

# Indonesian Economic Policies in a Jokowi Administration: A Preview

By **Vikram Nehru**

On August 21, 2014, Indonesia's Constitutional Court confirmed Joko Widodo – popularly known as Jokowi – as Indonesia's next president, assuming office on October 20.

However, compared to his previous positions as mayor and governor, Jokowi's presidency will have to tackle challenges that are orders of magnitude greater in size and complexity. Only two of his campaign manifesto's nine points focus on economic issues. They suggest a continuation in the direction of economic policy, but with a renewed emphasis on reducing poverty and inequality.

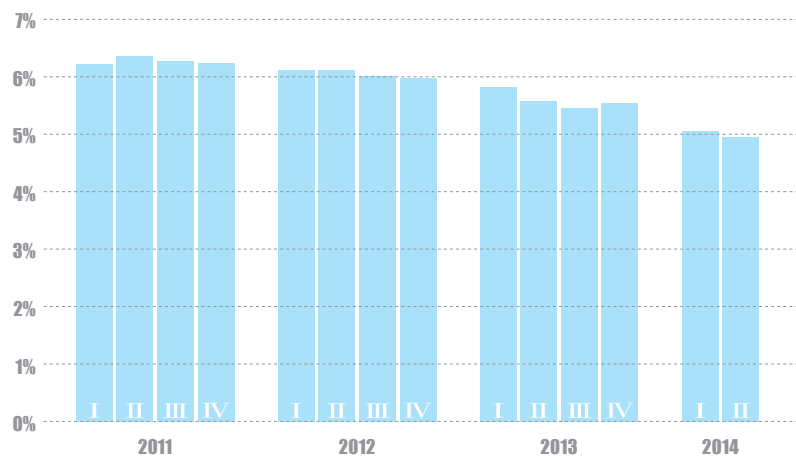
## Jokowi inherits a troubled economy

True, Indonesia's growth rate has been robust, but it has been declining steadily over the last three years (Figure 1), reflecting in large part the end of the China-driven commodities boom and Indonesia's own policy of limiting mineral ore exports. More importantly, Indonesia's external current account balance plunged into deficit for the first time in fifteen years (Figure 2) and its fiscal deficit this year will be perilously close to the 3 percent of GDP ceiling mandated by the constitution.

If Indonesia's macroeconomic challenges are of concern, its medium-term structural challenges appear even more daunting. The economy's growth potential is diminished by severe infrastructure bot-

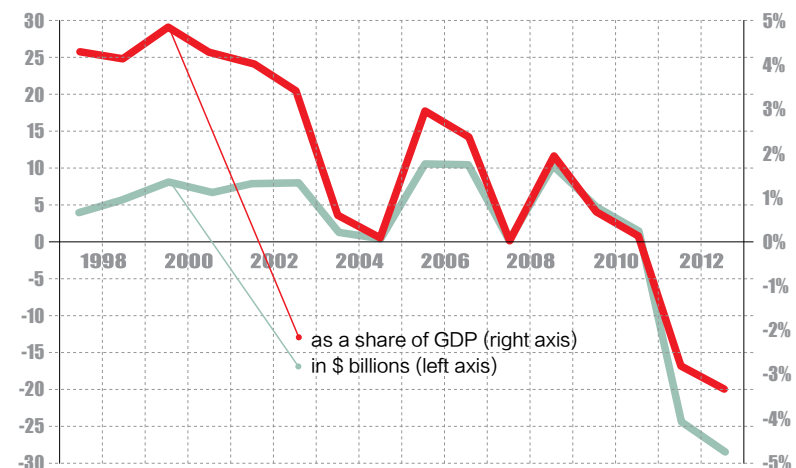
Jokowi will likely be a leader whose biggest imprint will be improvement in the quality, effectiveness, integrity and inclusiveness of government rather than in dramatic economic reforms.

