

# 1

## **SETTING THE SCENE**

### **The Indonesian Economy in Transition – the Jokowi Era and Beyond**

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#### **1.1 INTRODUCTION**

It is now more than twenty years since one of the most decisive and important turning points in Indonesian economic and political history. The year 1998 was one of exceptional turbulence, hardship and uncertainty. The seemingly impregnable thirty-two-year Soeharto presidency came to a sudden end on 21 May. The economy and the currency were in free-fall. An acrimonious relationship had suddenly emerged with international financial institutions. There were nasty conflict episodes, mostly with serious ethnic dimensions. Almost one million of its citizens were internally displaced. There were various “Yugoslav” scenarios of territorial disintegration. Most important of all, there was no institutional roadmap to guide the country through the vacuum that Soeharto’s hasty exit had created.

Viewing the country through the gloomy lens of that era, it is perhaps no exaggeration to state that the economic and political developments over the intervening two decades have been little short of miraculous. Crises of this depth and severity have often set countries back for extended periods, but Indonesian per capita income had recovered to pre-crisis levels by 2004. The country is now regarded as one of the most vibrant democracies in Southeast Asia and in the Muslim world. It has maintained its territorial integrity. There have been four rounds of credible national elections, while democracy has also taken root in the more than 500 subnational jurisdictions. A far-reaching programme of decentralization has been implemented. The economy has returned to at least a moderate growth rate of around 5 per cent per annum. Inflation is well under control, and the macroeconomic framework looks secure. The authorities navigated the 2008–09 global financial crisis with little difficulty. The economy is in much better shape than the resource-exporting members of the much-hyped BRICS (Brazil, Russia, India, China and South Africa) group. Indonesia is recognized as a significant regional power through its membership of the G20 and other international fora.

Yet in important respects Indonesia is still a country in transition, and one that faces major development challenges. It is still a relatively young democracy, in the process of establishing durable institutions that will be needed to underpin an upper middle-income economy. Its ambitious decentralization programme is still being bedded down into an effectively operating system of government. Tens of millions of its citizens live below or precariously above a meagre poverty line. The economy is not growing fast enough to quickly eradicate poverty and destitution. Perhaps paradoxically, inequality has risen appreciably during the democratic era. There are daunting environmental challenges. Corruption remains an ever-present and serious problem.

President Joko Widodo — widely known as Jokowi — was narrowly elected to office in 2014 with high expectations. The seventh president of the republic lacked family name, military background and wealth, itself an impressive reminder of the country's democratic progress and resilience. Jokowi campaigned successfully as an effective local government leader, with a reputation for clean and pragmatic administration. His agenda was to accelerate economic growth, overcome the country's massive infrastructure deficit, and eradicate poverty. He promised a professional Cabinet. His first major economic policy decision was a very significant one, to dramatically reduce the crippling fuel subsidies.

Almost five years later, what can be said about his record? Inevitably, as the papers in this volume document, the outcomes have been mixed. Most of Indonesia's major development issues are not amenable to quick solutions in a single-term presidency. Moreover, Jokowi had the misfortune to be elected just as the decade-long super commodity boom was fading. For growth to be maintained and the social policy agenda implemented substantial reform was required. In the event, Jokowi has been a decisive president in some respects, but he has not been the major reformer that some of his supporters had hoped for. He has lived up to his commitment to prioritize infrastructure, and continue with the popular social policies, including health ("*kartu sehat*"), education ("*kartu pintar*") and village grants. His personal integrity has been beyond reproach. He has maintained the stable macroeconomic policy settings of his predecessors.

Yet in other respects his policy narratives and achievements have struggled to make the transition from local to national government, in part reflecting the "rainbow coalition" of competing interests and diverse views that constitute his Cabinet. He has wavered on international economic policy, between pragmatic openness and economic nationalism. One obvious manifestation has been his three very different trade ministers, resulting in little progress in rolling back the increasingly protectionist policies that had been introduced during the commodity boom. The continuing very weak tax effort means that the government is not able to effectively fund the public services and social transfers that the community expects. A one-off tax amnesty hardly constitutes major fiscal reform. Microeconomic reform has also proceeded erratically: simplified business licensing procedures have been introduced, yet the sixteen "reform packages" in totality have not amounted to much. The continuing flow of cases before the Corruption Eradication Commission, the KPK, is testimony to the struggle to improve governance standards. Many observers fear a rising tide of political and social intolerance, especially towards "minority" groups. The result has been an economy that has continued to progress, but the "new normal" for economic growth appears to be 5 per cent, considerably slower than Jokowi's campaign pledge of 7 per cent.

Moreover, the international economic environment that Indonesia faces continues to be uncertain and at times volatile. The normalization of monetary policy in the rich economies, especially the United States, and the threat of an increasingly disorderly trading environment increase the vulnerability of commodity exporting emerging market economies. The

rising global energy prices of 2018 should be a positive development for Indonesia. But unless the government is willing to allow domestic prices to follow international trends, paradoxically these higher prices will place even greater stress on the budget as the energy subsidies again blow out.

The papers in this volume address these and other issues at this crucial juncture of Indonesian history, as the country approaches its fifth national elections of the democratic era. Section 1.2 provides an overview of recent economic developments. In section 1.3 we examine “Jokowinomics”, that is, economic policies and performance during the administration of President Joko Widodo, asking in particular whether they could be characterized more by continuity or by change. Section 1.4 provides a sketch of the contents of the volume, while the concluding section sums up.

## **1.2 THE INDONESIAN ECONOMY: AN OVERVIEW**

### **1.2.1 Historical Context**

Indonesia has achieved sustained economic growth only since the late 1960s. From 1966 to 1996, that is the Soeharto era, growth averaged 7.3 per cent per annum. The economy then contracted severely during the Asian Financial Crisis (AFC), 1997–99, including by 13.4 per cent in 1998. The economic momentum was then restored from 2000 onwards, with an average annual growth this century of 5.1 per cent. As a result, per capita GDP has risen rapidly over the past half-century, by more than sixfold.

Although there is no obvious comparator for Indonesia,<sup>1</sup> the country belongs to a very small group of mainly East Asian economies that have achieved exceptionally rapid growth for a sustained period. Two major World Bank studies (1993, 2008) illustrate this proposition. The Bank’s “miracle” study (1993) singled out seven East Asian economies, including Indonesia, for their very high growth. The Growth Commission (2008) report asked the question, which economies over the preceding century had grown exceptionally fast, defined as GDP growth averaging at least 7 per cent for at least a decade. The authors concluded that there were just 13 economies among the 150 for which they could obtain reliable estimates. Indonesia was one of these 13, for the period 1966–96.

Nevertheless, Indonesia has not grown as fast as China, and the four newly industrializing economies (NIEs) (and earlier Japan), which achieved such rapid growth that per capita income since around 1960,

has risen 12–16 fold. By contrast, the increase for Indonesia and other high-growth Southeast Asian economies has been a still very respectable 6–8 fold.<sup>2</sup> Table 1.1 compares Indonesia and three of its middle-income neighbours, Malaysia, the Philippines and Thailand. Since 1960 Thailand has been the most dynamic economy, with per capita income rising almost tenfold, whereas the Philippines has been the laggard with an increase of just 2.5 times. Indonesia and Malaysia adopt intermediate positions. Over the course of this century, however, their growth rates have been almost identical. For some periods Malaysia and Thailand have grown more quickly, but as open economies they were more seriously affected by the Global Financial Crisis (GFC).

### 1.2.2 The Economy under Jokowi

The “new normal” for the economy under Jokowi has been around 5 per cent annual growth. Growth has been stable, but well below the president’s 7 per cent target. This rate is somewhat slower than that of the commodity-driven Susilo Bambang Yudhoyono (SBY) era, but comparable to its ASEAN neighbours (Figure 1.1): in recent years, somewhat slower than the Philippines and Vietnam, but faster than Thailand.

