetables, Fruits and Plants	All kinds of plants, edible vegetables and fruits
Food and Preparations	Edible preparations, raw cooking materials and appliances
Clothing and Accessories	All kinds of fabrics, filament, clothing and accessories
Textiles	All kinds of textile articles and related products
Wood Products	Book, paper and other elementary products related to wood
Metals	Mining of all sorts of raw Metals
Refined and Processed Stones	Refined or processed stone products such as pearl and ceramics
Energy Drilling and Mining	Mining industry for energy, minerals, stone materials, etc.
Daily Instruments	Basic daily instruments such as sport requisites, timing and measuring tools
Raw Manufacturing	Basic products made from plastic, rubber, leather, etc.
Chemical Manufacturing	Advanced chemical products and pharmaceutical products
Chemicals	Raw chemical materials and by-products

Machinery and Construction	Machinery and mechanical appliances, including electrical equipment
Transportation	Vehicles and locomotives including aircraft, ship, railway, etc.
Weapons	Explosives, arms and ammunition
Services and Utilities	Financial, business, legal, communication, travel Services and Utilities, etc.
High-complexity Products	Agglomeration of advanced products with highest PCIs

Table 1: Categorization of Products

We further observe a positive correlation between the GDP and the export of High-complexity Products. A higher adjusted R-square exists between GDP and High-complexity Products exports, indicating that more successful economics, as measured by GDP, tend to be those that are capable of producing and exporting High-complexity Products as we define them. The Figure 3 and 4 show the OLS results in a universe of 107 and 21 typical countries respectively.

	High-complexity Products	Food and Preparations	Animals and By-products
Adj.R-squared	0.075	0.006	0.002
F-statistic	9.556	1.638	1.175
No. Observations	107	107	107

Figure 3: OLS Regression Results of GDP against Percentage Volume of Exports

	High-complexity Products	Food and Preparations	Animals and By-products
Adj.R-squared	0.149	0.003	-0.012
F-statistic	4.510	1.059	0.7542
No. Observations	21	21	21

Figure 4: OLS Regression Results of GDP against Volume of Percentage Exports

3.2 Realized Industry Development

Based on the product categorization aforementioned, we aim to capture Indonesia's realized industry production strategy between 2013 and 2018 on a complexity level. In Hausmann and Hidalgo (2009), distance is defined to be a measure of how far a country is from a certain product not in its product space. We extend this concept to all product groups and quantify how technically equipped a country is to develop the corresponding product groups. In other words, the shorter the distance between a country and a product group, the more capable a country is in developing products within that group. Defining this net distance change as the Realized Industry Development (RID), our export data allow us to calculate and compare RID of Indonesia and the 18 product groups in 2013 and 2018 through subtraction, where a positive RID indicates a shortening of the distance (i.e., advancement of the industry), and a negative RID indicates the reverse. As ranked in Table 2, during the period from 2013 to 2018, Indonesia has focused on products with a moderate level of complexity and those requiring intermediate skills.

Rank	Category	RID	Rank	Category	RID
1	Precious Stones	-0.237	10	Machinery and Construction	-0.186
2	Chemical Manufacturing	-0.220	11	Wood Products	-0.183
3	Clothing and Accessories	-0.217	12	Weapons	-0.141
4	Raw Manufacturing	-0.215	13	Metals	-0.130
5	Vegetables, Fruits and Plants	-0.205	14	Textile	-0.111
6	Chemicals	-0.200	15	High-complexity Products	-0.107
7	Energy Drilling and Mining	-0.188	16	Services and Utilities	-0.107
8	Daily Instruments	-0.188	17	Transportation	-0.086
9	Animals and By-products	-0.187	18	Food and Preparations	-0.053

Table 2: Realized Industry Development (RID) of Indonesia

3.3 Regional and Global Comparison

Table 3 and 4 below summarize how the production strategy adopted by Indonesia compares with leading economies and a selected group of emerging economies in the world, as measured in RID. It can be directly observed that Indonesia focused on products with a lower complexity level, when compared against leading economies such as the United States and Germany, which gave a considerable level of attention to more advanced product groups such as clothing, services and utilities, and chemical manufacturing.

Ranking	France	The United States	Germany
1	High-complexity Products	Services and Utilities	High-complexity Products
2	Chemical Manufacturing	Weapons	Transportation
3	Daily Instruments	Raw Manufacturing	Wood Products
4	Animals and By-products	Precious Stones	Metals
5	Food and Preparations	Animals and By-products	Food and Preparations

Table 3: RID Comparison across Leading Economies

Ranking	China	South Korea	Singapore
1	High-complexity Products	Transportation	Transportation
2	Transportation	Textile	High-complexity Products
3	Machinery and Construction	High-complexity Products	Precious Stones
4	Energy Drilling and Mining	Chemical Manufacturing	Daily Instruments
5	Daily Instruments	Machinery and Construction	Services and Utilities

Table 4: RID Comparison across Emerging Economies

Table 4 further examines Indonesia's development strategy against those of emerging economies on a global scale. Reasonably, emerging economies such as China, South Korea, Singapore and

India have devoted the majority of their efforts into intermediate industry groups while developed economies such as Indonesia should have relied more on advanced industry groups. This trend holds true in general, regardless of the continent or the time period, and serves as an indicator for which phase of development a country is currently in as evaluated from its production strategy. Based on this standard, Indonesia is indeed adopting a moderate but slightly out-of-phase strategy that seeks development in industry groups with a lower level of complexity than it should.

4. Product Space Design

4.1 Suggested Development Vector

As aforementioned, distance gives us an idea of how far each new product is from a country's current mix of exports. As defined in Hausmann and Hidalgo (2009), distance is "the weighted proportion of products connected to goods p that country c is not exporting, i.e., MCP=0." Based on this definition, the distance between a country and any product that the country is currently exporting (i.e., the country is a significant exporter in the product as compared to global average) is zero. Similarly, opportunity gain quantifies the contribution of a new product in term of opening up the doors to more and more complex products. Intuitively, a product that a country is currently exporting (i.e., MCP=1) has an opportunity gain of zero. And unreasonable investment on certain product p would lead to a relative decrement in export of more profitable products, and therefore lead to a negative opportunity gain of product p. The opportunity gain is not the only estimator of a country's level of economic development. However, among countries with comparable economics strength, those having higher ECI, or in other words, more reasonable economics structure are often in better shape.

