

IDENTIFICATION OF LEADING ECONOMIC SECTORS AND DEVELOPMENT CHALLENGES IN INDONESIA

Loso Judijanto

IPOSS Jakarta

losojudijantobumn@gmail.com

Abstract

This study aims to identify the main economic sectors and development challenges facing Indonesia in 2025 using a literature review method. The results of the study indicate that Indonesia's economic structure is dominated by the service, manufacturing, and agriculture sectors, with the service sector being the largest contributor to the Gross Domestic Product (GDP). However, Indonesia still faces various major challenges, including dependence on primary commodities, regional and income disparities, uneven infrastructure and human resource quality, and limitations in innovation and technology mastery. Additionally, external factors such as global demand fluctuations and climate change challenges further complicate the development process. This study emphasises the importance of strategic reforms and cross-sectoral collaboration to create inclusive, resilient, and sustainable economic growth in the future.

Keywords: key economic sectors, development challenges, Indonesia, literature review, services, manufacturing, inequality, innovation, sustainable development.

Introduction

Indonesia is a country with a huge economic potential and complex challenges. Its vast territory and diversity of natural and human resources make Indonesia one of the largest economies in Southeast Asia. However, Indonesia's economic development has not always been smooth and has often experienced fluctuations due to global dynamics and domestic factors.

Factors such as monetary policy, infrastructure, and the quality of human resources are the main determinants of economic development in this country (Aslan, 2019). Indonesia's economic growth in recent years has shown quite diverse trends. For example, in the years before the pandemic, economic growth was relatively stable at around 5 per cent per year.

However, in 2020, economic growth contracted due to the impact of the COVID-19 pandemic, which affected almost all economic sectors. Economic recovery began to emerge in 2021 and 2022, supported by improved domestic consumption and increased exports, particularly in certain service and industrial sectors (Setyawan, 2022).

The main economic sectors in Indonesia consist of agriculture, manufacturing, services, and mining. Each of these sectors plays a strategic role in supporting the national Gross Domestic Product (GDP) as well as employment. Agriculture, despite its declining share in GDP, remains the backbone of the rural population.

On the other hand, the manufacturing industry contributes significantly to exports and overall economic growth. The service sector is also growing in line with increased consumption and digital technology penetration (Feridun, 2021). Geographical factors and government policies also determine the development and dominance of these sectors. For example, the abundance of natural resources in certain regions supports the growth of the mining and plantation sectors.

Meanwhile, investment policies and infrastructure improvements influence the attractiveness of the industrial and service sectors. However, the transformation from an economy that relies on the primary sector to one that is more manufacturing and service-based still faces various obstacles (Tiawon, 2023).

The main challenges of Indonesia's economic development are diverse and complex. One of the most significant is the high level of regional and income inequality between urban and rural areas, as well as between provinces. This inequality causes gaps in access to education, health, and infrastructure, which in turn affect the quality of human resources and economic productivity (Wijayanti, 2023). In addition to inequality, inadequate infrastructure also hinders equitable economic growth. Access to roads, electricity, clean water, and transportation facilities that are not optimally distributed slows down economic development in several regions, particularly remote areas and small islands. Efforts to improve the quality and coverage of infrastructure are a priority in various national development plans (Fauzan, 2024).

Human resources are also an important concern in economic development. Uneven quality of education and training has resulted in a workforce that is unprepared to face the increasingly dynamic and technology-based demands of the modern economy. This has slowed down the process of economic transformation from the primary to the secondary and tertiary sectors (Santoso, 2023).

Environmental issues are also an equally important challenge. Rapid economic development without sustainable management of natural resources and the environment risks causing ecological damage and a decline in quality of life. Therefore, green development and sustainable economy have become important agendas in development policies. Dependence on certain export commodities, such as oil, gas, and mining products, also makes Indonesia's economy vulnerable to global price fluctuations (Kurniawan, 2021). Economic diversification and increasing the value added of domestic products are important strategies for strengthening national economic resilience. In addition to these issues, macroeconomic policies, such as monetary and fiscal policies, also play an important role in determining the direction of economic growth. Exchange rate stability, interest rates, and inflation must be managed well to create a conducive investment climate and support increased production (Sinaga, 2023).