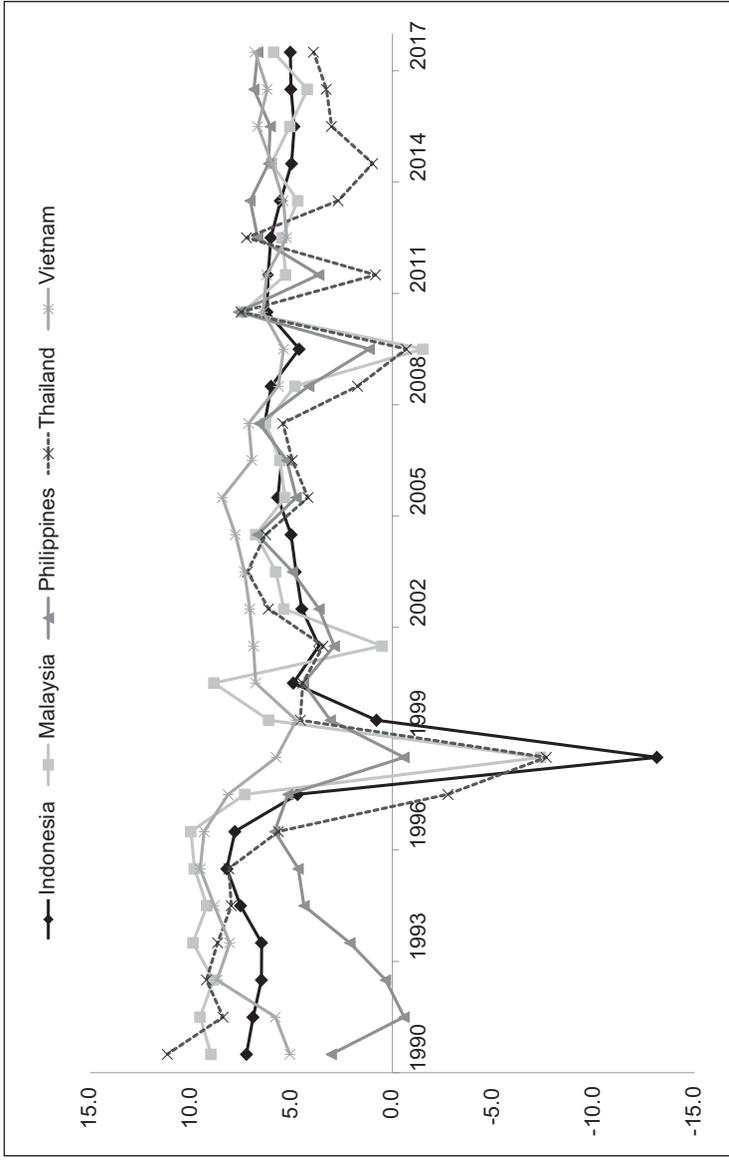
Indonesia struggles to create enough decent jobs. Some 3–4 million persons enter the labour market each year, in addition to the backlog of widespread underemployment. It is true that official unemployment has been declining gradually, to around 6 per cent. But this is relatively high compared to ASEAN neighbours (Figure 1.2), and the official definition does not take account of the many employed persons who are seeking additional

**TABLE 1.1**  
**The ASEAN Four: Comparative Economic Growth, 1960–2015**

Country	2015 GDP per capita (Constant 2010 US\$)	GDP per capita ratio between		
		2015 and 2000	2015 and 1980	2015 and 1960
Indonesia	3,834	1.8	3.5	6.6
Malaysia	10,878	1.6	3.3	7.7
The Philippines	2,640	1.6	1.6	2.5
Thailand	5,775	1.7	4.1	10.1

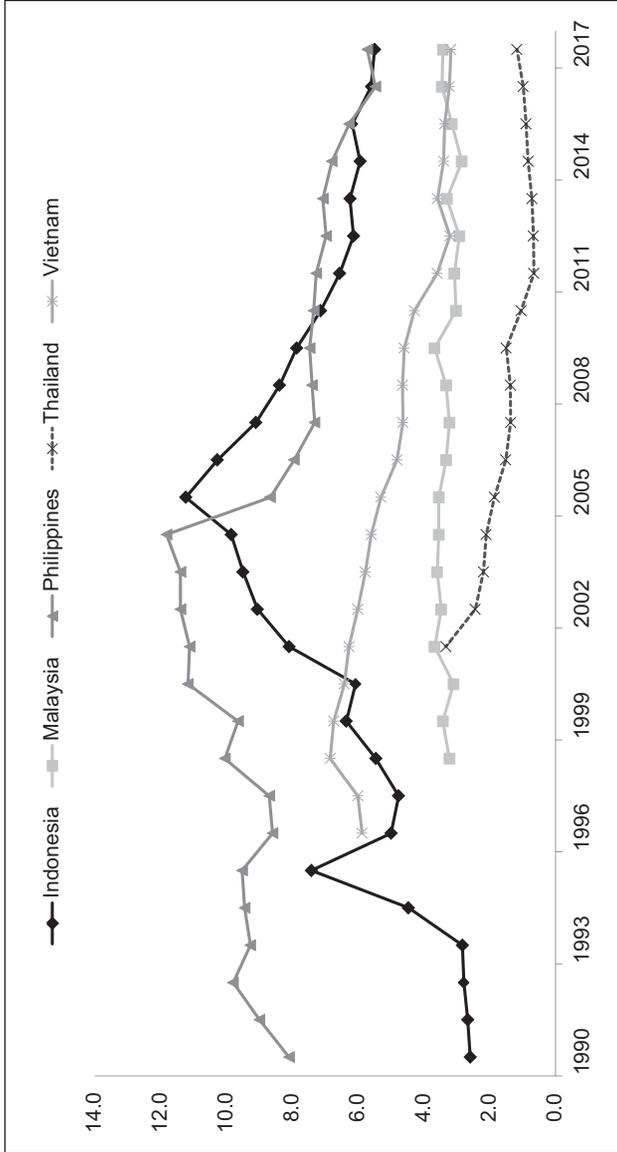
Source: WDI.

**FIGURE 1.1**  
**Economic Growth in Selected ASEAN Countries, 1990–2017 (% year on year)**



Source: CEC, ASEAN section.

**FIGURE 1.2**  
**Unemployment Rate in Selected ASEAN Countries, 1990–2017 (% , year on year)**



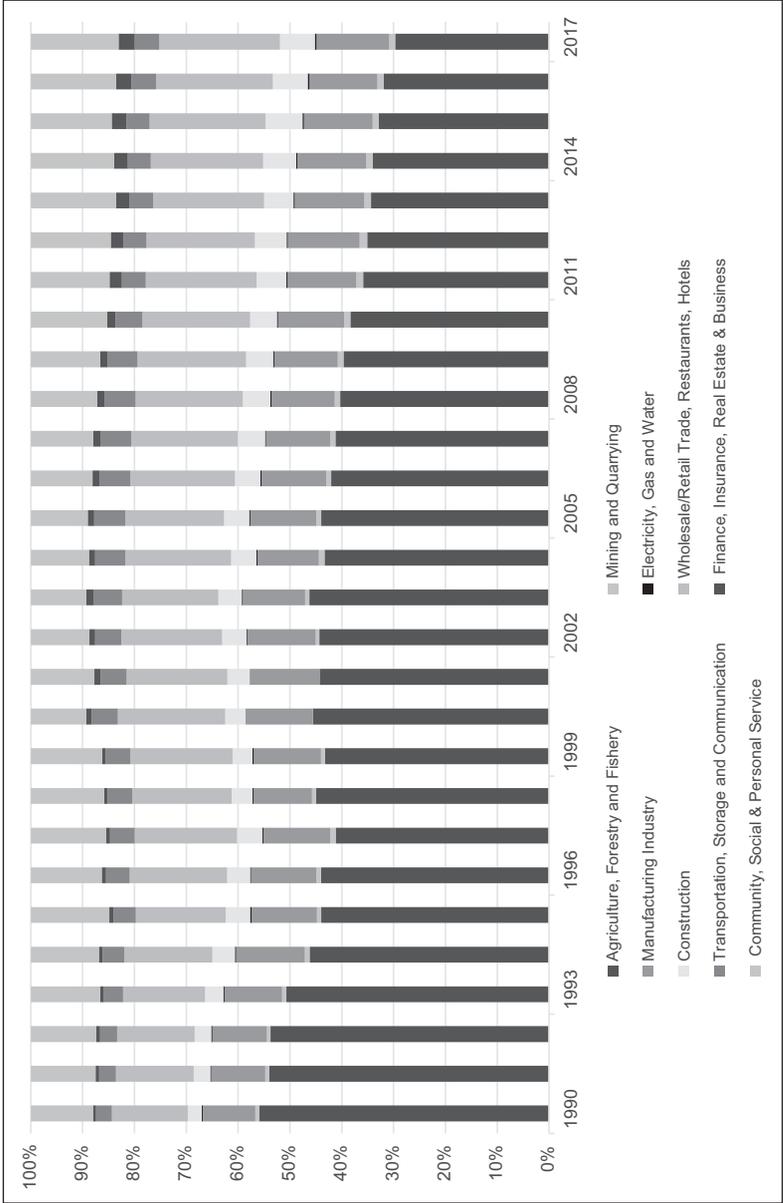
Source: CEIC, ASEAN section.