Ranking	Thailand	Malaysia	Indonesia
1	Animals and By-products	Services and Utilities	Precious Stones
2	Food and Preparations	Machinery and Construction	Machinery and Construction
3	Chemicals	Vegetables, Fruits and Plants	Food and Preparations
4	Raw Manufacturing	Energy Drilling and Mining	High-complexity Products
5	Textile	Raw Manufacturing	Services and Utilities
6	Machinery and Construction	Transportation	Metals
7	Transportation	High-complexity Products	Daily Instruments
8	High-complexity Products	Chemicals	Transportation
9	Energy Drilling and Mining	Weapons	Chemicals
10	Vegetables, Fruits and Plants	Chemical Manufacturing	Chemical Manufacturing
11	Precious Stones	Daily Instruments	Animals and By-products
12	Weapons	Animals and By-products	Vegetables, Fruits and Plants
13	Clothing and Accessories	Food and Preparations	Energy Drilling and Mining
14	Services and Utilities	Precious Stones	Raw Manufacturing
15	Wood Products	Textile	Wood Products
16	Metals	Wood Products	Clothing and Accessories
17	Chemical Manufacturing	Metals	Textile
18	Daily Instruments	Clothing and Accessories	Weapons
ECI	1.68914409	1.090379108	-0.298641635

Ranking	Thailand	Malaysia	Indonesia
1	Energy Drilling and Mining	Services and Utilities	Precious Stones
2	Vegetables, Fruits and Plants	Vegetables, Fruits and Plants	High-complexity Products
3	Animals and By-products	Energy Drilling and Mining	Machinery and Construction
4	Food and Preparations	Raw Manufacturing	Chemicals
5	Raw Manufacturing	Transportation	Chemical Manufacturing
6	Textile	Weapons	Transportation
7	Machinery and Construction	High-complexity Products	Services and Utilities
8	Transportation	Chemicals	Daily Instruments
9	Precious Stones	Precious Stones	Animals and By-products
10	High-complexity Products	Animals and By-products	Vegetables, Fruits and Plants
11	Clothing and Accessories	Textile	Food and Preparations
12	Wood Products	Food and Preparations	Energy Drilling and Mining
13	Chemicals	Wood Products	Raw Manufacturing
14	Services and Utilities	Daily Instruments	Wood Products
15	Weapons	Clothing and Accessories	Clothing and Accessories
16	Metals	Metals	Textile
17	Chemical Manufacturing	Chemical Manufacturing	Metals
18	Daily Instruments	Machinery and Construction	Weapons
ECI	1.272660382	1.232460036	-0.4615811

Table 5: Opportunity Gain Ranking on a Comparable Scale for 2013(up) and 2018 (down)

We define the ranking of opportunity gain for a country c, as the Suggested Development Vector (SDV) of c. Table 5 and 6 summarize how the SDV of Brazil compares with a selected group of comparable and leading economies in the world, with the industry groups ranked in decreasing order of significance. Dark blue indicates positive opportunity gain, light blue indicates zero opportunity gains, and white indicates negative opportunity gains. The result shows that leading countries barely have any industries with positive opportunity gain. In other words, those countries are already in the most stable and efficient economic structure. Without the necessity of economic transition, those countries merely need to maintain a steady and balanced economic development. In contrast, developing countries have nearly half of industries with positive opportunity gain, and share common interests in industrial manufacturing and High-complexity Products industries. It can be concluded that Indonesia shares the characters of developing countries, with a balanced economics structure that leans towards intermediate-level industries.

Ranking	Singapore	Japan	USA	Germany
1	Chemicals	Chemicals	Energy Drilling and Mining	Chemical Manufacturing
2	Transportation	Metals	Precious Stones	Wood Products
3	High-complexity Products	Machinery and Construction	Animals and By-products	Metals
4	Services and Utilities	Transportation	Vegetables, Fruits and Plants	Machinery and Construction
5	Machinery and Construction	Weapons	Food and Preparations	Transportation
6	Daily Instruments	Daily Instruments	Chemicals	Weapons
7	Weapons	High-complexity Products	Chemical Manufacturing	High-complexity Products
8	Textile	Services and Utilities	Raw Manufacturing	Services and Utilities
9	Chemical Manufacturing	Precious Stones	Wood Products	Energy Drilling and Mining
10	Raw Manufacturing	Energy Drilling and Mining	Machinery and Construction	Precious Stones
11	Clothing and Accessories	Textile	Weapons	Textile
12	Metals	Clothing and Accessories	Daily Instruments	Clothing and Accessories
13	Wood Products	Chemical Manufacturing	High-complexity Products	Chemicals
14	Precious Stones	Animals and By-products	Services and Utilities	Animals and By-products
15	Animals and By-products	Wood Products	Clothing and Accessories	Vegetables, Fruits and Plants
16	Food and Preparations	Vegetables, Fruits and Plants	Metals	Food and Preparations
17	Energy Drilling and Mining	Food and Preparations	Textile	Daily Instruments
18	Vegetables, Fruits and Plants	Raw Manufacturing	Transportation	Raw Manufacturing
ECI	2.751108815	2.154947	1.220401303	1.937171566

Table 6: Opportunity Gain Ranking on a Global Scale

4.2 Budgeted Industry Development Strategy and Interpretation

The optimal budgeted industry development strategy aims to solve the most efficient allocations under the budgeted constraint of different situations of heuristic total export growth. In order to obtain such an allocation portfolio, we formulate an optimization problem as the following:

$$\begin{aligned} &\underset{x \in \mathbf{R}^{|P|}}{\text{Max}} \quad (\frac{k(x) - < k(x) >}{stdev(k(x))})_C \\ &\text{Subject to} \\ &\sum_{p \in P} x_p \leq B \\ &x \succcurlyeq 0 \end{aligned}$$

where k(x) is the second largest eigenvector of $M_{CC'}$ after adding x to the original export vector, C is the country that we are interested in, P is the product space, B is the heuristic budget.

If we can solve this problem, then we can know what the largest ECI that a country can improve to. Accordingly, the optimal solution x * that we obtain here is exactly our optimal allocation. However, the biggest problem is that the objective function is not convex. Therefore, we cannot apply the classical tools for convex optimization on this problem. In order to solve this problem, our idea is to use greedy algorithm. The way that we apply greedy algorithm is that firstly we separate the total budget into k equal parts, and then for the first equal part we try to search for the product that can optimize our objective function by iterating through each $p \in P$. After we find the optimal product p for this equal part, we add the amount back to the export value of this product p and update the ECI for this country. If we observe that ECI does not change after iterating all the products, then we can add up one more equal part to invest. Until we find there is an ECI increment, we add the amount now to that product. The rest equal parts can be done in the same way.

However, as is known to all, greedy algorithm is a kind of local search algorithm, which is pretty possible to run into a local minimum. Therefore, for local search algorithms, one typical way is to keep it away from the local minimum is to enhance the vision of the algorithm by looking more steps forward. In our setting, whenever we obtain an increment of ECI, we mark down the required amount of export growth. Simultaneously, we continue searching for the next ECI increment point, compare the ratios of these two possibilities and pick the largest one. The ratio is defined as the following:

