

PERSPECTIVE

RESEARCHERS AT ISEAS – YUSOF ISHAK INSTITUTE ANALYSE CURRENT EVENTS

Singapore | 24 May 2019

The Indonesian Economy under Jokowi's Second Term

*Siwage Dharma Negara**

EXECUTIVE SUMMARY

- Joko 'Jokowi' Widodo is expected to push for key policy reforms and accelerate economic growth during his second presidential term.
- Indonesia's economy has performed relatively well during Jokowi's first term, despite weakening global growth and world trade. His administration has achieved some successes in improving the country's business environment and maintaining stable macroeconomic conditions. His infrastructure-focused policy is commendable, but will need to impact the rest of the economy to accelerate poverty reduction.
- Jokowi's main priority is to support local businesses and industries. Environmental issues may receive more attention but it remains to be seen if his administration can come up with a bolder and more coherent environmental policy, balancing the requirements of various energy, mining, marine, and industrial strategies.
- His second term will be marked by a continuing emphasis on infrastructure and social policy. In terms of trade and commercial policy, Jokowi's administration is expected to adopt both protectionist and liberal-reforming policies whilst containing inflation.

**Siwage Dharma Negara is Senior Fellow at ISEAS – Yusof Ishak Institute. He would like to thank Cassey Lee, Francis Hutchinson, and Hui Yew-Foong for their helpful comments on an earlier draft.*

INTRODUCTION

Indonesia's recent general election on April 17 is a historical event combining, for the first time, both the presidential and legislative elections. As predicted by many pollsters, the incumbent President Joko 'Jokowi' Widodo's has secured a second presidential term (2019-2024).¹

In the election, Jokowi's opponents argued that the presidential election was a referendum on economic issues.² During the election campaign, the opposing team consistently criticised Jokowi's economic plans and policies, especially with regard to the lack of job creation, higher prices of staple foods, and increase in foreign debt. However, the election results showed that Indonesian voters are pleased with Jokowi's overall performance.

Entering his second term, there is optimism that Jokowi will be able to improve the state of the economy, considering that he has secured stronger political support, and thus may be more confident in pushing for economic reforms. However, there is also a risk stemming from a larger coalition government, in which Jokowi will be forced to make more concessions - which may end up in delaying or even diluting his reform plans.

This short essay analyses the state of Indonesia's economy and its prospects after the 2019 election. The next section discusses Indonesia's economic performance during Jokowi's first term. The subsequent section attempts to conjecture what economic trends will prevail during the Jokowi's second term. The final section concludes.