Enhancing the capacity of financial institutions, such as banks, is also an important part of providing capital to productive sectors. Easier and cheaper access to

capital will encourage investment and productivity, which in turn will accelerate economic growth (Kim, 2023).

Efforts to increase non-oil and gas exports and develop a strong domestic market are key to supporting sustainable economic growth. The government and business actors need to work together to create products and services that are competitive in the global market and meet domestic needs (Aswicahyono, 2021).

The role of technology and innovation cannot be ignored in the context of Indonesia's economic development. The utilisation of digital technology and the development of knowledge-based industries can drive production efficiency, increase competitiveness, and create new quality jobs.

Overall, Indonesia's economic development faces significant opportunities as well as challenges that must be addressed in a comprehensive manner. Through collaboration between government policies, the private sector, and society, Indonesia can achieve inclusive, sustainable, and equitable economic growth, ultimately improving the well-being of all its citizens.

Research Method

This study uses a literature review method by collecting, analysing, and synthesising data from credible secondary sources such as books, journal articles, official government reports, and relevant statistical publications. Through this method, the study aims to identify the main economic sectors in Indonesia and analyse the main challenges in development by comparing previous research findings and existing theoretical frameworks (Elijah & Aslan, 2025). This qualitative approach enables a comprehensive understanding of economic trends, sectoral contributions, and ongoing development constraints, while ensuring that the discussion is based on the latest and most reliable scientific evidence (Gough et al., 2020).

Results and Discussion

Identification of Major Economic Sectors in Indonesia

The economic landscape of Indonesia in 2025 will be shaped by a combination of tradition and modernisation, encompassing the agriculture, industry, and rapidly growing service sectors. Identifying key economic sectors provides important insights into the country's development priorities, opportunities, and challenges (Sari, 2021).

The services sector in Indonesia is the largest contributor to the national economy, accounting for approximately 44.8% of Gross Domestic Product (GDP) in 2023. The service sector encompasses finance, telecommunications, transportation, logistics, tourism, healthcare, and education—which have received significant boosts from digitalisation, population growth, and increasing domestic demand (Nugraha, 2022). Rapid growth is particularly evident in the tourism, logistics, accommodation, and food services sectors, which have been accelerated by digital platforms.

The manufacturing and industrial sectors rank second, contributing approximately 40–42% to Indonesia's Gross Domestic Product (GDP). Key industries include textiles, food and beverages, automotive, electronics, chemicals, mining, smelting, and construction materials. Manufacturing alone accounts for around 18.7–20% of GDP in recent years and is an important driver of GDP growth and exports. Investment, particularly foreign direct investment, continues to flow into industrial and mineral processing areas such as nickel and copper smelting, in line with the policy of downstreaming natural resources (Nugroho, 2022).

The agricultural sector, which has historically been the backbone of Indonesia's economy, still contributes around 13% of GDP and plays a very important social role. This sector supports food security, rural livelihoods, and absorbs the majority of the workforce, particularly in remote and less industrialised areas. Major commodities include rice, palm oil, rubber, cocoa, coffee, and fisheries. Recent reforms, such as fertilizer deregulation, have successfully increased rice production to record highs (Patricia, 2021).

Natural resources and the extractive sector—particularly mining and energy—also play a major role. Indonesia is one of the world's leading producers of coal, palm oil, nickel, bauxite, and copper. These sectors shape the export profile and attract strong investment. Mining and smelting together accounted for about a quarter of total foreign direct investment in the first quarter of 2025, reflecting global demand and government policies to develop domestic processing industries (Nugraha, 2022).

Trade, both wholesale and retail, is also a significant contributor (around 13% of GDP), closely linked to the manufacturing, agriculture, and services sectors. Indonesia's large and relatively young population supports strong domestic demand, with rapid growth in retail trade, particularly through digital channels (Riyanto, 2024).

The construction and infrastructure sectors have a smaller but rapidly growing share of the economy. Large-scale government investments in roads, ports, urban transport, and connectivity (including the construction of a new capital city) aim to unlock regional potential, support equitable development, and attract further investment (Indonesian Cabinet Secretariat, 2024).