$$Ratio(p) = \frac{ECI_p - ECI_0}{||x_p - x_0||_1}$$

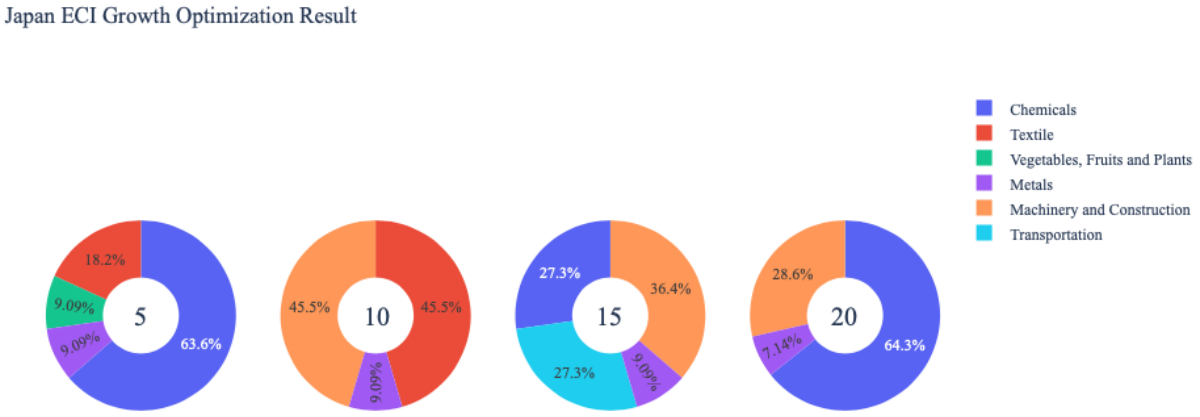
where ECI_p is just the ECI of the country after adding some amount of export increment to product p, which is exactly the amount that is able to make ECI change. Also, we can express it in the way of $||x_p - x_0||_1$.

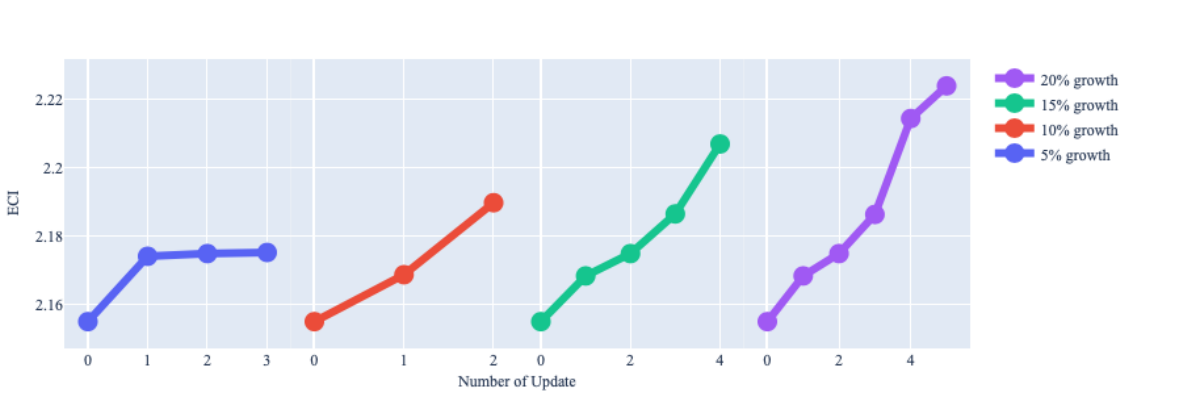
In this way, we can obtain a further sighted greedy algorithm. Also, the number of parts that we would like to separate the budget into also matters. In order to solve this problem, we added a stabilizer on top of the enhanced greedy algorithm, by running the algorithm for different number of parts and selecting the portfolio with the largest ECI increment and most complex economic structure.

Besides, it is quite common that there is a surplus for the budget. To deal with the surplus, we just add it to the product which needs the least amount of dollar to make M_{cp} = 1, (i.e., the smallest amount of required export increase).

Economic Panel:

As stated above, the enhanced greedy algorithm is developed mainly for solving the optimal allocation strategy. In order to visualize this allocation, an economic panel is created, consisting of a pie chart, a line chart and a table. Firstly, a pie chart is used to show the percentage of each product in the optimal portfolio. The number located in the center of the circle denotes the heuristic growth of total export, which is also our budget. For example, for the first pie chart below, it shows we should allocate 25% for food and preparations, animals and by-products, and chemicals. In addition, we should allocate 12.5% for raw manufacturing and chemical manufacturing. The lines below the pie charts show how the ECI changes during the searching process of the greedy algorithm. For example, in the last pie chart, we can see there are three components, but there are four increments in the last line chart. That is just because many equalized amounts have been invested in high-complexity products. Even though sometimes people may feel 15% and 20% is nonsense to developed countries, yet it can also give a sense of how a country should develop in the long term. Eventually, the graph in the end is just for numerical explanation for the pie charts.



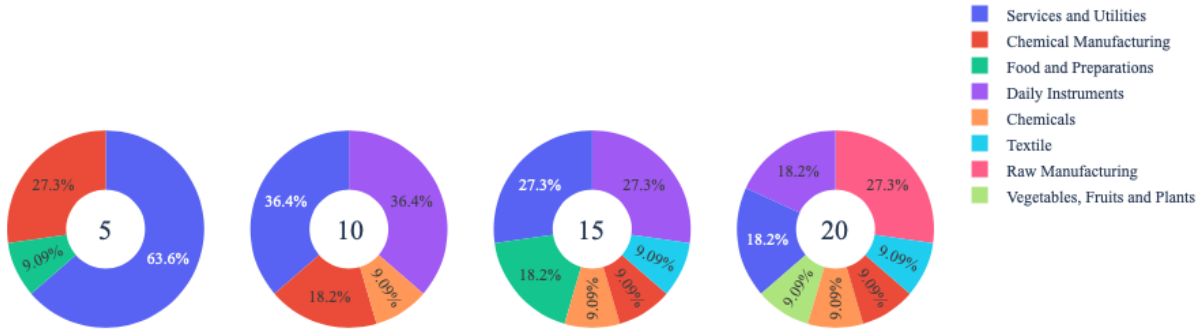


Japan (2013)				
Total Export in 2013 (US. $)	1.17E+12			
Original ECI	2.155			
Heuristic Export Growth (%)	5%	10%	15%	20%
Heuristic Export Growth (US. $)	5.86E+10	1.17E+11	1.76E+11	2.35E+11
Metals(US. $)	5.33E+09	1.07E+10	1.60E+10	1.68E+10
Transportation(US. $)	0.00E+00	0.00E+00	4.80E+10	0.00E+00
Chemicals(US. $)	3.73E+10	0.00E+00	4.80E+10	1.51E+11
Machinery and Construction(US. $)	0.00E+00	5.33E+10	6.40E+10	6.70E+10
Textile(US. $)	1.07E+10	5.33E+10	0.00E+00	0.00E+00
Vegetables, Fruits and Plants(US. $)	5.33E+09	0.00E+00	0.00E+00	0.00E+00
Increased ECI	2.175	2.190	2.207	2.224

Interpretation:

Below is the economic panel for Indonesia in 2013. We can see that for different percentages of heuristic total export growth, the ECI of Indonesia has different performance. From all the four line graphs, we see that Indonesia already obtains some great increment in terms of ECI. Most importantly, the higher the budget is, the greater the ECI will be. This means that in both short term and long term, Indonesia still has great room to improve. For the case of 5 percent growth, the ECI increment is because of services industry, chemical manufacturing and food products. For the 10, 15 and 20 percent, both services industry and daily instrument serve as the main power for the ECI increment.