employment. The sluggish employment record partly reflects the growth slowdown after the commodity boom and the decade or more of jobless growth in manufacturing. However, as Manning and Pratomo (Chapter 11) argue, there are hopeful recent signs that manufacturing employment is picking up. Consistent with general patterns of structural change, the share of agricultural employment continues to decline, by almost 10 percentage points in the past decade. The main driver of employment growth has been services, including trade and tourism (Figure 1.3). Notably, the two countries in Figure 1.2 with the most regulated labour markets, Indonesia and the Philippines, have higher unemployment than their less regulated neighbours. With accelerating technological change, especially in IT-related activities, Indonesia will need to equip its labour force for the challenges that lie ahead, in basic educational skills, in vocational education and training, and in lifetime training opportunities. As Kurniawati et al. (Chapter 10) show, in spite of significantly increased funding over the past decade, Indonesia's educational performance continues to lag.<sup>3</sup>

Indonesia's inflation outlook is comfortable (Ramayandi and Negara, Chapter 3). Historically Indonesia registered relatively high rates of inflation compared to most of its neighbours, necessitating frequent nominal depreciations of the rupiah to maintain international competitiveness. However in recent years it has managed to narrow the gap (Figure 1.4). Inflation is of course first and foremost a monetary phenomenon, and thus arguably Bank Indonesia (BI) is insufficiently "monetarist" in its approach. But it could also be argued that the country's relatively closed trade regime and the high costs of logistics in this archipelagic nation have complicated BI's mission. Import restrictions on key food commodities (rice, beef, wheat, sugar, salt, soybeans, etc.) have pushed up domestic prices.<sup>4</sup> Moreover, the gradual (and commendable) reduction in energy subsidies, at least during the first three years of the Jokowi administration, increased administered inflation for periods of time, as shown in Figure 1.5.

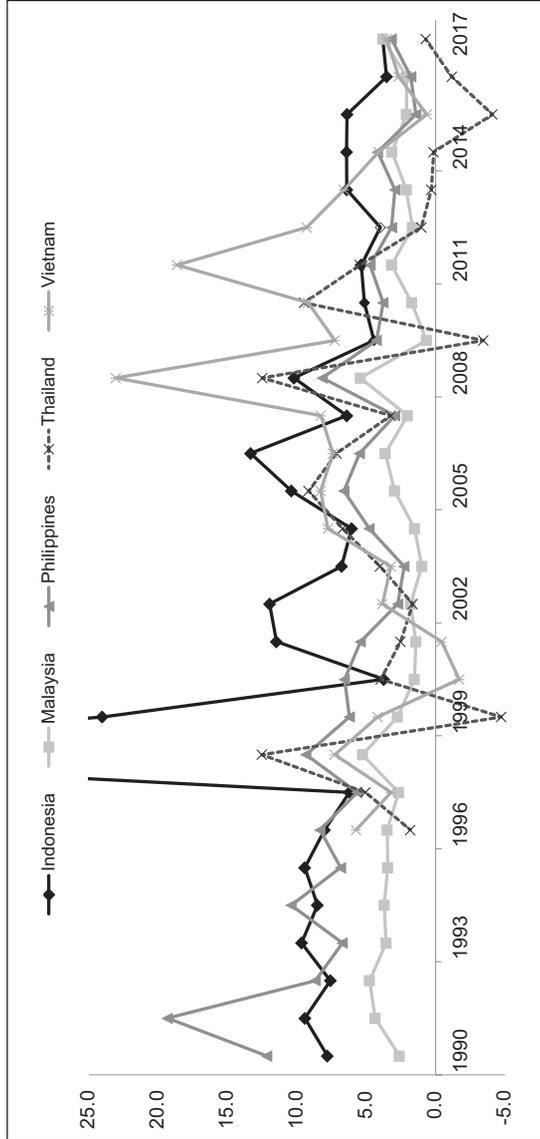
Indonesia faces a huge infrastructure deficit, and improved infrastructure was a key campaign commitment of Jokowi (Salim and Negara, Chapter 9). Ever since the AFC, Indonesia has underinvested in infrastructure compared to its neighbours, even including the Philippines (Figure 1.6). According to Bappenas estimates, Indonesia needs to spend about Rp4,800 trillion (approximately US\$356 billion) over the period 2015–19 to achieve its targets. It further calculates that the central and regional governments can finance only about 41 per cent of this amount.

**FIGURE 1.3**  
**Indonesia: Employment by Sector, 1990–2017 (% of total employment)**



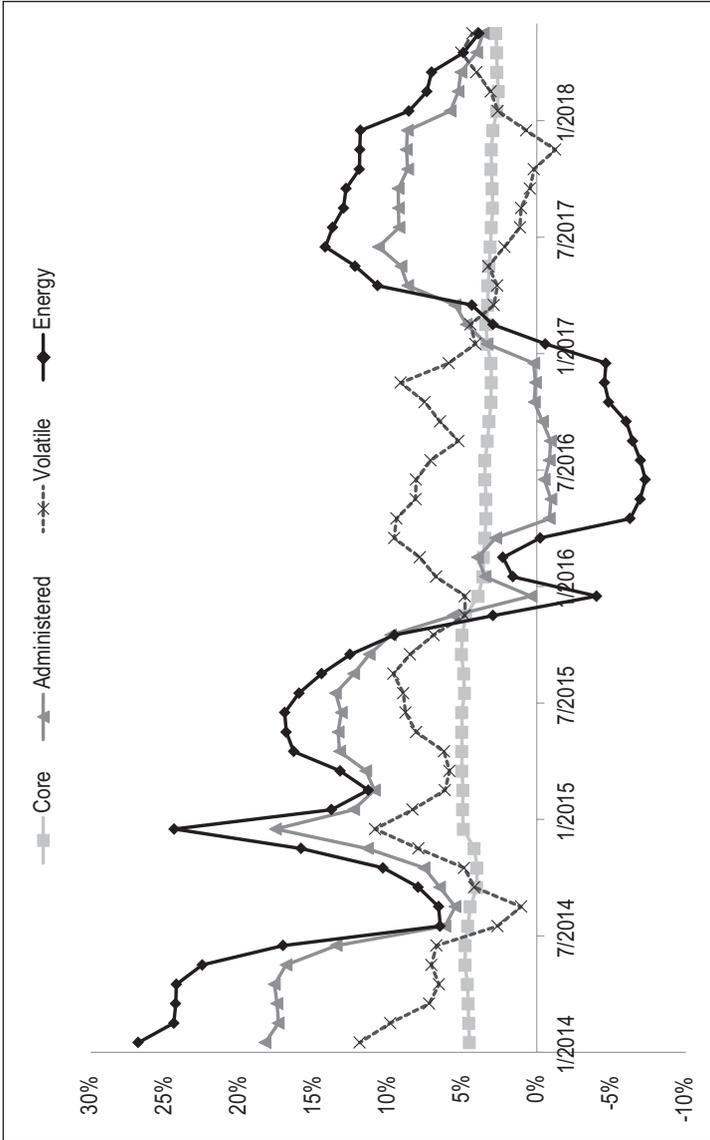
Source: BPS via CEIC.

**FIGURE 1.4**  
**Inflation Rate in Selected ASEAN Countries, 1990-2017 (% , year on year)**



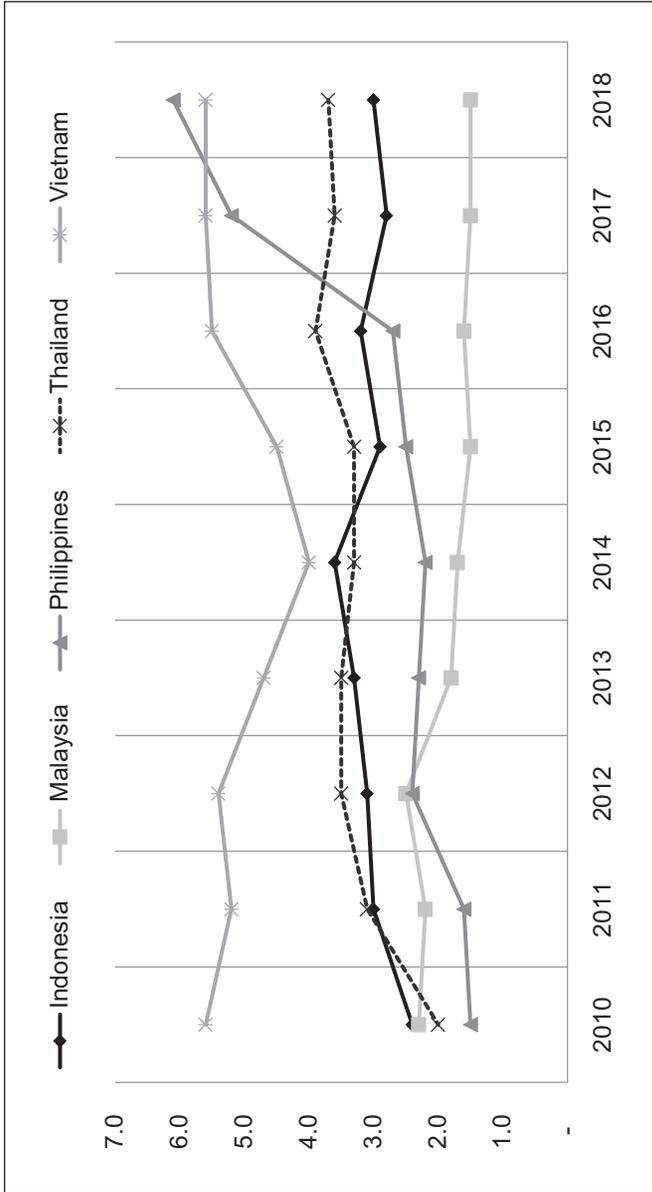
Source: CEIC, ASEAN section.