**Figure 1**  
Indonesia's growth rate has declined steadily over the last three years  
(seasonally adjusted, year-on-year, quarterly growth rate in real terms)



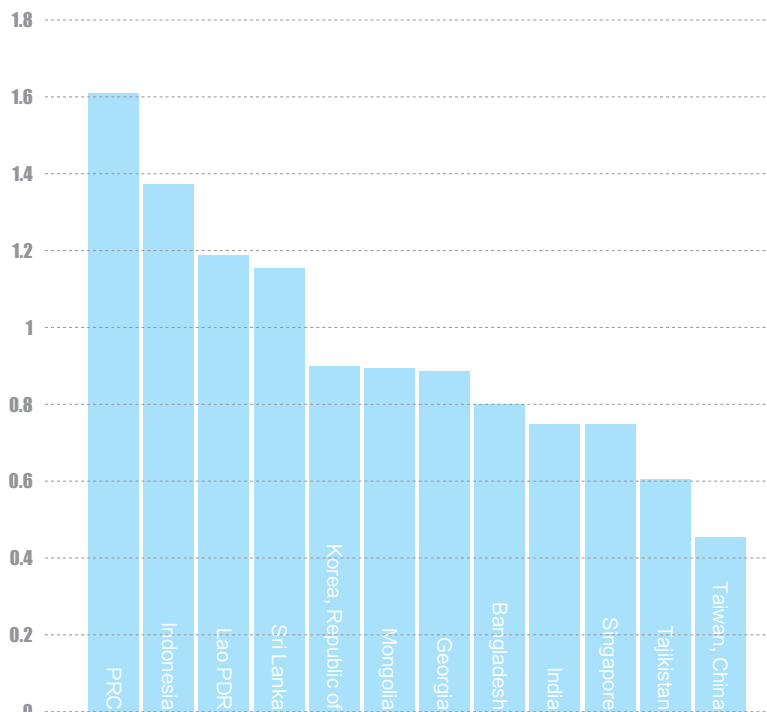
Source: BPS; author's calculations

**Figure 2**  
Indonesia's current account balance, 1998-2013



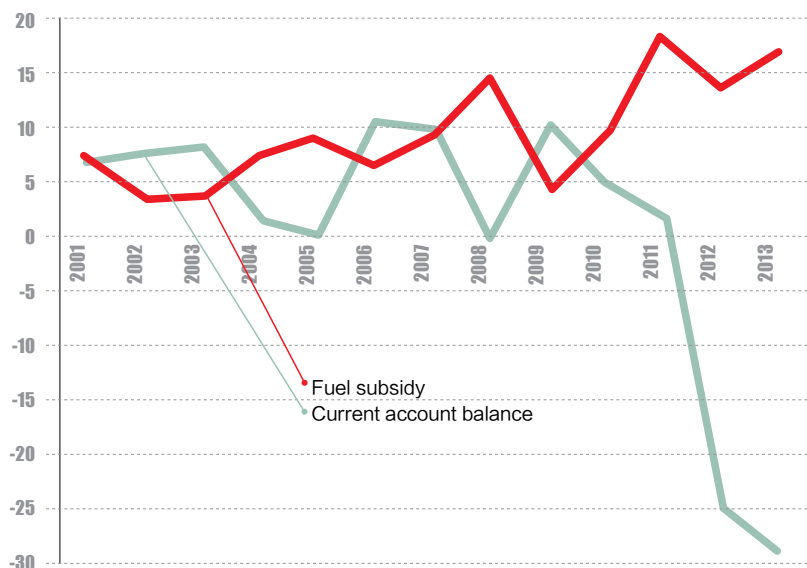
Source: IFC Doing Business Survey 2013

**Figure 3**  
**Annual growth of inequality**  
 (Average annual growth of the Gini coefficient, 1990s to 2002, percent a year)



Note: PRC=People’s Republic of China; Alo PDR=Lao People’s Democratic Republic  
 Source: Asian Development Outlook 2012, Asian Development Bank, Manila, Philippines

**Figure 4**  
**Indonesia: The fuel subsidy and the current account balance are inversely correlated**  
 (in \$ billions)



Sources: Bank of Indonesia; Bloomberg; OECD

**Table 1**  
**Indonesia’s international ranking in IFC Doing Business Survey**  
 (out of 189 assessed economies)



tlenecks, a shortage of skills across a range of occupations and an investment environment that places Indonesia near the bottom of international rankings in cross-country surveys (Table 1). At the same time, income and consumption inequality in Indonesia have been rising faster than in any other Asian country (apart from China – Figure 3).