Indonesia ECI Growth Optimization Result



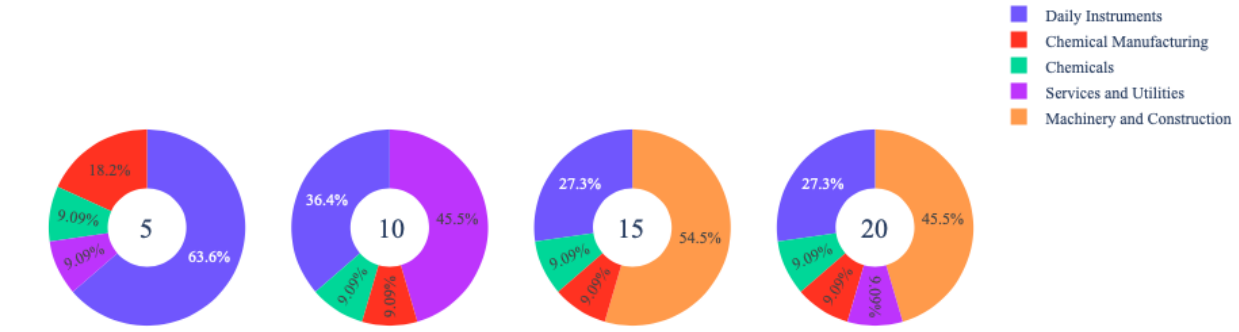
Indonesia ECI Increment

Indonesia (2013)				
Total Export in 2013 (US. $)	2.13E+11			
Original ECI	- 0.299			
Heuristic Export Growth (%)	5%	10%	15%	20%
Heuristic Export Growth (US. $)	1.06E+10	2.13E+10	3.19E+10	4.26E+10
Food and Preparations(US. $)	9.67E+08	0.00E+00	5.80E+09	0.00E+00
Chemical Manufacturing(US. $)	2.90E+09	3.87E+09	2.90E+09	3.87E+09
Daily Instruments(US. $)	0.00E+00	7.74E+09	8.70E+09	7.74E+09
Chemicals(US. $)	0.00E+00	1.93E+09	2.90E+09	3.87E+09
Raw Manufacturing(US. $)	0.00E+00	0.00E+00	0.00E+00	1.16E+10
Textile(US. $)	0.00E+00	0.00E+00	2.90E+09	3.87E+09
Services and Utilities (US. $)	6.77E+09	7.74E+09	8.70E+09	7.74E+09
Vegetables, Fruits and Plants(US. $)	0.00E+00	0.00E+00	0.00E+00	3.87E+09
Increased ECI	0.062	0.276	0.282	0.286

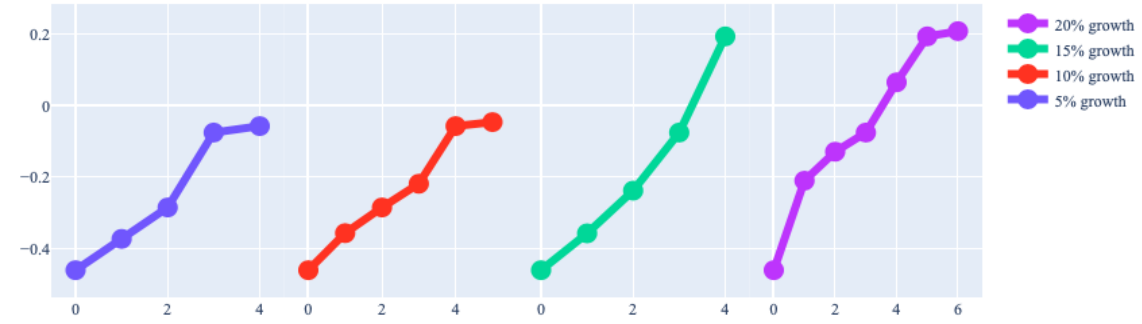
For further suggestions on Indonesia's development in the future. We also offer the optimization result of Indonesia based on export data in 2018. Below is the economic panel for Indonesia in 2018. We can see that for different percentages of heuristic total export growth, the ECI growth pattern of Indonesia is more stronger than the one in 2013. From all the four line graphs, we see that Greece already obtains some great increment in terms of ECI. Most importantly, the higher the budget is, the greater the ECI will be. This means that in both short term and long term,

Greece still has great room to improve. For the case of 5 and 10 percent growth, ECI increment can be attributed to the development of machinery products and services industry. Therefore, for future strategy, Indonesia should prioritize development of services and utilities as well as machinery and construction, which causes the great jumps in the last two stages. And then daily instrument, in order to optimize ECI.

Indonesia ECI Growth Optimization Result



Indonesia ECI Increment



Indonesia (2018)				
Total Export in 2018 (US. Dollars)	2.13E+11			
Original ECI	- 0.46			
Heuristic Export Growth (%)	5%	10%	15%	20%
Heuristic Export Growth (US. $)	1.06E+10	2.13E+10	3.19E+10	4.26E+10
Chemicals	9.68E+08	1.94E+09	2.90E+09	3.87E+09
Chemical Manufacturing	1.94E+09	1.94E+09	2.90E+09	3.87E+09
Machinery and Construction	0.00E+00	0.00E+00	1.74E+10	1.94E+10
Daily Instruments	6.78E+09	7.75E+09	8.71E+09	1.16E+10
Services and Utilities	9.68E+08	9.68E+09	0.00E+00	3.87E+09
Increased ECI	-0.06	-0.05	0.19	0.21

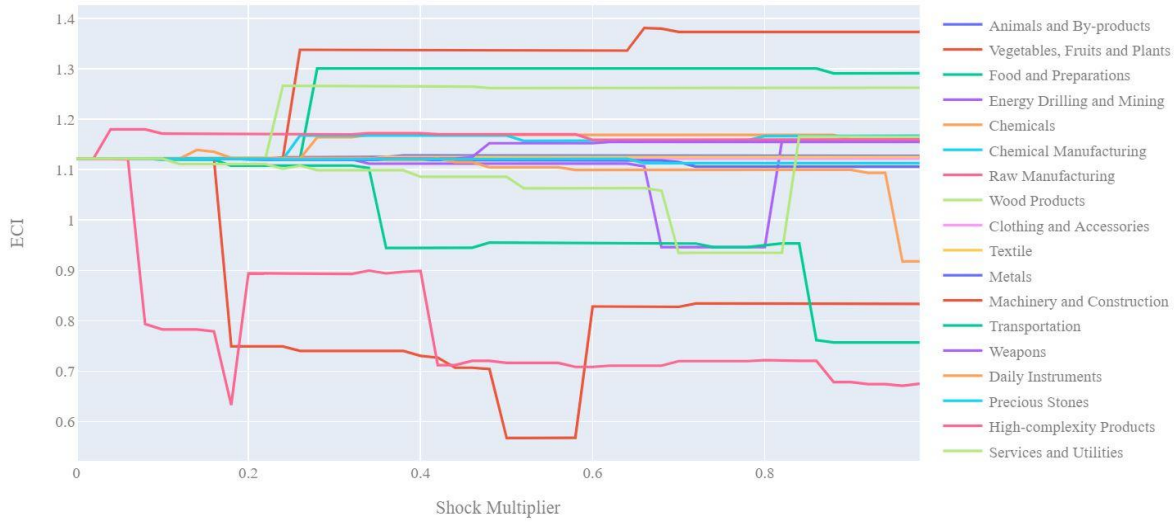
4.3 Sensitivity Analysis and Contingency Strategy

In the following section our broad aim is to understand how sensitive Indonesia is to changes in export in various industries. While the Economic Complexity Index has been shown to contain valuable information about the economic strength/capacity of a country, little has been said as to the stability of the measure itself. We seek to uncover the main drivers of stability under a country's ECI score and better understand longer-term projections for ECI growth. Additionally, gaining an intuition on the industries that are bolstering an economy and the industries that offer the greatest return per unit of investment is best done through visualization of industry specific sensitivity.