**FIGURE 1.5**  
**Indonesia: Monthly Inflation Rate, 2014–18 (% , year on year)**



Source: CEIC, ASEAN section.

**FIGURE 1.6**  
**Infrastructure Spending in Selected ASEAN Countries, 2010–18 (% of GDP)**



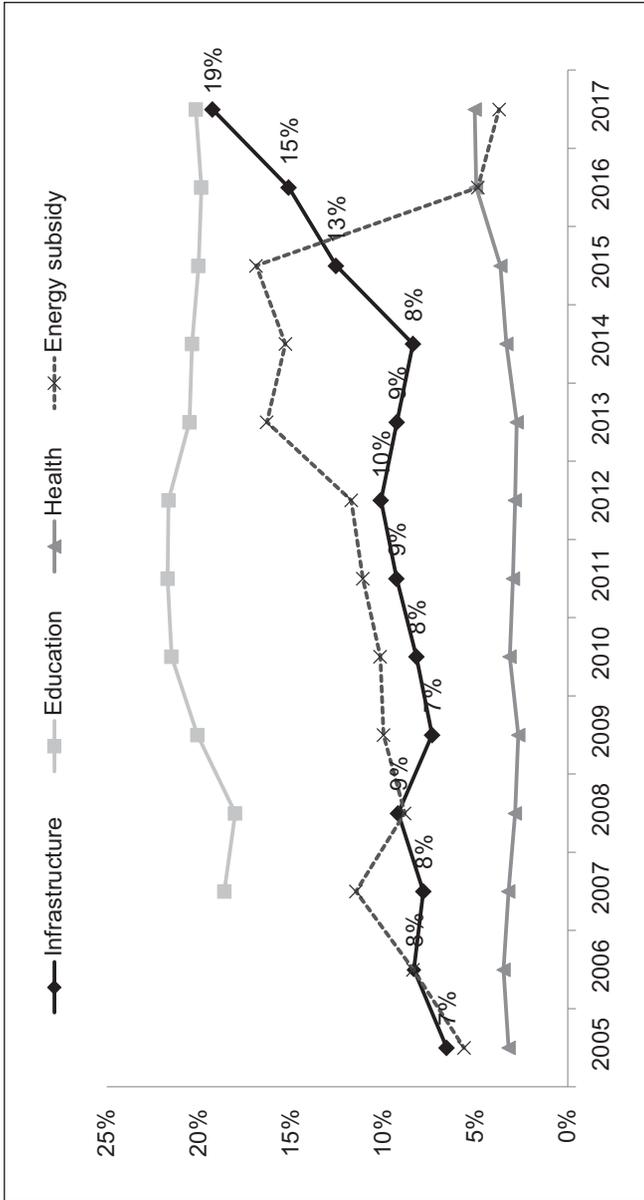
Note: 2017 and 2018 figures are forecasted figures. Indonesia's figures are budgeted data (not realized). They include 25% of total regional government budget for infrastructure.  
 Source: CEIC, HSBC.

The rest will have to come from state-owned enterprises (SOEs, 22 per cent) and the private sector (37 per cent). At least through to the mid-point of the Jokowi presidency, infrastructure spending remained low, at about 18.5 per cent of the total state budget, equivalent to 2.8 per cent of GDP. Not surprisingly, given the financial constraints and the policy uncertainty, the private sector has not been able to match its target. Foreign investors also await a more reassuring and predictable policy environment. Nevertheless, Jokowi has gradually matched his campaign rhetoric. As Figure 1.7 shows, his government's infrastructure spending has been rising since 2015, and is projected to reach Rp388 trillion in 2018, equivalent to 2.8 per cent of GDP. The increase has been financed by reduced subsidies, although these are likely to increase in the current year unless the government is willing to allow fuel prices to adjust to the higher international levels. Meanwhile, the government has continued to implement the 20 per cent and 5 per cent targets for education and health respectively, as mandated by Laws 20/2003 and 36/2009.

However, official infrastructure expenditures remain hobbled by Indonesia's anaemic tax effort. The country has one of the lowest tax/GDP ratios in the region, at about 10.3 per cent (Hamilton-Hart and Schulze (2016) and Ramayandi and Negara, Chapter 3). This is in spite of a succession of tax initiatives over the years, including the 2016–17 tax amnesty programme, which at best resulted in a one-off boost to revenues. The inescapable reality is that Indonesia's fiscal space is severely limited: a weak tax effort; about one-third of the national budget being passed on automatically to local governments (whose own revenue-raising efforts are also weak); the 3 per cent fiscal deficit limit; the education and health spending mandates as noted; some of the "low-hanging fruit" of subsidy reform already completed; and the large (and inflexible) allocations to civil servants' salaries.

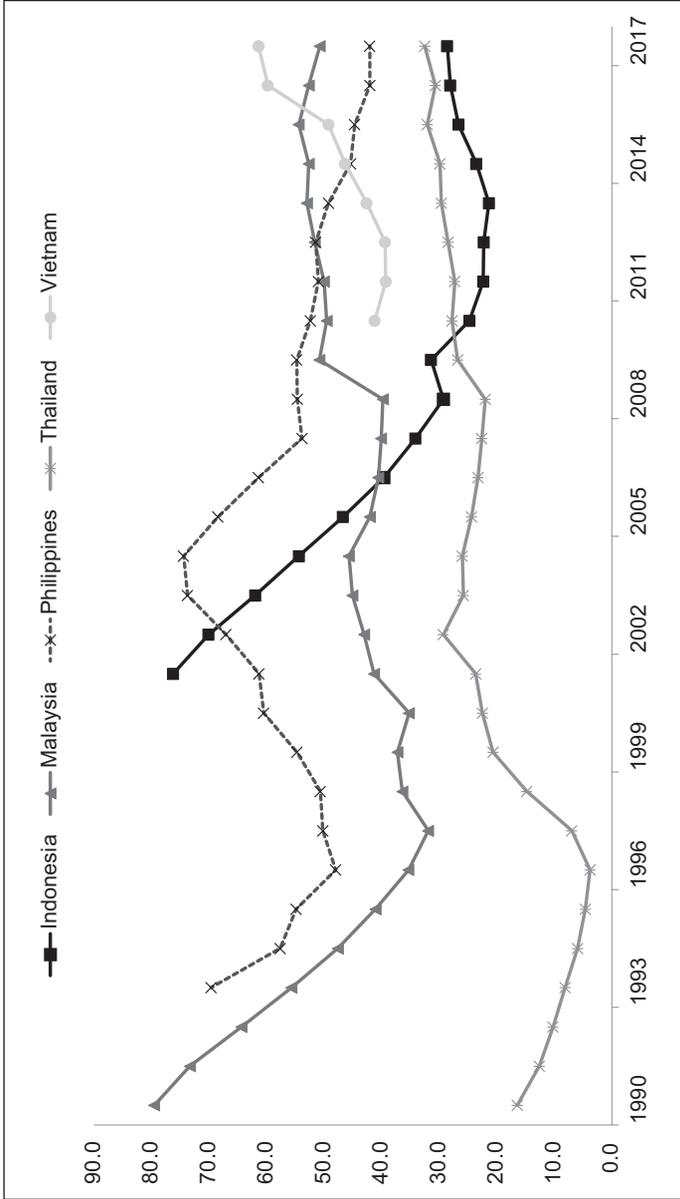
With little progress on the tax effort, the restoration of investment grade from several key ratings agencies, and continuing low global interest rates, not surprisingly there have been mounting calls for the government to relax the fiscal deficit limit and embark on more aggressive international borrowing for infrastructure. In principle, borrowing for investment projects with rates of return higher than the cost of borrowing makes sense. Undoubtedly Indonesia has many infrastructure projects that would easily meet this benchmark. Moreover, Indonesia's public debt is low by regional and international standards (Figure 1.8), thanks to the remarkably

**FIGURE 1.7**  
**Indonesia: Budget Allocations across Key Sectors, 2005–17 (% of total budget)**



Source: DG Budget via CEIC.