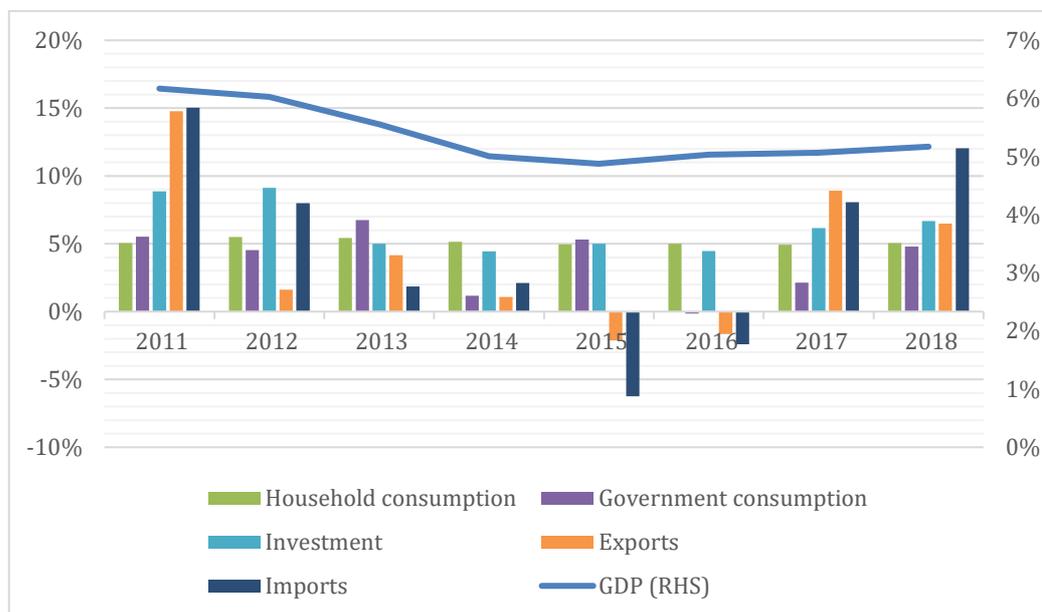
ECONOMIC PERFORMANCE

During Jokowi's first term (2014-2019), the growth of the Indonesian economy was relatively strong amidst weakening global growth and world trade. Jokowi had the misfortune to be elected just as the decade-long super commodity boom was fading.³ However, his administration managed to bring a steady 5% annual economic expansion between 2014 and 2018 (Figure 1), boosting the country's GDP to \$1 trillion in 2017. Even though the realized growth rate was lower than the 7% that Jokowi promised at the outset of his administration in late 2014, this did not penalize him from being re-elected. In fact, the 5% economic expansion was perceived by many as an achievement in itself given slowing global growth.⁴

As Figure 1 shows, economic growth has been driven by household consumption, which grew at 5% per year. This also indicates that to boost growth, Indonesia needs to increase investment and export performance.

Jokowi's administration has been successful in improving the country's business environment by reducing bureaucratic red tape. Consequently, Indonesia's ranking in the World Bank's Ease of Doing Business has dramatically improved from 120th in 2014 to 73rd in 2018. Moreover, due to prudent fiscal and monetary policies, Indonesia received a favourable investment grade status in 2018 from all three major rating agencies (Fitch, Moody's, and S&P) for first time since the 1997-98 Asian financial crisis.

Figure1: GDP Growth by Expenditure Items, 2011-2018



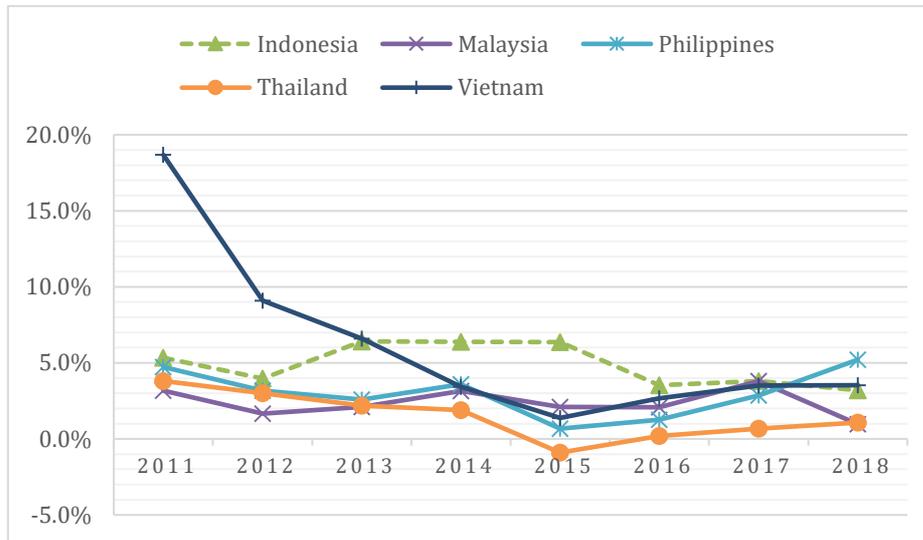
Source: BPS via CEIC

During Jokowi first term, the country’s inflation rate converged towards that of its neighbouring countries (Figure 2). Interestingly, despite a declining inflation trend, the price of staples was a contentious issue during the election. The opposition used the issue of price affordability to challenge Jokowi’s trade and agriculture policies. Indonesia’s import restrictions on key food commodities, such as rice, beef, wheat, sugar, salt, and soybeans, often pushed up domestic prices.⁵ Moreover, the high cost of logistics in this archipelagic nation also complicated government’s effort to bring down inflation.