**Jokowi’s proposed economic policies**

In the short term, perhaps the most important policy reform Jokowi has promised is to reduce Indonesia’s out-of-control energy subsidies by raising the price of fuels and electricity. Raising fuel prices, although politically unpopular, will increase fiscal space and release public funds for infrastructural development and social protection. It will not only lower the current account deficit in the external balance of payments (by reducing fuel consumption and hence fuel imports – Figure 4), but will also reduce pollution and greenhouse gas emissions. Furthermore, it will help reduce inequality, because Indonesia’s fuel subsidy benefits the rich more than it does the poor and draws resources away from social protection programs.

Jokowi says he will raise fuel prices in stages over the next three to four years. The considerable political opposition from a fractious parliament might be averted by building a supportive parliamentary coal-

tion. Jokowi would also be wise to keep the fuel subsidy per liter fixed, regardless of the ballooning of the inflation rate and the exchange rate each time, or the fluctuations of international oil price.

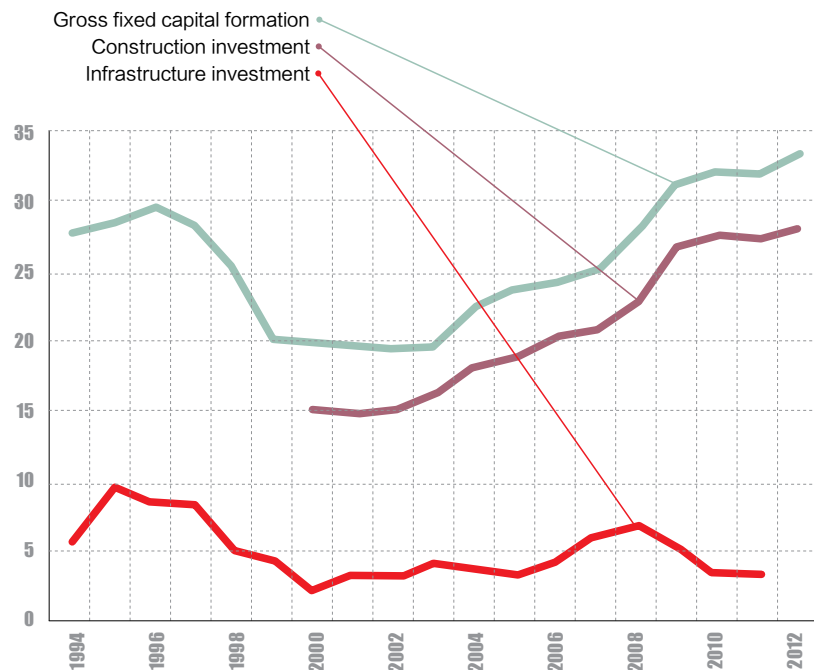
Another priority will be Indonesia's woeful infrastructure situation. While construction investment has boomed, corresponding infrastructure investment has languished (Figure 5). To ease the infrastructure bottleneck, Jokowi says he will construct 2,000 kilometers of roads, 10 airports, 10 seaports, 10 industrial estates and 5,000 traditional markets. He also intends to process investment and business licenses in 15 days (the current average is 45 days), starting with infrastructural projects. These are laudable goals but the challenge of moving Indonesia's bureaucracy to achieve them cannot be overestimated. Jokowi will need to accelerate the glacial pace of land acquisition (notwithstanding a new land acquisition law), strengthen project implementation capacity and streamline a complicated and anachronistic legal and regulatory structure that inhibits private sector participation in infrastructure projects.

Among Indonesia's medium-term challenges are its policies toward international trade and investment. Jokowi's statements suggest an intention to continue with the protectionist trend and anti-foreign bias that emerged during President Yudhoyono's tenure.