**FIGURE 1.8**  
**Public Debt of Selected ASEAN Countries, 1990–2017 (% of GDP)**



Source: CEIC, ASEAN section.

successful fiscal consolidation that has occurred since the AFC (Figure 1.9). In spite of recent calls to relax the deficit and debt ceiling, there are powerful contrary arguments. Indonesia's macroeconomic policy framework has served the country well since the AFC, including its management of the GFC. There is also the question of whether it has the institutions to absorb and spend a large increase in its infrastructure budget. In addition, with reform, a lot more private funding could be mobilized. Moreover, debt has become a controversial political issue, with public commentators focusing (wrongly) on the country's total public debt (the left axis in Figure 1.9) rather than its size relative to GDP (the right axis).

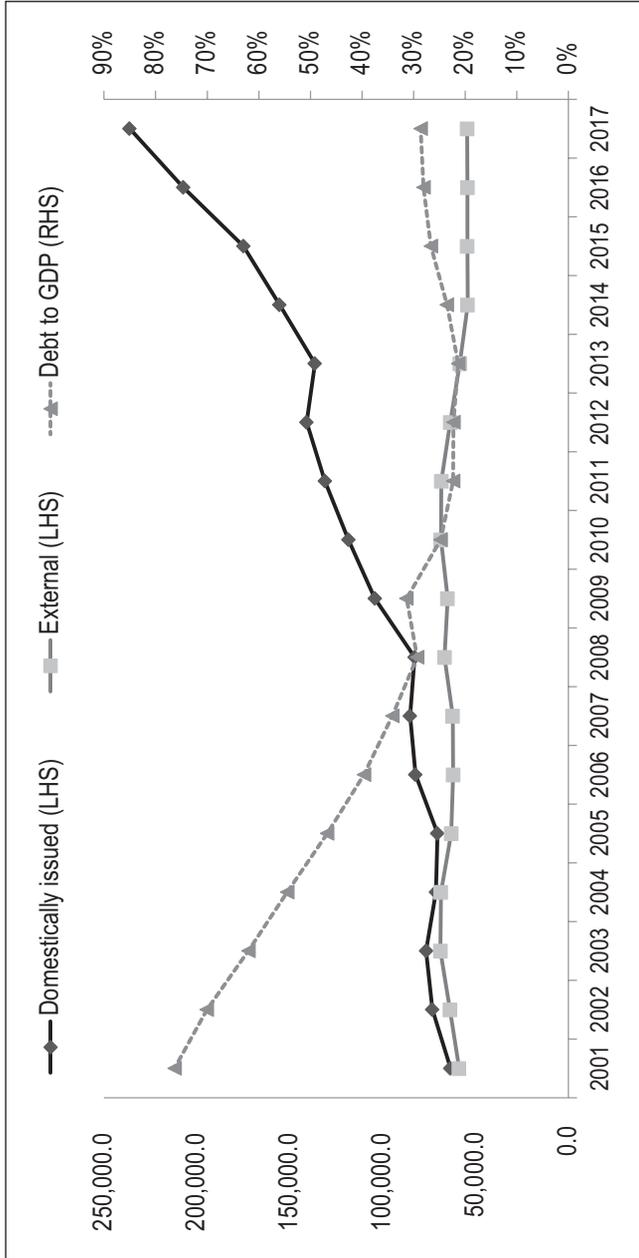
Slower economic growth and rising inequality have renewed public apprehension about the slow pace of poverty reduction. There is concern that the increasing inequality over the past two decades may weaken social cohesion and heighten social instability. In response, governments in the democratic era have introduced various social programmes aimed at achieving more inclusive growth. These include land redistribution to landless farmers, housing for the urban poor, credit for micro and small business, health care and education assistance for low-income households. These and related issues are discussed extensively in the chapters that follow, by Suryahadi and Al Izzati (Chapter 12), McCarthy and Sumarto (Chapter 13), Kurniawati et al. (Chapter 10), and Manning and Pratomo (Chapter 11).

As these chapters show, the impact of the various social programmes has been mixed. The percentage of the population below the poverty line has been declining very slowly in recent years, while the Gini ratio, which rose sharply through to around 2012, has declined slightly in recent years (Figure 1.10). According to the official BPS estimates, based on the national poverty line, there were 27.7 million poor people in March 2017, equivalent to 10.6 per cent of the population. The expenditure Gini ratio was 0.39. There is therefore still some progress required to achieve the Jokowi campaign promises of a poverty rate of 7–8 per cent and a Gini ratio of 0.36 by the end of 2019.

### **1.3 “JOKOWINOMICS”: CONTINUITY AND CHANGE**

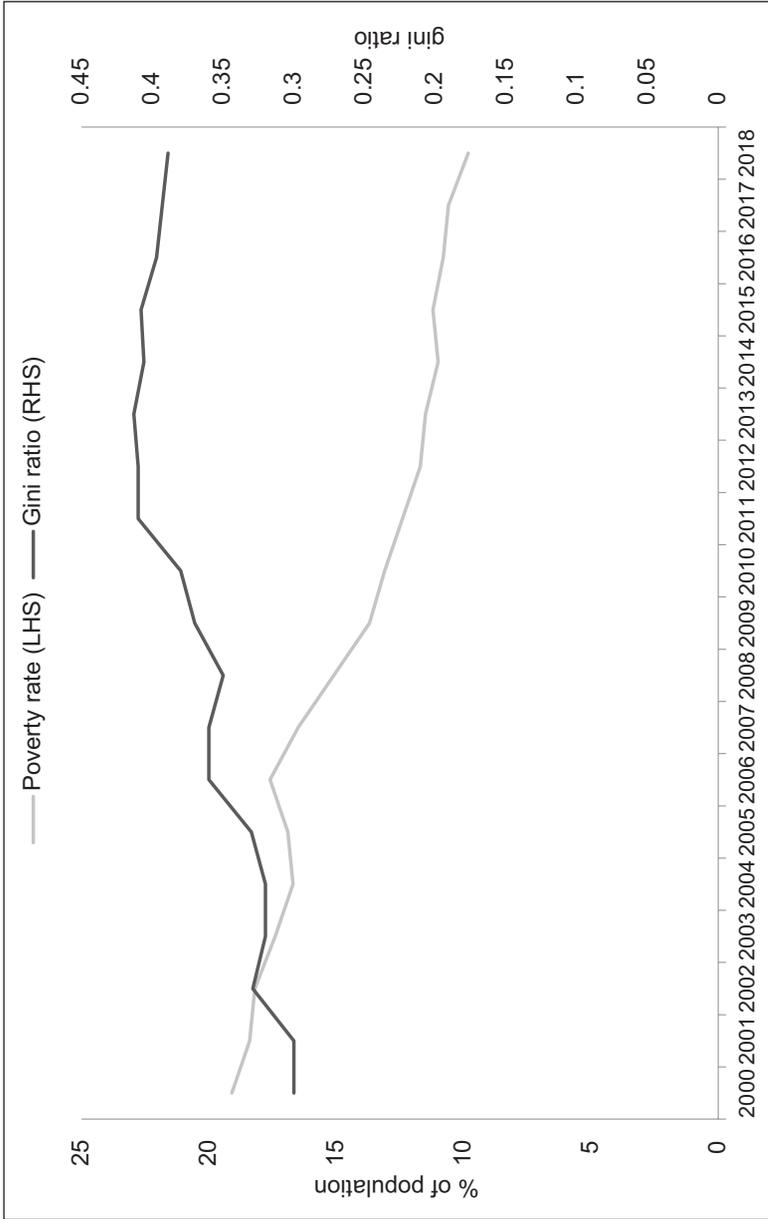
Some world leaders come to be defined by their policies. In the case of Japan, for example, there is Prime Minister Abe's “Abenomics” and the “three arrows”, of monetary stimulus, fiscal flexibility, and structural

**FIGURE 1.9**  
**Indonesia: Public Debt by Sources, 2001–07 (US\$ million)**



Source: CEIC.