Jokowi’s administration has implemented broad-based social protection programs. In healthcare, for instance, his administration introduced the Indonesian health card (*Kartu Indonesia Sehat* or KIS) and the Indonesian Health Insurance Scheme (*Badan Penyelenggara Jaminan Sosial* or BPJS), aiming for universal health care. In education, the Jokowi administration launched the Smart Indonesia Card (*Kartu Indonesia Pintar* or KIP), to improve enrolment and attainment rates of the obligatory 12-year school program. In addition, the government also rolled out a conditional cash transfer program for the poor (*Program Keluarga Harapan* or PKH), which aims to support targeted poor households in maintaining their consumption in the short run, while attempting to promote better health, education, and nutrition outcomes in the long run. His administration also expanded credit for micro and small businesses, housing for the urban poor, and land redistribution to landless farmers.

Nevertheless, on the whole the impact of those social security programs on poverty and inequality remains unclear. In fact, the percentage of the population below the poverty line has been declining very slowly in recent years (see Figure 3). According to official BPS estimates, based on the national poverty line in 2018, there were around 26 million poor people, equivalent to 9.8% of the population. Meanwhile, inequality measured by the Gini ratio remains relatively high, at 0.39. Jokowi had made campaign promises for a targeted poverty rate of 7-8% and a Gini ratio of 0.36 by the end of 2019.

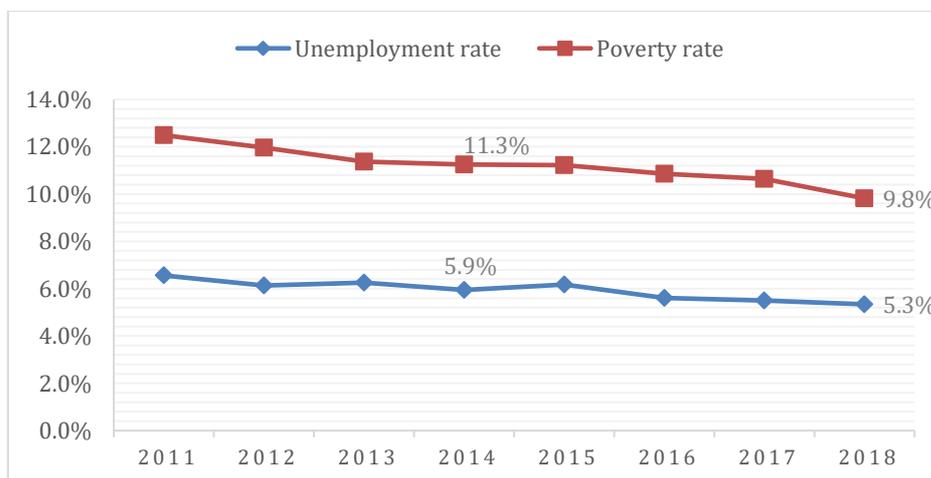
Figure 2: Inflation Rate in select ASEAN Countries, 2011-2018



Source: CEIC

Another important challenge faced by Jokowi’s administration was to the creation of enough decent jobs for around 3-4 million new workers each year, in the face of a widespread build-up of underemployment.⁶ In his first term, open unemployment declined slightly from 5.9% in 2014 to 5.3% by 2018 (Figure 3). The sluggish job creation was caused by a combination of slower growth, indifferent quality of human resources, and technological change in the manufacturing sector (becoming more capital-intensive).⁷

Figure 3: Poverty and Unemployment Rate, 2011-2018



Source: BPS via CEIC

That said, the declining unemployment rate may have disguised the real employment situation. More than half of total workers are engaged in informal employment. Moreover, unemployment among youth is as high as 17%.⁸ Indonesia’s labour force is dominated by low skilled labour. About 40% of the total labour force have only primary education, while only 9% of the labour force hold a university degree. The issue of sluggish job creation has been used by the opposition to criticize Jokowi’s economic performance.⁹