In terms of labour absorption, the services and agriculture sectors remain the largest employers in Indonesia, followed by manufacturing and trade. Manufacturing directly employs between 14 and 21% of the workforce. This pattern of labour absorption continues to change with a shift from agriculture to manufacturing and services, reflecting the process of economic modernisation, urbanisation, and digital transformation (Purnamasari, 2023).

The digital economy has experienced significant growth, supported by the e-commerce, fintech, and online services sectors. The value of the internet economy is estimated to exceed US\$130 billion by 2025, making this sector a symbol of Indonesia's adaptation to technological developments and its global ambitions. Regional

concentration remains evident. Java dominates industrial and service activities, serving as the main manufacturing and business hub, while resource-rich regions outside Java (such as Kalimantan, Sulawesi, and Papua) are mining centres. Despite decentralisation efforts, development and investment gaps between provinces persist (Parker, 2024).

Indonesia's export profile remains heavily reliant on commodities: mineral fuels and refined petroleum products account for around 21% of export value, with palm oil, rubber, and fisheries products also being major commodities. However, the government is aggressively promoting industrial downstreaming and product diversification to reduce vulnerability to global commodity price fluctuations (Ramayandi, 2021).

The economic growth outlook remains generally positive. In the first quarter of 2025, Indonesia's GDP growth reached 4.87% year-on-year, with manufacturing, agriculture, trade, and services as the main pillars, despite challenges from global uncertainty.

Economic resilience is supported by low inflation, stable macroeconomic policies, and a strengthening exchange rate (Shukor, 2022). The latest government policies include deregulation to facilitate farmers' access to fertilisers, incentives for industrial downstreaming, and major investments in logistics and connectivity.

These efforts aim to improve competitiveness, boost exports, and create quality jobs.

However, dependence on primary commodities, regional development gaps, uneven productivity, and skills mismatches remain major challenges. Future success will depend heavily on Indonesia's ability to optimise industrialisation, service development, digitalisation, and sustainable reforms.

Thus, Indonesia's economic structure in 2025 will be a blend of tradition and innovation, consisting of three main pillars: a dynamic service sector, a resilient manufacturing industry, and agriculture that is important for social stability. The natural resource and trade sectors remain dominant, while the digital economy and construction sector demonstrate the country's forward momentum. Sustainable growth and progress depend on the success of the transition to higher value-added activities, reducing inequality, and improving the quality of human resources to address the challenges of the 21st century.

Key Challenges for Economic Development in Indonesia

Entering 2025, Indonesia's economic development faces various major structural, social, and external challenges. The slowdown in global economic growth due to international trade tensions and geopolitical conflicts has added pressure on the national economy. This situation resulted in Indonesia's economic growth in the first quarter of 2025 reaching only 4.87%, the lowest since the third quarter of 2021, and far from the government's target (Hakim, 2023).

The 12% decline in global commodity prices has had a significant impact on state revenues, which are still heavily dependent on exports of coal, palm oil, and raw minerals. This dependence creates vulnerability to international price fluctuations, meaning that any global shocks are immediately felt domestically (Rahmawati, 2021).

Another challenge is the imbalance between economic growth and people's purchasing power. The increase in Value-Added Tax (VAT) to 12% and the surge in prices of basic necessities have put pressure on household consumption, even though domestic consumption contributes more than 50% to Indonesia's GDP. Weak purchasing power has further weakened the main drivers of national economic growth. Income inequality and development disparities between regions remain fundamental problems. Java dominates the industrial and service sectors, while areas outside Java still depend on agriculture and mining. This hinders inclusive and sustainable growth (AMRO, 2020).

At the micro level, MSMEs, which are the backbone of the domestic economy, also face serious challenges in adopting digital technology and financial literacy. In rural areas, limited infrastructure and internet access worsen the position of MSMEs in competing in national and global markets. Rising living costs, shrinking formal employment opportunities, and the imbalance between minimum wage growth and inflation are creating social unrest among young people and vulnerable groups. The phenomenon of 'brain drain' is also occurring as skilled workers choose to pursue careers abroad, leading to a decline in domestic productivity and innovation (LPEM FEB UI, 2020).