ECI Sensitivity Graph

Firstly, in order to assess the effect particular industries have on each respective country, we developed ECI Sensitivity graphs. We use shocking methodology to increment or decrement an industry's export level by a certain percentage and recalculate the ECI all else being equal. While freezing the export dynamics of the rest of the world and enacting an instantaneous shock in export for a particular industry and country may not reflect real-life dynamics, what it does offer us is an understanding of a country's level of dependency on an industry in the context of ECI. The shocking is done in small percentage increments in order to smooth out the resulting curve. Additionally, a recurring theme one will see is that for most industries, a breaking point occurs where the ECI either jumps upwards or downwards, creating a hockey stick shape rather than a linear trend. While the inflection point may not be accurate in context of real life, comparing the various inflection points across industries can give us valuable insight.

The graphs are formulated as follows: There are four ECI Sensitivity graphs. The first two represent data from 2018. The first chart shows positive shocking in which export numbers are shocked upwards per industry. The X-axis is in terms of percentage shock per current dollar value of export. The Y-axis is the recalculated ECI level post-shocking. The second chart follows the same format except the X-axis represents negative shocking. In other words, exports for each industry are decremented and the ECI is accordingly recomputed. The final two sensitivity graphs show the same results using 2013 data. Below is an example of an ECI sensitivity graph.



Example 2018 (Incremental ECI Sensitivity)

SDV sensitivity

Secondly, we analyze the sensitivity of the SDV to changes in export levels. The goal is to understand how export level changes for a particular industry can affect the marginal opportunity gain for other industries. We will be using specifically High Complexity Products and Food and Preparations as our base industries. We will be increasing or decreasing the absolute export level in both of these industries and observing the effects on the SDV.

When the opportunity gain of an industry is negative, the SDV sensitivity approximates how an over-development of the industry jeopardizes the economic structure of a country. When the opportunity gain of the industry is zero, the SDV sensitivity determines whether the further development of the industry shapes the country with a better economic structure and predicts how the SDV would change accordingly. Specifically, as we reduce the export of such an industry to 25%-50% of its original value, a few other industries originally with negative opportunity gain could likely become profitable.

Similar to the ECI sensitivity graphs above, we will be shocking export of High Complexity Products and Food and Preparations in small percentage increments. A new SDV, represented by a new column in the charts, is recorded only when a certain level of shock changes the structure of the SDV. In effect we are incrementing or decrementing export levels of two industries until the marginal opportunity gain of any industry changes in category (positive, negative, or neutral). Below is an example of a SDV Sensitivity chart with Positive Shocking. Industries with positive marginal opportunity gain are colored blue, neutral is colored white and negative is colored red.

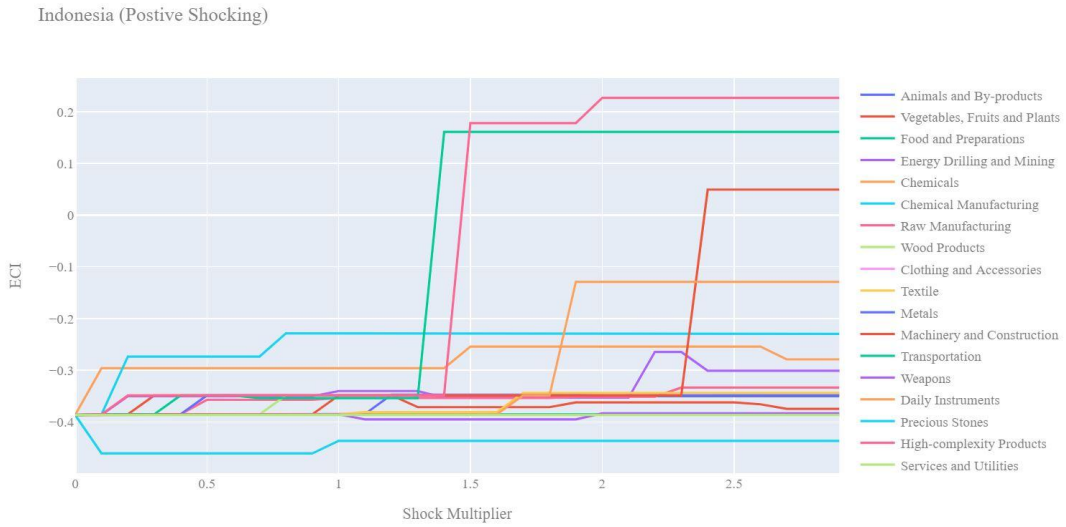
	0.0%	10.0%	30.0%	50.0%	80.0%	100.0%	120.0%
0	Vegetables, Fruits and Plants	Vegetables, Fruits and Plants	Vegetables, Fruits and Plants	Chemicals	Chemicals	Chemicals	Machinery and Construction
1	Daily Instruments	Daily Instruments	Daily Instruments	Services and Utilities	Services and Utilities	Daily Instruments	Chemicals
2	Weapons	Weapons	Weapons	Textile	Textile	Textile	Daily Instruments
3	Transportation	Transportation	Transportation	Weapons	Daily Instruments	Services and Utilities	Services and Utilities
4	Machinery and Construction	Machinery and Construction	Machinery and Construction	Transportation	High-complexity Products	Transportation	Transportation
5	Metals	Metals	High-complexity Products	Machinery and Construction	Transportation	Chemical Manufacturing	Textile
6	High-complexity Products	High-complexity Products	Chemicals	High-complexity Products	Machinery and Construction	Weapons	Chemical Manufacturing
7	Chemicals	Services and Utilities	Services and Utilities	Daily Instruments	Chemical Manufacturing	High-complexity Products	Weapons
8	Services and Utilities	Chemicals	Textile	Chemical Manufacturing	Weapons	Machinery and Construction	High-complexity Products
9	Textile	Textile	Chemical Manufacturing	Precious Stones	Clothing and Accessories	Clothing and Accessories	Clothing and Accessories
10	Chemical Manufacturing	Chemical Manufacturing	Precious Stones	Clothing and Accessories	Precious Stones	Precious Stones	Raw Manufacturing
11	Precious Stones	Precious Stones	Clothing and Accessories	Vegetables, Fruits and Plants	Raw Manufacturing	Raw Manufacturing	Precious Stones
12	Clothing and Accessories	Clothing and Accessories	Raw Manufacturing	Raw Manufacturing	Wood Products	Metals	Wood Products
13	Raw Manufacturing	Raw Manufacturing	Metals	Metals	Metals	Wood Products	Metals
14	Energy Drilling and Mining	Energy Drilling and Mining	Energy Drilling and Mining	Wood Products	Energy Drilling and Mining	Energy Drilling and Mining	Energy Drilling and Mining
15	Wood Products	Wood Products	Wood Products	Energy Drilling and Mining	Animals and By-products	Animals and By-products	Animals and By-products
16	Animals and By-products	Animals and By-products	Animals and By-products	Animals and By-products	Vegetables, Fruits and Plants	Food and Preparations	Food and Preparations
17	Food and Preparations	Food and Preparations	Food and Preparations	Food and Preparations	Food and Preparations	Vegetables, Fruits and Plants	Vegetables, Fruits and Plants
ECI	2.261503667	2.520234671	3.08896214	3.452901685	4.299466299	4.439916975	5.069638102