**FIGURE 1.10**  
**Indonesia: Poverty and Inequality, 2000–18**



Source: BPS, CEIC.

reform (Ito et al. 2018). President Trump's economic policies have focused on increasing the fiscal deficit (at a time of full employment) through large tax cuts, and mercantilist trade policy focused on bilateral trade deals with countries that have trade surpluses with the United States (Corden and Garnaut 2018).<sup>5</sup>

What about President Jokowi? The term "Jokowinomics" is in common parlance in Indonesia. Does it have any substance? Obviously the president has left his mark on the country, through particular policy initiatives, through his selection of Cabinet members and other senior government officials, and through his style of government. But are there distinctive and significant departures from his predecessors that go beyond the rhetoric of campaign speeches and Independence Day addresses? Has he set Indonesia on a new development trajectory with different policy priorities and modalities? We briefly address these questions and draw out examples from the chapters that follow. Our main conclusion is that the continuities in economic and social policy are greater than the changes. In making this judgement, the main comparison is obviously with the two-term SBY era (on which see Aspinall, Mietzner and Tomsa (eds, 2015)), by which time Indonesia had overcome the devastating economic crisis of 1997–99 and the country's democratic institutions and processes were more or less established. It is also important to take account of changing external circumstances, a factor of particular relevance to Jokowi's presidency since he took office just as the massive commodity boom was coming to an end.

President Jokowi has not articulated a detailed vision, philosophical or programmatic, of where he wishes to take Indonesia. His goals, as for example articulated in his *Nawacita* (nine priorities) and major speeches, include poverty alleviation, rural development, economic nationalism, infrastructure, maritime development, and clean government. He is seen as a pragmatic president who gets things done, as he did as mayor of Surakarta and (briefly) as governor of Jakarta. He set an ambitious growth target which, as we observed above, the country has fallen well short of. To further evaluate his record it is useful to survey policies, approaches and outcomes across the major areas of government.

Perhaps the clearest illustration of continuity is with respect to *macroeconomic policies* (Ramayandi and Negara, Chapter 3). There is very little that distinguishes him from the SBY era: he has appointed respected technocrats to the key positions of Minister of Finance and Governor

of Bank Indonesia, the fiscal rule that deficits not exceed 3 per cent of GDP has been adhered to, and the monetary policy settings of a floating exchange rate, inflation targeting and an open capital account have been maintained. The weak tax effort has persisted. There was a bold effort to control fuel subsidies in his first budget but, apart from increased infrastructure expenditure, made possible by the reduced subsidies, thereafter there has hardly been a significant change in expenditure or revenue priorities. The Jokowi administration has also broadly followed similar policies with respect to the regulation and supervision of the financial sector (Hamilton-Hart, Chapter 5).

The continuities are also evident in the case of *trade and commercial policy*. The president and his administration have continued the ambivalence on trade policy that was evident especially in the second SBY administration, as Patunru (Chapter 6) demonstrates. Jokowi actually had three trade ministers in his first three years, and their stances ranged from highly protectionist to liberal-reforming and then back to a more inward-looking approach. The goals of “food sovereignty” and “self-sufficiency” (the terms are sometimes used interchangeably) remain paramount (Wihardja, Chapter 14). Indonesia has tended to take a back seat on regional and international trade initiatives. It did not join the Trans-Pacific Partnership (TPP), it has not played a leadership role commensurate with its size either in ASEAN or the Regional Comprehensive Economic Partnership (RCEP). It has not signed on to the Information Technology Agreement II (ITA II) (which governs global trade in electronics). Perhaps fortunately, it has not signed a bilateral trade deal of any significance. A similar ambivalence is evident in foreign investment policy.

The one major break from the past is a determined effort to simplify the complex regulatory regime. Jokowi’s impatience with bureaucracy is well known, and the investment board’s (BKPM) procedures have been simplified. This has resulted in the country’s much-publicized ascent up the ranks of the 190 countries in the World Bank’s annual Ease of Doing Business (EODB) calculations, from 106 in 2016 to 91 in 2017 and to 72 in 2018.<sup>6</sup> Nevertheless, at the sector level, much-needed reform is still needed (Kuncoro, Chapter 7; and Anas and Wikapuspita, Chapter 8).

*Infrastructure* was a major Jokowi campaign commitment and, as Salim and Negara (Chapter 9) show, expenditure has been rising through his term, once the subsidy reforms provided the fiscal space for increased spending. The differences should not be overstated, however. Local government

infrastructure spending is often not rising commensurately. It is not evident that the much-vaunted *Poros Maritim Dunia* (Global Maritime Fulcrum) will transform inter-island shipping and connectivity. Land acquisition issues remain complex. Efforts to engage the private sector, including foreign investors, have resulted in mixed outcomes. Major projects continue to encounter serious problems, such as the China-backed Jakarta–Bandung high-speed rail project.

On relations between the *central and regional governments*, Jokowi has had to juggle conflicting forces. With his background in local government, he is instinctively supportive of local initiative and autonomy. Yet as Schulze and Gonschorek (Chapter 4) show, here too the reform agenda is a sizeable one, and little major reform has been enacted in his term. One-third of the national budget flows through to subnational governments, mostly on a formula-driven basis, yet many of these governments have little to show by way of improved service quality. Local revenue efforts also remain weak, with the large vertical imbalances in the system providing a strong inducement for these governments to pass the responsibility of unpopular taxation measures back to the central government. Significant reforms are said to be under consideration, but they have yet to materialize.

With regard to *social policy*, as noted, poverty has declined very slowly and the Gini ratio has remained high. There is of course no evidence to suggest that these outcomes can be attributable to President Jokowi, either in the positive or negative sense. The slow poverty reduction is primarily the result of slower growth in the context of the now elevated inequality. His administration's social policies have essentially been more of the same, basically adopting the same set of social policy initiatives of the SBY era, with some rebranding. As Chapters 10 to 13 on poverty, education and the labour market show, the relatively small conditional cash transfer programmes, formerly known as *Bantuan Langsung Tunai* (Unconditional Cash Transfers) and now referred to as *Program Keluarga Harapan* (literally Hopeful Families Programme), have achieved some success in targeting the poor, but this is a complex technical and social issue, and mis-targeting is therefore inevitable. The funding guarantees for education and health have been maintained. There is slow progress towards a rudimentary national health scheme, albeit with major gaps in coverage and a chronic under-supply of the requisite professional skills. Inter-jurisdictional coordination is required for effective service delivery. The labour regulatory regime has become more predictable. The important work of the government's

principal social policy think-tank, known as TNP2K, located within the office of the vice-president, appears to have been somewhat marginalized.

Jokowi reportedly takes *environmental* issues quite seriously, but there have been few significant policy developments. He combined the portfolios of environment and forestry, which dismayed environmental activists. Illegal deforestation and over-fishing evidently remain rampant. The occasional high-profile destruction of illegal foreign fishing ships is no substitute for a coherent marine management strategy (Resosudarmo and Kosadi, Chapter 15). There has been no concerted action, or regional leadership, on climate change. Nevertheless, the major investments now underway in urban mass transit should at least lead to some gradual improvement in air quality in the major cities.

While Indonesia's democracy remains vibrant, and election processes and results are largely credible, the country's *formal institutions* are still relatively weak (Warburton, Chapter 2). Perhaps not surprising given the complexities involved, legal institutions are developing very slowly, as illustrated by the various comparative international metrics. Bureaucratic reform has been minimal. The highly popular anti-corruption commission (KPK) is frequently under assault by the legislature, and is more tolerated than supported by the administration. Nevertheless, supporters of the Jokowi presidency, and for that matter SBY also, can at least point to the fact that the president has not lurched significantly in the direction of authoritarian leaders like Presidents Trump, Putin, Erdogan and Duterte.

In sum, there is much to admire about President Jokowi. Unlike many among the Indonesian political class, he has great personal integrity. Unlike many of the country's elite, he sets an example in modest living. He achieved office without the usual credentials of dynasty, military or wealth. He rarely if ever displays the arrogance and hubris found among many world leaders. He retains the common touch. His adroit management of the 2014 election campaign illustrated his extraordinary political dexterity. He not only led a party accustomed to opposition and sentimentally attached to the Sukarno legacy and family, but he also faced off an aggressive and richer opponent, while also nullifying the dark politics and innuendo directed at him.

It is no exaggeration to state that Jokowi is arguably the most attractive head of state in contemporary ASEAN. It is true that he has little interest in international affairs, other than in the realm of commercial deals, and that he does not appear comfortable on the international stage. But this

can hardly be counted as a criticism. What matters is the quality of his domestic governance, and his ability to at least manage the country's ASEAN and bilateral relationships, especially with the great powers. In this regard he has proven to be quite effective.