Dubbed an “infrastructure President”, Jokowi has shifted spending from fuel subsidies towards infrastructure during his first term. In 2018, infrastructure spending reached Rp388 trillion (around US\$27 billion), equivalent to 2.8% of GDP (still much lower than the 5% level prior to the 1997 Asian Financial Crisis). Despite some progress on infrastructure development, including the completion of the first phase of the Jakarta Mass Rapid Transit (MRT) project, critics argue that the effects of most of his infrastructure projects have not trickled down to the rest of the economy. Specifically, there is concern that his infrastructure projects merely benefit state owned-enterprises to the detriment of the local private sector.¹⁰ Moreover, the infrastructure being built is perceived as not pro-poor and not pro-environment enough. For instance, the majority of Jokowi’s toll road projects in Java are perceived to benefit car owners rather than the poor. Moreover, his ambitious 35,000 MW electricity programme will mainly use coal, which is detrimental to the environment and health.¹¹

In addition, his infrastructure ambition has been constrained by limited fiscal space due to weak tax revenue. As a result, there is a huge spending gap in the sector. The country has one of the lowest tax/GDP ratios in the region, at about 10.3% (compared to Philippines (14.7%); Thailand (14%); Malaysia (13%)). This is in spite of a succession of tax initiatives over the years, including the 2016-17 tax amnesty program, which at best resulted in a one-off boost to revenues.

With little progress on the tax effort, his administration has embarked on more aggressive international borrowing, including inviting China’s Belt and Road Initiative (BRI) financing for infrastructure development. As a result, Indonesia’s public debt as percentage of GDP has risen during Jokowi’s first term. It should be noted that the increase has been caused by both an increase in the amount of debt and the weakening rupiah simultaneously. One may argue that Indonesia’s public debt (around 30% of GDP) is comparatively low by international standards. However, the increase in debt has provided effective ammunition for his political opponents to criticize his ambitious infrastructure policy.¹²

ECONOMIC PROSPECTS

How will the Indonesian economy fare in Jokowi’s second presidential term? There have been expectations that Jokowi might be able to improve the state of the economy in the next five years. This is because he is now supported by a larger coalition which will allow him to push for his reform plans, including the bureaucracy and state institutions. However, there is also a concern that he may end up as a lame-duck president who will seek stability and consensus at the costs of genuine reforms. So how will Indonesia’s economic performance unfold over the next five years?

Jokowi’s second term is likely to be marked by more continuities in his main economic policies rather than radical changes. Perhaps the clearest policy continuity will be in macroeconomic policies. Jokowi’s administration is expected to continue maintaining macroeconomic stability given the increase in global economic uncertainties. For this, he will likely to appoint some experienced technocrats to the key positions of Minister of Finance, Minister of Planning, Coordinating Minister of Economic Affairs, and Governor of Bank Indonesia. His administration will maintain an expansionary fiscal policy to counter slowing global growth and world trade. Gradual reform in tax policy will be continued, but

the country's persistent weak tax effort is likely to persist. This will in turn drag down the overall fiscal balance. On state spending, the expenditure priorities will remain relatively unchanged, namely on infrastructure, education, health and various social safety-net programs. Other than that, his administration will continue to use monetary and exchange rate policies to cope with volatility of the rupiah and inflation.

Jokowi's administration will need to find ways to address the issue of an increasing current account deficit. Looking at the country's balance of payment (Table 1), Indonesia's current account deficit has increased significantly in 2018 (around 3% of GDP). This is partly due to trade deficits in both goods and services. However, the biggest contributor to Indonesia's current account deficit is primary income outflows, which has increased from \$29.7 billion in 2014 to \$30.4 billion in 2018. This indicates that the amount of payments made by overseas investors, whose assets are held in Indonesia, exceed the returns held by domestic investors in foreign countries. Therefore, any increased in negative sentiment regarding the economy will most likely lead to a sudden capital outflow.

Table 1: Indonesia's Balance of Payment, 2016-2018 (US\$ million)

	2016	2017	2018
Current Account: Goods	15,318.0	18,814.0	-439.0
Goods: Exports	144,469.8	168,883.0	180,725.0
Goods: Imports	-129,151.8	-150,069.0	-181,164.0
Current Account: Services	-7,083.7	-7,379.0	-7,068.0
Services: Export	23,323.5	25,328.0	28,003.0
Services: Import	-30,407.2	-32,707.0	-35,071.0
Current Account: Primary Income	-29,647.0	-32,131.0	-30,435.0
Current Account Balance	-16,952.3	-16,196.0	-31,051.0
Capital Account	40.7	46.0	97.0
Financial Account	29,305.6	28,686.0	25,219.0
Direct Investment	16,135.9	18,502.0	13,654.0
Portfolio Investment	18,995.6	21,059.0	9,311.0
Overall Balance	12,088.9	12,536.0	-5,734.0
Current Account Balance/GDP (%)	-1.8	-1.6	-3