Example High-complexity Products 2018 (Incremental SDV Sensitivity)

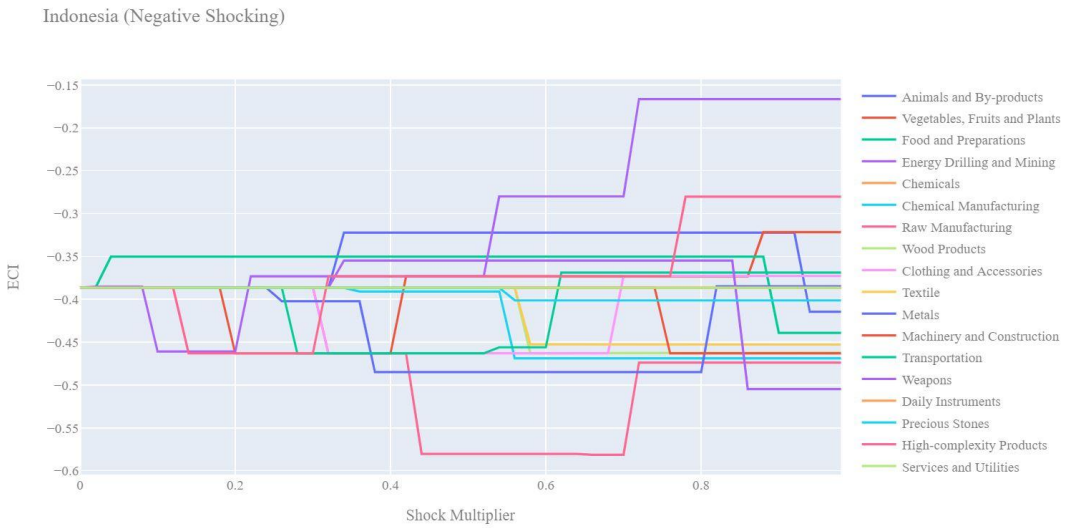
4.3 Sensitivity Analysis Results and Interpretation

Below is Indonesia's 2018 ECI Sensitivity Charts. Firstly in the positive chart, we notice that an increase in exports of High Complexity Products and Transportation lead to significant increases in ECI however export levels must be expanded by over 125%. The majority of the remaining industries have little effect on theECI gains.

Next we consider Indonesia's 2018 Negative Shock chart. We can see that Indonesia is fairly sensitive to the majority of the industries though the absolute range of the ECI on either side is not drastic. Indonesia is most sensitive to Raw manufacturing however export drops of over 40% are needed to experience the decrease in ECI.



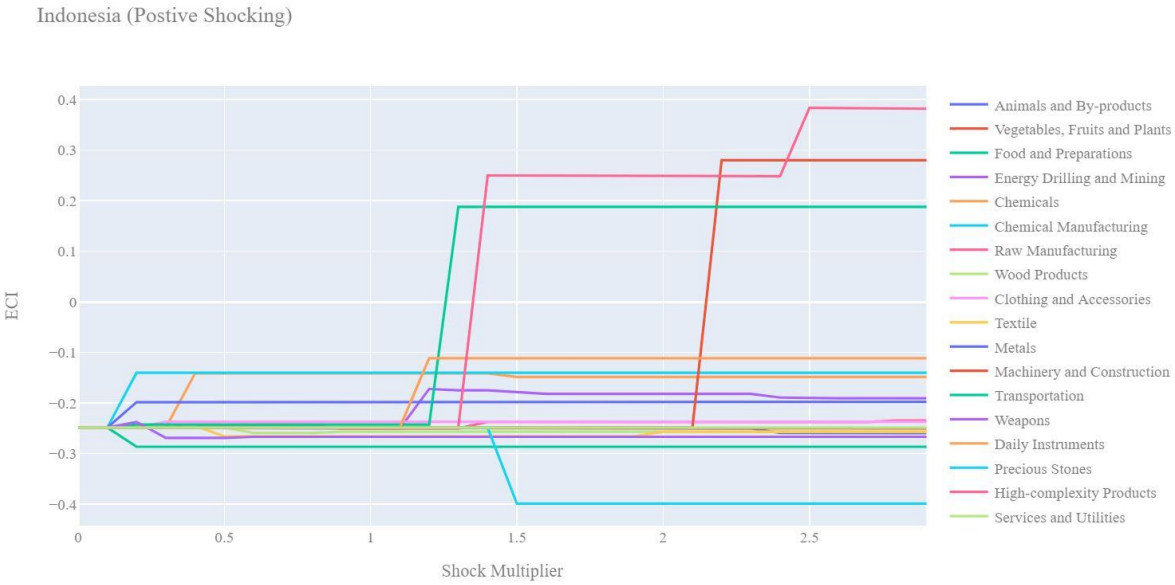
Indonesia 2018 (Incremental ECI Sensitivity)



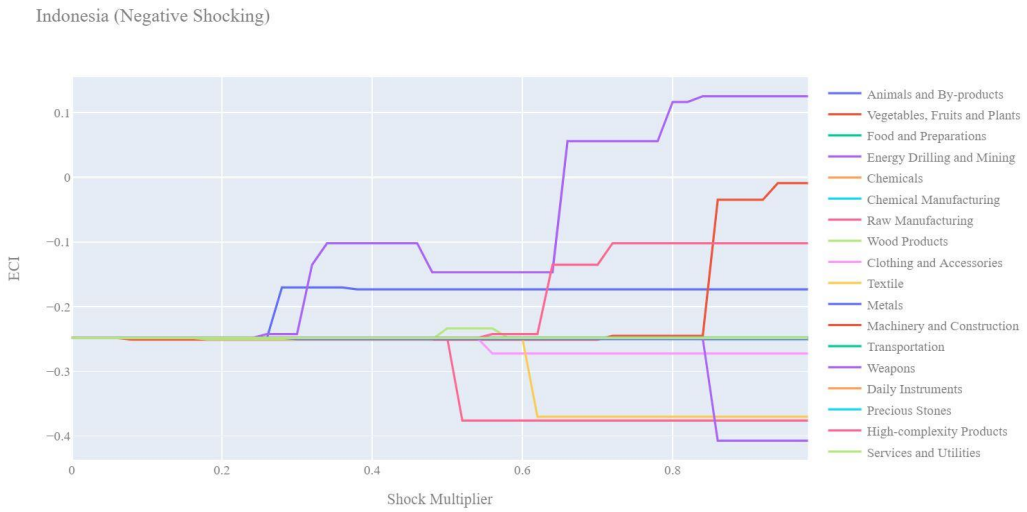
Indonesia 2018 (Decremental ECI Sensitivity)

Next we consider the 2013 ECI Sensitivity graphs. We see that in the positive shocking case the 2013 profile is fairly similar to the 2018 sensitivity profile. increase in exports of High Complexity Products and Transportation lead to significant increases in ECI however export levels must be expanded by over 125%.