Corruption, bureaucratic inefficiency, and inconsistent fiscal policies, such as frequently changing energy subsidies and widening budget deficits, have weakened business confidence and investor trust. Additionally, tax revenues falling far short of targets have forced the government to increase debt to cover deficits, posing a risk of burdening future generations.

The issue of human resource quality also continues to haunt the country, with unequal access to education, skills that are not in line with industry needs, and low mastery of technology and innovation. This has caused national productivity to stagnate and made it difficult to compete (Gunawan, 2022). Environmental issues and climate change are real obstacles.

The threat of land degradation, industrial pollution, and mining without proper environmental management hinders sustainable development and increases the risk of natural disasters. Rising open unemployment, mainly due to mass layoffs in certain sectors and the challenges of digitalisation that are not yet inclusive, add to the socio-economic burden on the community, especially during the post-pandemic recovery period (Prasetyo, 2021).

Stagnant investment, both foreign and domestic, is another serious challenge, influenced by high global interest rates, policy uncertainty, and global geopolitical tensions. This hinders the expansion of production capacity and the creation of added

value in the national industry. Fiscal stability and the exchange rate of the rupiah remain vulnerable due to a narrowing trade deficit, rising imports, and a decline in export surpluses. The inability to expand the domestic industrial base has made Indonesia vulnerable to changes in the trade policies of its main trading partners (Bappenas, 2020).

Infrastructure, although continuously being developed, remains uneven and inefficient. Many remote areas do not yet have access to adequate transportation, energy, clean water, and internet networks. These deficiencies hamper equitable development and hold back regional growth potential.

Other challenges include low innovation in the industrial sector and dependence on foreign technology, resulting in low national value added and limited opportunities for quality employment. Rising food inflation due to fluctuations in rice and basic commodity prices has exacerbated economic pressures on households, particularly the lower middle class (Arifin, 2020). Social assistance and price stability policies that are not well targeted often result in overlap and inefficiency. Declining real consumption and stagnant purchasing power have also contributed to the overall economic slowdown, adding to the government's challenges in implementing fiscal stimulus amid a budget deficit (Dewi, 2025).

In general, Indonesia's economic structure is still not sufficiently prepared to face the challenges of the 4th Industrial Revolution due to weak adoption of science and technology, the need to improve human resource quality, and limitations in infrastructure and regulations that are adaptive to global digital economic changes (OECD, 2020).

In conclusion, the main challenges for Indonesia's economic development in 2025 include a slowdown in growth due to global pressures, dependence on commodity exports, weak purchasing power, regional and income disparities, low human resource quality, corruption and bureaucratic inefficiency, as well as environmental threats and unpreparedness for digitalisation. Integrated and collaborative efforts between the government, private sector, and society are essential to address these challenges and achieve inclusive, sustainable, and highly competitive economic growth.

Conclusion

Indonesia's economic structure in 2025 will be shaped by a dynamic combination of tradition, dependence on natural resources, and growing innovation. The main economic sectors will consist of services, manufacturing, and agriculture, with the service sector contributing the most to gross domestic product (GDP), followed by manufacturing and agriculture.

The mining, energy, trade, and construction sectors also play important roles, with industrial digitalisation and downstreaming driving economic growth. However, Indonesia faces challenges to sustainable development. High dependence on primary

commodities, regional and income disparities, volatile global demand, and uneven infrastructure and human resource quality are major constraints.

Rapid technological developments, low innovation, and skill gaps among workers also hinder Indonesia's ability to transition to a more advanced and diversified economy. Additionally, governance issues, environmental degradation, and vulnerability to external shocks further complicate the situation.

The success of Indonesia's economic development by 2025 depends on its ability to leverage sectoral advantages while addressing these challenges simultaneously. Strategic reforms and collaboration between the government, private sector, and society are crucial to driving inclusive, resilient, and sustainable growth that benefits all regions and improves the overall standard of living for the Indonesian people.

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