Jokowi's strategy is one of small steps — getting things built, removing bureaucratic obstacles for business, backing initiatives for the poor, and good housekeeping. He is not a reforming leader, nor has he appointed reformist ministers, with a few notable exceptions such as his finance minister. There is no coherent strategy of how to translate the 7 per cent growth target into action. He does not have a vision of an internationally oriented Indonesian economy. His social vision is commendable, but it too translates into action in a sporadic and half-hearted manner. His support for protectionist food policies, for example, inflates the domestic price of rice and pushes more Indonesians into poverty than would otherwise be the case (Patunru, Chapter 6; Wihardja, Chapter 14).

Perhaps this judgement is too harsh. Indonesia is an extraordinarily difficult country to govern. At the national level, presidents need to form coalitions of parties and vested interests that are united by little more than opportunism. They have to manage the more than 500 local governments, all democratically elected and many with independent fiscal resources. The sectarian politics behind the removal in 2017 of his one-time Jakarta running mate, Basuki Tjahaja Purnama or Ahok, threatened to polarize the nation. And, as noted, Jokowi had the misfortune to assume office just as one of the largest commodity booms in Indonesian history was coming to an end, which necessitated managing the expectations of an electorate and political class that had grown accustomed to the largesse created by the boom.

## 1.4 THIS VOLUME

Collectively, the papers in this volume address a number of dimensions that are key to understanding the economic changes in, and challenges for, the Indonesian economy as it seeks to attain high-income status.

This volume opens with an "insider" view. Boediono, who served as vice-president during SBY's second term (2009–14), and before that held all major Cabinet-level economics posts during the Soeharto and democratic eras, provides his reflections on what Indonesia could learn from the experience of the East Asian economies. He includes Japan,

Taiwan, South Korea, Singapore, Hong Kong and, more recently, China and also Vietnam in the group that is unique because, in their quest for development, they carried out broadly similar strategies with similarly successful outcomes.

Relating the East Asian approach and outcomes to his own experiences, Boediono concludes that for Indonesia to improve its policy performance in the coming years, it needs to make progress in three strategic areas, namely, education, bureaucracy and infrastructure. Well-targeted education-cum-health interventions are necessary to raise the quality of Indonesia's human resources over the long run. Moreover, he argues, institutional reform is needed to create an effective bureaucracy that can promote development. And finally, an effective network of infrastructure with a good long-term plan of infrastructures development is key to support the first two goals.

Following this introductory, scene-setting chapter by the editors, Chapter 2 by Eve Warburton discusses whether Indonesia had entered a new era of "developmentalism" under Jokowi. She argues that over the course of the past decade, Indonesia's economic planning has become increasingly "developmentalist" in orientation. Aspects of this model have deep roots in Indonesian history. But a more self-conscious developmentalist agenda re-emerged during President Susilo Bambang Yudhoyono's second term in office (2009–14). This chapter suggests that, under President Jokowi, a new developmentalism has crystallized further and, arguably, become a defining feature of Indonesia's political economy. To advance this argument, Warburton draws upon studies of the "new developmentalism" in middle-income and emerging economies. The strategy is characterized by a normative commitment to an activist state that can engineer fast economic growth, direct industrial upgrading, and ensure economic redistribution. However, she argues that developmental agendas should be distinguished from developmental outcomes. For Indonesia, she argues, state-led programmes for industrialization and inclusive economic growth have often fallen short. Warburton also highlights some structural constraints upon the new developmentalism in Indonesia, with a particular focus upon politics. Specifically, she identifies patronage and clientelism as fundamental challenges to an effective state-led developmental model. Successive Indonesian governments, Jokowi's included, have taken a cautious approach to the political problems that undermine their developmental goals.

In Chapter 3, Arief Ramayandi and Siwage Dharma Negara examine Indonesia's macroeconomic trends and challenges. The chapter discusses the evolution of Indonesian economic management post AFC by concentrating mainly on fiscal and monetary policy in dealing with both internal and external economic challenges. Then it looks at the evolution of macroeconomic management during the two most recent administrations. They highlight fiscal and monetary policy management post the GFC to provide a discussion of whether or not the manner and the style of macroeconomic policy management has changed under the Jokowi presidency. Overall, they argue that there is continuity: that is, the Jokowi administration has also sought to maintain a prudent fiscal rule, a flexible exchange rate regime, an accommodative monetary policy, and an open capital account. In particular, monetary policy is directed towards maintaining exchange rate stability and achieving inflation targets. The two administrations have also faced similar challenges of weak tax revenue and pressure to achieve a balance between fuel subsidies and other social expenditure priorities. What is different, arguably, is that the Jokowi administration faces more complicated external challenges stemming from a combination of lower commodity prices of Indonesia's main exports, increased protectionism around the world, and rising interest rates in advanced economies, particularly the United States. These factors have put Indonesia's macroeconomic stability under pressure in recent years. The chapter also discuss the prospects and challenges that the economy is facing to reform its fiscal structure in this uncertain international economic environment.

Gerrit J. Gonschorek and Günther G. Schulze's Chapter 4 examines Indonesia's intergovernmental fiscal transfer system. They look at the size, allocation mechanisms, and the economic rationale for the various transfer schemes. Their chapter describes some substantial changes in institutional arrangements and in relative magnitudes of the transfers effected by the Jokowi administration. It assesses to what extent the government has shifted the policy stance on fiscal decentralization. It also analyses the effectiveness and efficiency of the existing system including the recently implemented reforms. They observe a significant increase in overall funds transferred to the regions, which demonstrates a commitment to fiscal devolution to the subnational level. The implementation of village funds, they argue, extends Indonesia's fiscal decentralization even further. The new scheme may be the biggest change so far in the intergovernmental

transfer system under President Widodo. However, instead of solving more urgent problems, such as increasing the local own source revenue or the overall quality of spending, it devolves more funds and fiscal responsibilities to another level of local government. Therefore, they argue that the policy has shied away from the more far-reaching (but necessary) reforms of the intergovernmental fiscal transfer system. In the implementation of village funds, in particular, the design has been found to be suboptimal.

Chapter 5 by Natasha Hamilton-Hart looks at how well Indonesia's banking and financial systems serve the needs of savers and business. She argues that financial sector performance in recent years has shown a marked improvement in many areas. Financial stability indicators are mostly robust, suggesting a relatively resilient banking sector. The interventionist policies aimed at promoting financial inclusion and growth introduced by the Jokowi administration have so far not been excessively costly. Moreover, a degree of inefficiency may be the price to pay for financial stability. This chapter explores some of the policy and structural sources of inefficiency in the banking sector as they have developed over recent years. Hamilton-Hart shows that Indonesia's banking sector is structurally segmented, with limited competition among the largest banks and a competitive but constrained mid-size bank segment.

Arianto Patunru discusses Indonesia's rising economic nationalism in Chapter 6. He shows that protectionism started to come back in the early 2000s and that, despite some reform initiatives, economic nationalism is in general amplified under the Jokowi administration, and that in all likelihood it will continue to do so in the near future. He examines the political-economic factors that might explain the re-emergence of protectionist measures under Jokowi's presidency. Using the case of fuel and rice as illustrations, Patunru shows that, while economic nationalism might pay politically, it is however detrimental to the poor. It is therefore in Indonesia's interest to resist the continuing push for protectionist policies.

In Chapter 7, Ari Kuncoro discusses trends and challenges in the manufacturing sector. He argues that Indonesian manufacturing has gone from being an export-driven sector to become dependent on the growth of domestic demand. The commodity boom, which was present from 2005 until 2012, has created the familiar "Dutch-disease" problem, in which the booming commodity sector has reduced the incentive for

manufacturing exports as domestic demand is readily available. This chapter shows that Indonesia's manufacturing exports are based on fewer and fewer products, which are dominated in particular by palm oil. It also discusses how Indonesia's manufacturing has lagged behind its neighbours in exploiting the international value chain. This is because the country's industrial policies are becoming more inward-looking. Kuncoro argues that traditional sectors like textiles and automotive products are still promising. However, to effectively promote manufacturing exports, Indonesia needs to improve its logistics, lower non-tariff barriers and improve the quality of its human resources.