In the 2013 negative shocking case, we see that again Indonesia is marginally less sensitive to downturns than in the 2018 sensitivity profile. This suggests that Indonesia has become more sensitive to export downturns in the recent past as their economy begins to rely more heavily on a wider spectrum of industries to bolster their ECI score. We also see that decreases in export of Animals and By-Products as well as Energy and Drilling actually increase ECI significantly.



Indonesia 2013 (Incremental ECI Sensitivity)



Indonesia 2013 (Decremental ECI Sensitivity)

Below we see the SDV sensitivity charts for High Complexity Products. We see that in both the positive shocking and negative shocking cases Indonesia's SDV is fairly insensitive to changes in High Complexity Product export levels. We see some shifting around of industries from positive to neutral however no major changes or trends are apparent.

	-0.0%	-14.0%	-32.0%	-78.0%
0	High-complexity Products	High-complexity Products	High-complexity Products	Machinery and Construction
1	Machinery and Construction	Machinery and Construction	Machinery and Construction	High-complexity Products
2	Transportation	Transportation	Transportation	Transportation
3	Services and Utilities	Services and Utilities	Services and Utilities	Services and Utilities
4	Daily Instruments	Daily Instruments	Wood Products	Raw Manufacturing
5	Chemicals	Chemicals	Vegetables, Fruits and Plants	Vegetables, Fruits and Plants
6	Raw Manufacturing	Raw Manufacturing	Food and Preparations	Food and Preparations
7	Vegetables, Fruits and Plants	Vegetables, Fruits and Plants	Energy Drilling and Mining	Energy Drilling and Mining
8	Food and Preparations	Food and Preparations	Chemicals	Chemicals
9	Energy Drilling and Mining	Energy Drilling and Mining	Raw Manufacturing	Chemical Manufacturing
10	Clothing and Accessories	Clothing and Accessories	Clothing and Accessories	Clothing and Accessories
11	Wood Products	Wood Products	Textile	Wood Products
12	Textile	Textile	Metals	Textile
13	Metals	Metals	Weapons	Metals
14	Weapons	Weapons	Precious Stones	Weapons
15	Animals and By-products	Precious Stones	Animals and By-products	Precious Stones
16	Chemical Manufacturing	Animals and By-products	Daily Instruments	Animals and By-products
17	Precious Stones	Chemical Manufacturing	Chemical Manufacturing	Daily Instruments
ECI	-0.386538813	-0.463048185	-0.3732747	-0.280306864

Indonesia High-complexity Products 2018 (Decremental SDV Sensitivity)

	0.0%	20.0%	150.0%	200.0%
0	High-complexity Products	High-complexity Products	Services and Utilities	Services and Utilities
1	Machinery and Construction	Machinery and Construction	Machinery and Construction	Machinery and Construction
2	Transportation	Transportation	Daily Instruments	Daily Instruments
3	Services and Utilities	Services and Utilities	Chemicals	Chemicals
4	Daily Instruments	Daily Instruments	Transportation	Chemical Manufacturing
5	Chemicals	Chemicals	Wood Products	Transportation
6	Raw Manufacturing	Chemical Manufacturing	Vegetables, Fruits and Plants	Precious Stones
7	Vegetables, Fruits and Plants	Raw Manufacturing	Energy Drilling and Mining	Raw Manufacturing
8	Food and Preparations	Vegetables, Fruits and Plants	Raw Manufacturing	Vegetables, Fruits and Plants
9	Energy Drilling and Mining	Energy Drilling and Mining	Clothing and Accessories	Energy Drilling and Mining
10	Clothing and Accessories	Clothing and Accessories	High-complexity Products	Clothing and Accessories
11	Wood Products	Wood Products	Textile	Wood Products
12	Textile	Textile	Metals	High-complexity Products
13	Metals	Metals	Weapons	Textile
14	Weapons	Weapons	Animals and By-products	Weapons
15	Animals and By-products	Animals and By-products	Chemical Manufacturing	Animals and By-products
16	Chemical Manufacturing	Precious Stones	Precious Stones	Metals
17	Precious Stones	Food and Preparations	Food and Preparations	Food and Preparations
ECI	-0.386538813	-0.348736289	0.177785826	0.226716023

Indonesia High-complexity Products 2018 (Incremental SDV Sensitivity)

Below we see the SDV sensitivity charts for Food and Preparations. As expected for a developed country, Indonesia is not very sensitive in both the positive shocking and negative shocking case to Food and Preparations. The country's SDV is largely unaffected by this particular industry.

	-0.0%	-4.0%	-90.0%
0	High-complexity Products	High-complexity Products	High-complexity Products
1	Machinery and Construction	Machinery and Construction	Machinery and Construction
2	Transportation	Transportation	Transportation
3	Services and Utilities	Services and Utilities	Services and Utilities
4	Daily Instruments	Daily Instruments	Daily Instruments
5	Chemicals	Chemicals	Chemicals
6	Raw Manufacturing	Chemical Manufacturing	Chemical Manufacturing
7	Vegetables, Fruits and Plants	Raw Manufacturing	Raw Manufacturing
8	Food and Preparations	Vegetables, Fruits and Plants	Vegetables, Fruits and Plants
9	Energy Drilling and Mining	Energy Drilling and Mining	Energy Drilling and Mining
10	Clothing and Accessories	Clothing and Accessories	Clothing and Accessories
11	Wood Products	Wood Products	Wood Products
12	Textile	Textile	Textile
13	Metals	Metals	Metals
14	Weapons	Weapons	Weapons
15	Animals and By-products	Animals and By-products	Precious Stones
16	Chemical Manufacturing	Precious Stones	Animals and By-products
17	Precious Stones	Food and Preparations	Food and Preparations
ECI	-0.386538813	-0.350317566	-0.439241984

Indonesia Food and Preparations 2018 (Decremental SDV Sensitivity)

	0.0%
0	High-complexity Products
1	Machinery and Construction
2	Transportation
3	Services and Utilities
4	Daily Instruments
5	Chemicals
6	Raw Manufacturing
7	Vegetables, Fruits and Plants
8	Food and Preparations
9	Energy Drilling and Mining
10	Clothing and Accessories
11	Wood Products
12	Textile
13	Metals
14	Weapons
15	Animals and By-products
16	Chemical Manufacturing
17	Precious Stones
ECI	-0.386538813

Indonesia Food and Preparations 2018 (Incremental SDV Sensitivity)

5. Macro-level Predictions

5.1 Structural Optimality Index

Indeed, such choice of prioritization has proven to be a significant factor in deciding the economic outcomes of countries. In order to quantitatively evaluate how effective our development strategies are and how deviations from the suggested developmental path will lead to suboptimal growth results, we define the measure – Structural Optimality Index (SOI) – on a country level as the Adjusted R-Square obtained from regressing the country's realized industry development over the suggested development strategy. Both strategies are quantified in nature, with the realized development represented by export increase in every major industry group and the suggested development strategy represented by the opportunity gains of developing the corresponding industry groups as calculated in previous sections. The adjusted R-square from the regression thus provides us with a quantified measure of how the development path adopted by the country has fitted with/differed from calculations on a complexity level.