A good example is the mineral export ban introduced at the start of 2014. Jokowi agrees with the stated aim of the ban – which is to increase domestic value added by forcing mining companies to invest in downstream smelting industries – but at the same time he wishes to honor existing mining contracts. Indonesia's new mining policy not only restricts exports of ores, it also requires divestment of majority ownership within 20 years, and gives subnational governments authority to issue mining licenses, adding a new layer of uncertainty to the investment process. Maintaining the policy may benefit Indonesian conglomerates, but will hurt Indonesia in three ways. The economy will lose mineral export revenues amounting to \$5-7 billion a year and will force mineral exporters to invest in downstream smelting plants that will most likely be energy-intensive and uncompetitive internationally. It will encourage corruption, especially at the subnational level. And it will further damage Indonesia's reputation as an investment destination (Indonesia is already considered the least attractive jurisdiction for mining investment in the world according to the Fraser Institute Survey).

Jokowi's reputation as a "man of the people" will be reflected in his policies toward the poor. He will likely extend nationwide the health-card system for

**Figure 5**  
Infrastructure investment has not kept pace with construction  
(investment as share of GDP)



Source: BPS and World Bank

the poor that he introduced as the governor of Jakarta. He has also promised to create 10 million jobs over the next five years. These will need to be "good" jobs in high-productivity manufacturing or services, for which Jokowi will first need to improve the quality of education, the skills of new entrants into the labor force, and the flexibility of the labor market. His proposal to provide 12 years of free schooling will help, but pedagogical outcomes will also need to improve and labor laws need to be overhauled to encourage employment in the formal sector.

Finally, and perhaps most importantly, Jokowi has promised that his administration will focus on eliminating corruption and emphasizing good governance. He has said he will reform the bureaucracy and law enforcement, require all government institutions to prepare performance reports, increase government transparency, enhance access to public information, improve the quality of public services and require teachers to focus on building "attitude and character" in elementary schools. His proposal to expand e-governance should reduce corruption by eliminat-

ing bureaucratic discretion in key areas, but this will need to be accompanied by smarter regulations and increased accountability, such as strengthening the Anti-Corruption Commission, especially in subnational governments where corruption is rampant.

### Jokowi's transition to power

Jokowi has already put together a high-powered five-member transition team to prepare a policy road map. Jokowi's campaign focused on the "ends". The transition team, headed by Rini Suwandi, a 56-year old technocrat, will focus on the "means". To increase government efficiency, the team's proposals could include the reorganization of some ministries, the abolition of coordinating ministries and the merger of other ministries (for example, trade with industry, agriculture with fisheries, public works with transportation, and education with research and development). A separate "headhunting team" is vetting potential ministerial candidates using criteria such as professionalism, integrity, youth and reformist credentials. To complement the team's efforts, Jokowi launched an innovative online survey soliciting views from the public on which candidates they favored for key ministerial posts.

At the same time, Jokowi is in discussion with other political parties to broaden his coalition in parliament and gain support for his many policy initiatives. In doing so, he will face the trade-off between keeping his campaign promises on the one hand, and accommodating the interests of new coalition members on the other.

Like every other new political figure catapulted onto a national stage, Jokowi's biggest challenge will be to manage expectations. He should prepare himself for a brutally short honeymoon. His administration's first policy action -- increasing the fuel price -- while critically important, will inevitably become a lightning rod for political opposition in parliament and in the streets. He should be willing to spend some of his political capital in the early days of his presidency and create the policy space in subsequent months and years to pursue more popular programs such as infrastructure development and social protection.

Jokowi is likely to be a leader whose biggest imprint will be improvement in the quality, effectiveness, integrity and inclusiveness of government rather than in dramatic economic reforms. Although his administration will be broadly supportive of open trade, market-oriented policies and foreign investment, Indonesia's slide toward trade protectionism and resource nationalism will unlikely be reversed.

While growth may remain below potential, it will still be better than most other emerging market economies. More importantly, Indonesia under a Jokowi administration is likely to see a more responsive, less corrupt and more efficient government. Emphasis will be given to delivery of basic public services -- health, education and infrastructure -- especially to the poor. Most Indonesians would welcome this.

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