QNB Economics
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Election results in Indonesia likely positive for structural reforms

On 17 April 2019, for the first time in Indonesia's history, the president, the vice-president, and members of the People's Consultative Assembly (MPR), were elected on the same day. This took place in a massive general election in which 190+ million voters were eligible to participate. While official results are expected to be released by the General Election Committee only by May 22, reputable quick-count surveys suggest a comfortable re-election of the incumbent, President Joko Widodo, popularly known as 'Jokowi.' With an estimated 55% of the vote or a 9% advantage over his rival, former military general Prabowo Subianto, Jokowi will likely be confirmed for another five-year term (2019-2024). Importantly, the coalition of parties supporting Jokowi is also expected to have taken 60% of the popular vote, which should guarantee a majority in parliament (MPR) and be supportive for economic reforms.

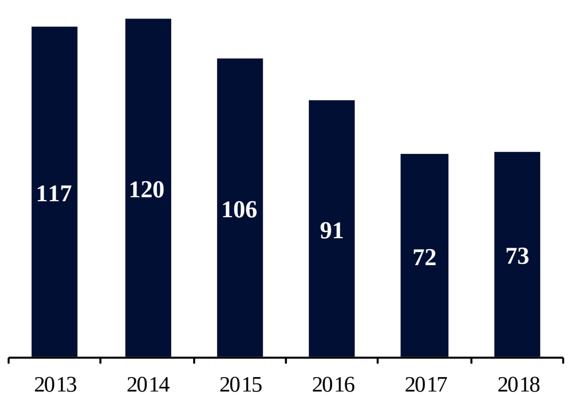
Markets are interpreting the election results as a positive outcome. Investors were concerned about the opposition's plan to cut corporate and personal income taxes, which would have affected government revenues and pushed up yields. Moreover, Prabowo's nationalism, including his stance against Chinese investment projects in the country, was also a cause for concern, given its negative implications for infrastructure development. Whereas Jokowi was the embodiment of continuity and stability.

With the re-election out of the way and a strong coalition backing his new term, Jokowi will likely be in a better position to take on vested interests and push through a comprehensive economic reform agenda. Our analysis delves into Indonesia's structural reforms and assesses recent progress and current challenges to some of its main points, including business environment, infrastructure spending, foreign direct investment (FDI) liberalization, subsidy reform and labor market flexibilization.

Improvement in business environment was one of the most important successes of Jokowi's first term. Indonesia has made good progress with several de-regulation initiatives and reform packages to reduce red tape and simplify business procedures. From 2014 to 2018, Indonesia has leapt up 47 places in the World Bank's Ease of Doing Business ranking. Despite the improvements, further progress is necessary in order to increase competitiveness, especially as key ASEAN neighbors still present more competitive business environments than Indonesia.

Infrastructure spending is another area in which good progress has been made. One of Jokowi's first steps as president was to cut inefficient fuel subsidies and re-direct resources to infrastructure investments. Over Jokowi's term, infrastructure spending increased by an average of 30% a year. Continued growth in infrastructure spending is necessary to address existing infrastructure gaps vis-à-vis ASEAN peers.

Indonesia's rank at the Ease of Doing Business report
(lower rank = better business environment)



Sources: World Bank, QNB Economics analysis

FDI liberalization and subsidy reforms is where recent policies have been a mixed bag. While reforms have removed foreign ownership caps in 35 sectors, there are still restrictions in a broad-base of sectors. In addition, the recent forced nationalization of the Grasberg copper and gold mine from a US-based firm did not bode well with investors. In terms of subsidies, the government had taken advantage of the crash in oil prices in 2016 to cut spending in energy subsidies. This was a positive initiative that contributed to reduce energy subsidies from 3.6% of GDP in 2015 to an average of 1.3% over the last four years. However, as oil prices recovered, the government started to employ state-owned entities (SOE) to effectively shoulder the financial burden of enforcing *de facto* price controls, partially undermining both SOE governance and previous progress in subsidy reform.

Less progress has been made with labor market reforms. Labor protection in Indonesia is very strong, so over-stringent dismissal procedures and severance payments need to be revised. Manufacturing wages in Indonesia are significantly higher than in the Philippines or Vietnam. Labor market inefficiency, including high redundancy costs and low flexibility of wage determination, makes it difficult for Indonesia to follow the successful path of other Asian economies in developing labor intensive manufacturing.

Indonesia has clearly made some progress with reforms, but the pace has been rather slow and fraught with ebbs and flows, so more effort is needed to support competitiveness and continued growth. A solid coalition behind Jokowi's second term will likely create political space for positive change. All in all, the recent election can be interpreted as a way forward to continue the reform agenda.

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