Some of these challenges are also evident in Indonesia's services sector, which is examined in Chapter 8 by Titik Anas and Thaliya Wikapuspita. They argue that Indonesia has not paid enough attention to this sector. Although services is the largest employer of labour, its contribution to GDP is below the world average. Its productivity is also lower than that of the manufacturing sector. The policies towards services have been relatively more restrictive than those of manufacturing, particularly on foreign investment and workers. The restriction on foreign investment and workers limits its domestic capacity, which in turn translates into a persistent services account deficit and weakened competitiveness in general. During President Jokowi's term, the policies towards the services sector have remained restrictive, notwithstanding new policies on foreign investment in 2016 and foreign workers in 2018. Further foreign investment liberalization, relaxing the list of occupations open to foreign workers, and reforming the tertiary education sector are among the main agenda items for the next government. Reforms in these areas will have the potential to improve the performance of the services sector in particular and modern business in general.

Chapter 9 by Wilmar Salim and Siwage Dharma Negara examines the progress, challenges and policies regarding infrastructure development in Indonesia. The Jokowi administration is ambitious in its plans to develop the country's infrastructure. The authors argue that, compared to the previous administration, the Jokowi government has taken a more pragmatic approach to execute infrastructure development. One of its major policies has been to shift budget allocations away from fuel subsidies and towards infrastructure. Moreover, there have been continued efforts to reform the needed regulatory and institutional aspects to expedite infrastructure development. Notwithstanding this strong political commitment, overall,

the progress is not as smooth as hoped for. Limited resources and capacity require the administration to re-evaluate the number of national strategic projects and to be more selective in prioritizing any infrastructure projects. Moreover, this chapter argues that the national strategic projects must be linked more closely to national development plans that have longer time-frames, such as the National Spatial Plan and sectoral master plans. This is necessary to achieve integrated regional development, and to build Indonesia from the periphery, as outlined in the *Nawacita*.

In Chapter 10, Sandra Kurniawati, Daniel Suryadarma, Luhur Bima and Asri Yusrina look at the education system in Indonesia. After successfully improving access to education in the early 1990s, with virtually universal primary school completion and similarly positive trends at the secondary level, Indonesia began investing to improve learning outcomes since 2005. For almost a decade, the country has been spending about one-fifth of its public funds on education. Teachers have received significant salary increases through the certification programme. However, using international test results, this chapter shows that improvements in learning levels are too small to justify the significant investments to date. It argues that without adding accountability measures that focus on learning outcomes, there is little chance that the investments will provide significant returns in the form of substantially improved learning outcomes.

Related to education, in Chapter 11 Chris Manning and Devanto Pratomo review developments in the labour market during the Jokowi presidency. It is set in the context of changing employment, wages and productivity since the Asian Financial Crisis and the policies pursued during the previous Yudhoyono government. They argue that Jokowi's approach has been positive for employment and wages, although less so for labour productivity. Formal sector jobs have been growing quite rapidly and have recovered somewhat in manufacturing, while the downward trend in unemployment has continued. Reform of the minimum wage setting processes has not endeared the president to vocal union groups. But it appears to have moderated the minimum wage increases in the country's main industrial centres. At the same time, a wider wage gap has emerged between permanent and casual workers and this could have contributed to rising inequality.

Chapter 12 by Asep Suryahadi and Ridho Al Izzati examines Jokowi's social assistance programmes. These have given the poor access to education and health services as well as food and cash transfers, and grants for

villages as mandated by the Village Law. They assess the implications of these initiatives for poverty and inequality by correlating economic growth with real per capita household consumption growth by quintile at the district level. This chapter shows that economic growth became less pro-poor during the first three years of the Jokowi government, as indicated by the lower growth elasticity of consumption of the poorest 20 per cent of the population. By contrast, those of the middle quintiles have increased significantly and that of the richest 20 per cent the most of all. This indicates that the poor have been less connected to economic growth compared to the middle class and the rich. In turn, this implies that Jokowi's poverty and inequality reduction strategy, through the expansion of social assistance programmes and grants for villages, does not appear to be sufficient to help the poor. Hence, the authors argue that a complementary strategy to connect the poor to economic growth through job creation and income generation is needed.

Addressing a similar set of issues, John McCarthy and Mulyadi Sumarto in Chapter 13 look at distributional politics in Indonesia, where social protection policies are rapidly expanding. They discuss the dilemma of "layering", "nesting" and social fit in Jokowi's poverty policies. Their chapter discusses two programmes most relevant to the poor, the rice-for-welfare and the conditional cash transfer programmes. They draw attention to the tension between a layered approach to social protection, where new institutional arrangements are placed on top of or alongside existing ones, and a "nested" approach where the principles of a community's own distributional arrangements are located within wider state arrangements. The chapter concludes that Indonesia is still in search of a welfare regime that fits with the country's political-economic situation and cultural practices. It suggests that improving the "social" and "institutional fit" of social protection policies will involve working towards a more polycentric approach where the state-supported targeting logic accommodates the social ethics and moral concerns of rural people.

Chapter 14 by Maria Monica Wihardja discusses Indonesia's food policy with special focus on rice. She argues that Indonesia's food policy has a macroeconomic dimension, as it has implications for inflation, for fiscal policy, and it also affects the trade balance. It is central to the government political base, as a failure to manage food policy has the potential to disrupt politico-socio-economic stability. The author examines Indonesia's food value chain, and key policies and programmes under the

Jokowi administration. Posing the question, “has Indonesian food policy failed?”, the chapter also examines the shortcomings and challenges facing policymakers to improve the efficiency of the sector.

The final chapter by Budy P. Resosudarmo and Ellisa Kosadi discusses Indonesia’s environmental policies during the Jokowi era, with special reference to the country’s controversial illegal fishing war. In view of Indonesia’s immense environmental challenges, the authors argue that it is time the country started seriously dealing with this issue. SBY clearly showed the world that he was willing to meet this challenge by making climate change policy a top national priority. It remains questionable whether Jokowi has also been willing to do so, despite the controversial war on illegal fishing, led by his minister of marine affairs and fisheries, which has attracted considerable domestic and international media attention. This chapter argues that, in general, Jokowi so far has not significantly improved the management of Indonesia’s environment. It is also difficult to determine how much the campaign has been able to reduce the size of illegal fishing. The impact of this illegal fishing war on the national formal fishery sector has been relatively small. The impact might be significant at a local level but only in a few areas in Eastern Indonesia. Moreover, while this local impact could have benefited small-scale fishing operations, it has negatively affected larger operations.

## 1.5 SUMMING UP

Indonesia is both on the move and at the crossroads. Its citizenry is immeasurably better off than just two generations ago. Its last serious crisis was two decades ago. Since then, living standards have progressed. The country is comfortably within the middle-income group. It has achieved what in retrospect was a remarkably smooth transition from authoritarian rule to democracy, together with a major devolution of power and resources to the regions. Its national borders are secure, and it is recognized throughout the world as a major emerging power.

But it is also at the crossroads, facing the choice between a dynamic and internationally oriented economy and society, and a slower growing, more inward-looking economy, and possibly a less tolerant society. The choices it makes in the coming years will therefore be decisive. The chapters in this volume lay out an agenda for policy reform, to achieve faster economic growth, economic stability, stronger institutions, more liveable cities, better

connectivity across a vast archipelago, more inclusive development, and environment sustainability.

Indonesia clearly needs to accelerate its economic growth in order to reach high-income status. With a GDP per capita of US\$3,878 in 2017, it will take the country at least two decades of sustained growth acceleration to reach this level, and longer still if the recent growth trajectory persists. Current global economic uncertainties and disruptive technological changes also require policy responses that not only enhance growth but also promote inclusive outcomes. The fourteen chapters that follow provide wide-ranging insights into some of the deep economic and institutional reforms that are required to meet these challenges.

## Notes

1. In the 1970s the usual comparator was Nigeria, given its size, tropical location and endowment of energy resources. Around 1970 Nigeria's per capita income and its human capital were somewhat higher than Indonesia's. However, the two countries parted company thereafter. By 1990, Indonesia's per capita income was three times that of Nigeria.
2. See Perkins (2013) who draws out this distinction.
3. For recent analyses of the Indonesian labour market, see also Allen (2016) and Dong and Manning (2017).
4. See Patunru and Rahardja (2015), Patunru (Chapter 6) and Wihardja (Chapter 14).
5. How far these characterizations can be taken is a moot point. Commenting on Prime Minister Mahathir's election victory in May 2018, the cover of the June edition of the *Malaysian Business* magazine described it as "The Rise of Rakyatnomics", a term that remains ill defined, as is the similar Indonesian term "*Ekonomi Rakyat*" (People's Economy).
6. While an increase of this magnitude must be regarded as significant, the analytical rigour of the EODB estimations has come into question following the high-profile resignation of the Bank's chief economist in 2017 over alleged politicization of the numbers.

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