Source: BI

To improve current account balance, his administration will be tasked to promote manufacturing-exports, thus minimizing the country's reliance on commodities export. At the same time, we will also see efforts to promote import-substituting policies to reduce Indonesia's reliance on imports of intermediate inputs. Another risk to its current account is related to the rise of international oil prices combined with the weakening rupiah. These two factors will increase the trade deficit further if Indonesia fails to control its oil imports. The government has introduced the B-20 biofuel mandatory policy in order to reduce the use of fossil fuel and increase the use of renewable energy.¹³ However, the impact of this policy will depend on effective implementation and enforcement.

In terms of trade and commercial policy, Jokowi's administration is expected to adopt a mixed approach involving protectionist and liberal-reforming policies. Indonesia will continue to be ambivalent towards regional and international trade initiatives, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) or even the ASEAN-lead Regional Comprehensive Economic Partnership (RCEP). Jokowi's administration will continue to welcome China-led Belt and Road Initiative (BRI) investments. The BRI is perceived as an opportunity to satisfy Indonesia's financing needs for its infrastructure plan. Some projects are currently under preparation and may likely be approved during his second term, including the development of the Sei Mangkei industrial estate and Kuala Namu Aerocity in North Sumatera; the construction of a hydro-power plant in Kayan river, North Kalimantan; the development of Bitung industrial estate in North Sulawesi; and the development of science and technology park in Bali.¹⁴ Indonesia requires that these investment projects fulfil the following criteria: 1) use environmentally-friendly technology; 2) train local workers and reduce the use of foreign workers; 3) promote higher value-added manufacturing exports; and 4) enable the transfer of technology. It is also cautious about the widely reported inherent risks related to Chinese investment, i.e. debt traps, foreign domination, large flows of migrant workers, and environmental degradation among others.

With the presence of Ma'ruf Amin, an influential muslim cleric and chairman of Majelis Ulama Indonesia (MUI, or Indonesian Ulema Council), Jokowi's second term will also be marked by a greater emphasis on the Islamic or sharia economy. His administration has quite ambitious plans to further promote Indonesian sukuk products (sharia bonds), Islamic banking, as well as capital and insurance products. In addition, the government plans to establish a shariah economic development body which will promote Indonesian halal products and tourism.¹⁵ One may argue that by focusing on the Islamic economy, Jokowi will continue to showcase his Islamic identity, an aspect that he has tried to emphasize during the last election.

While we may see some improvements in the overall ease of doing business in the country, there will be additional layers of bureaucratic red tape due to new regulations. For instance, the implementation of the Law No 33/2014 on halal products assurance, which will come into effect this year, requires all products that enter the Indonesian market to have halal certificates. The law is meant to give legal basis for what has been a long established (but voluntary) practice of giving Halal certification by the Indonesian Ulema Council (MUI). This law has been driven by consumer demand for greater assurance of various products by many producers of food and beverages, cosmetics and medicinal products. To support the implementation of the law, Jokowi's administration has issued a Presidential Regulation No. 83/2015 on the establishment of the Halal Certification Agency (BPJPH). Clearly, foreign exporters and investors may need to consider this additional layer of bureaucratic red tape when they enter the Indonesian market.

Finally, environmental issues will receive more attention. His administration has been praised for its progressive efforts in preserving forests and stopping forest fires. Nevertheless, there have been few significant policy developments with regard to new environmental legislations. Illegal deforestation and over-fishing remain rampant. His ambitious 35,000 MW projects are in fact dominated by coal-fired power plants, which certainly will have a massive environmental impact. It remains to be seen if his

administration can come up with a bolder and coherent environmental policy, balancing demands arising from various energy, mining, marine and industrial strategies.