After obtaining this measure for all countries in our database, we further regress countries' five-year economic growth, which is defined as the percent increase in GDP (USD), over their SOI. Figure 6 illustrates the regression output, which shows a strong positive correlation between countries' SOI and their five-year GDP growth, significant at the 1% level and achieving an adjusted R^2 of 4.5%. In other words, the more a country develops as suggested by calculations on a complexity level, the better economic outcomes it achieves.

Table 18: OLS Regression Results	
Dep. Variable: GDP	**F-Statistic:** 5.963

R^2: 0.054	**Prob (F-Stat):** 0.0163
Adj R^2: 0.045	**No. Observations:** 106

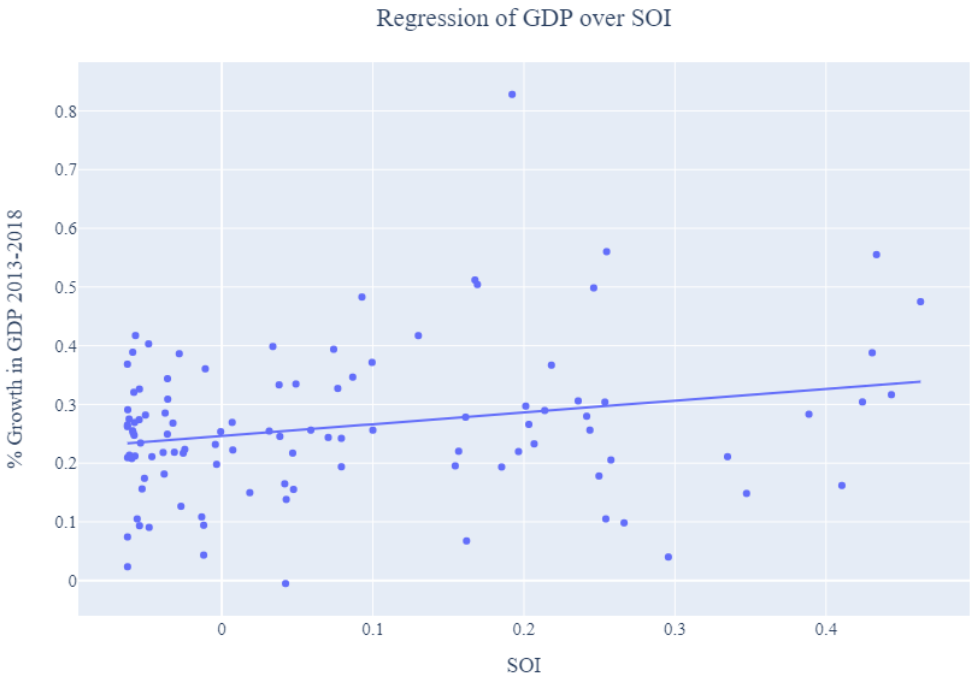


Figure 2: Regression of Five-year GDP Growth over SOI

5.2 SOI of Indonesia and Its Implications

Indonesia, for instance, has a low level of structural optimality. As the regression in Figure 7 suggests (the orange curve represents export increase and the blue curve stands for opportunity gain of the corresponding industry), Indonesia demonstrates a low level of correlation with the suggested developmental path, having an adjusted R-square of around -5.8%. Malaysia ranks 100th place among all countries in terms of SOI and has an 5-year growth rate of 38.0% from 2013 to 2018, which is somewhat inconsistent with the regression result in Figure 6. Indonesia has grown much faster than the SOI model expected. Still, Indonesia's amazing economic progress from 2013 to 2018 can be at least partially explained by an above average optimal development strategy that demonstrates a considerable level of matches with our suggested developmental path.

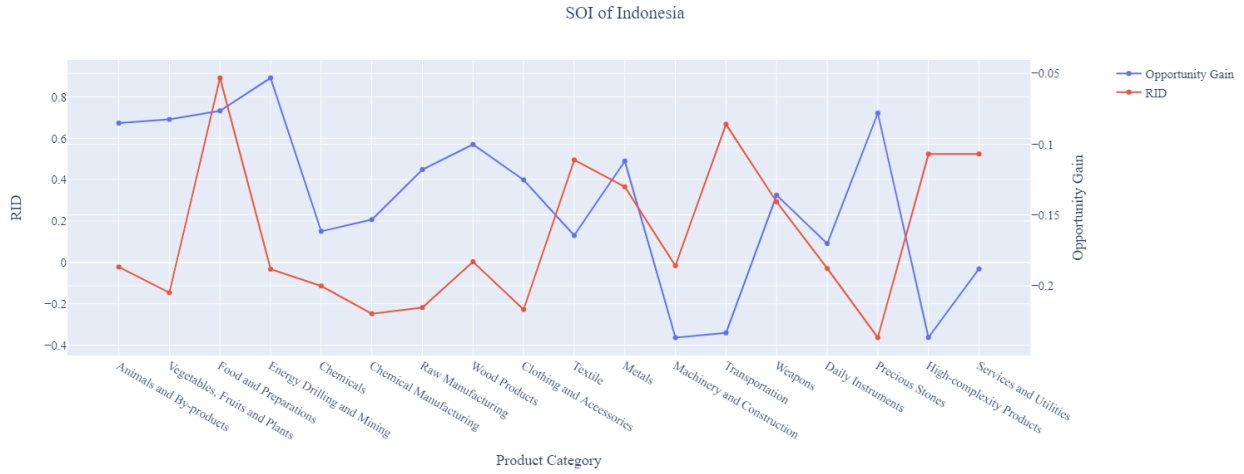


Figure 7: SOI of Indonesia (2013-2018)

6. Concluding Remarks

In conclusion, Indonesia has demonstrated a low level of economic growth in terms of GDP during the period from 2013 to 2018, concurrent with a stagnation in economic complexity as compared with other major Asian economies.

The level of economic progress during the period, we believe, can be partially explained through analysis of the economic and product complexity structure of Indonesia on the industry group level. The product classification system we adopt allows us to measure the realized industry development for various industry groups and to observe that Indonesia invested heavily in developing Precious Stones, Chemical Manufacturing, and Clothing and Accessories during the period, while its emerging peers and developed economies around the globe have adopted much more complex and progressive paths.

Based on our analysis of the opportunity gain and a sensitivity analysis of major industry groups, Indonesia can further its gains by prioritizing Services and Utilities. We further note that Indonesia has a slightly mismatched development strategy that indicates a low level of structural optimality on the complexity level, having an adjusted R-square of around -5.8%. Since a significant positive correlation exists between five-year GDP growth and the structural optimality index of an economy as we define and calculate, Indonesia indeed has a suboptimal growth experience as compared with fast-growing economies both on a regional scale and on a global scale, and has the potential to further its economic gains through industrial structure optimization as suggested in the paper.

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