CONCLUSION

Jokowi has secured a second presidential term and will have the opportunity to consolidate his legacy. His first challenge is to unite the nation after a polarizing election. His cabinet will consist of a mix of political figures and technocrats. The latter will no longer be as powerful as the New Order technocrats. His second term will be a challenging one given the increase in global uncertainties. However, we expect some continuities in his domestic-oriented policies. Specifically, his pragmatic approach to get things built and to remove bureaucratic obstacles for businesses will be continued. Also, we will also see a continuation and expansion of his populist social programs to support initiatives for the poor. Jokowi may avoid a major policy reform in bureaucracy and state institutions, in order to maintain stability in his coalition government. However, overall the economy will continue to grow steadily supported by robust domestic consumption. The economy will remain semi-open in terms of the trade and investment regime.

¹ See Hui Yew-Foong, Made Supriatma, Aninda Dewayanti and Benjamin Hu, "Preview of the 2019 Indonesian Elections", *ISEAS Perspective*, Issue 2019, No. 24, 9 April 2019.

² See Hui, Yew-Foong and Siwage Dharma Negara, "The 2019 Presidential Election as a Referendum on the Economy: An Interview with Sandiaga Uno", *ISEAS Perspective*, Issue 2019, No. 12, 12 March 2019.

³ Hal and Negara, 2019. *The Indonesian Economy in Transition: Policy Challenges in the Jokowi Era and Beyond*. ISEAS.

⁴ Asian Development Bank, *Asian Development Outlook 2019: Strengthening Disaster Resilience*.

⁵ Arianto A. Patunru, "Rising Economic Nationalism in Indonesia", *Journal of Southeast Asian Economies*, Volume 35, Number 3, December 2018, pp. 335-354.

⁶ Hill and Negara, 2019. *The Indonesian Economy in Transition: Policy Challenges in the Jokowi Era and Beyond*. ISEAS.

⁷ Haryo Aswicahyono & Hal Hill, 2015. "Is Indonesia Trapped in the Middle?," Discussion Paper Series 31, Department of International Economic Policy, University of Freiburg, Aug 2015.

⁸ <https://www.bps.go.id/dynamic/table/2018/05/17/1322/tingkat-pengangguran-terbuka-berdasarkan-kelompok-umur-2015---2018.html>.

⁹ See Hui, Yew-Foong and Siwage Dharma Negara, "The 2019 Presidential Election as a Referendum on the Economy: An Interview with Sandiaga Uno", *ISEAS Perspective*, Issue 2019, No. 12, 12 March 2019.

¹⁰ Ibid

¹¹ Jamie S. Davidson, (2018), *INDONESIA Twenty Years of Democracy*, Cambridge University Press.

¹² See Hui, Yew-Foong and Siwage Dharma Negara, "The 2019 Presidential Election as a Referendum on the Economy: An Interview with Sandiaga Uno", *ISEAS Perspective*, Issue 2019, No. 12, 12 March 2019.

¹³ A type of biofuel blend which consists of up to 20 percent Biodiesel and 80 percent petroleum diesel.

¹⁴ Information given by the Indonesian investment coordinating board (BKPM) on 9 May 2019.

¹⁵ <https://money.kompas.com/read/2019/05/14/155653426/pemerintah-luncurkan-masterplan-ekonomi-syariah-2020-2024>. Accessed on 17 May 2019.

<p><i>ISEAS Perspective</i> is published electronically by:</p> <p>ISEAS - Yusof Ishak Institute</p> <p>30 Heng Mui Keng Terrace Singapore 119614 Main Tel: (65) 6778 0955 Main Fax: (65) 6778 1735</p>	<p>ISEAS - Yusof Ishak Institute accepts no responsibility for facts presented and views expressed.</p> <p>Responsibility rests exclusively with the individual author or authors. No part of this publication may be reproduced in any form without permission.</p> <p>© Copyright is held by the author or authors of each article.</p>	<p>Editorial Chairman: Choi Shing Kwok</p> <p>Editorial Advisor: Tan Chin Tiong</p> <p>Managing Editor: Ooi Kee Beng</p> <p>Editors: Malcolm Cook, Lee Poh Onn, Benjamin Loh and Ng Kah Meng</p> <p>Comments are welcome and may be sent to the author(s).</p>
--	---	--