Jokowi’s second term: economic challenges and outlook

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Introduction

Indonesia has completed a historic general election, after holding both the presidential and legislative ballots simultaneously on 17 April 2019. There was no surprise outcome this time, following many polls that predicted President Joko ‘Jokowi’ Widodo’s comfortable victory against his opponent, Prabowo Subianto of the Great Indonesia Movement Party (Gerindra). In fact, Jokowi and his Vice President, Ma’ruf Amin, an influential figure in the large Islamic organisation, Nahdlatul Ulama (NU) and chairman of Majelis Ulama Indonesia (the Indonesian Ulema Council), won the election with a margin of around 11% over their rivals, Subianto and Sandiaga Uno—a substantial lead in most electoral systems. Jokowi and Ma’ruf were also able to consolidate their votes in the densely populated Central and East Java provinces and attract the support of 70% of 20 million new voters. As expected, Gerindra’s legal challenge to the election result hasn’t succeeded, so Jokowi will serve his second term.
Jokowi has a majority coalition in the parliament, with support from big parties, such as his own Partai Demokrasi Indonesia Perjuangan (Indonesian Democratic Party of Struggle), the Golkar Party, the Partai Kebangkitan Bangsa (National Awakening Party), the Nasdem Party, and the Partai Persatuan Pembangunan (United Development Party). The president has also secured support from the NU. With NU and Ma'ruf on his side, there's a likelihood that Jokowi's political and economic policies will pay closer attention to maintaining his Islamic political base. At the same time, he's been trying to consolidate his bloc, supported by technocrats, ex-generals and influential clerics, around himself as the key figure. With the support of Ma'ruf and NU, he's expected to unite a very polarised society and a fragmented elite. Nevertheless, whether or not he'll be successful will depend very much on what kind of concessions he offers to satisfy his diverse coalition members. Despite NU and Ma'ruf, who bring religious identity closer to the heart of the Indonesian Government, this essay argues that Jokowi will continue taking control of the big economic and strategic decisions.

Jokowi's economic policies achieved mixed outcomes in his first term (2014–2019). He hasn't delivered a promised 7% economic growth, but steady 5% growth is perceived as a commendable achievement, given slowing global growth, rising uncertainties, and low commodity prices. Macroeconomic stability has been well maintained, and Indonesia's creditworthiness has improved during this first term.

In his second term (2019–2024), there's a question about whether he'll be able to push through needed reforms to improve the business environment, which is important for attracting more investment into the country. However, he'll need to accommodate a larger coalition government, which means he now needs to make concessions and compromises on his reform agenda, so those hopes for boldness may be misplaced. One point of difficulty in dealing with his coalition is related to his cabinet appointments. To successfully execute his policy agenda, Jokowi must choose a solid team, consisting of professional people with relevant backgrounds. In his first term, he was forced to reshuffle the cabinet several times, due to ministers' poor performance or lack of cooperation with other ministers. At that time, however, he was able to appoint a significant number of professionals, whose qualifications matched their ministerial posts and who were independent from political parties. In his second term, the situation is different. There's a risk that he might surrender to political pressure to appoint members of political parties to the cabinet. NU and Partai Kebangkitan Bangsa have blatantly asked for him to give their members some posts, stating that their political support is not free. This is despite having their influential figure, Ma'ruf Amin, as the Vice President. One indication that Jokowi will accommodate the pressure has been his own statement that his second-term cabinet would be filled mostly by political appointees.

Despite such political pressure, Jokowi will maintain some key members of the current cabinet who have earned his trust to handle strategic areas, including in infrastructure, maritime, and finance. While there's speculation that Ma'ruf Amin will try to push his own Islamic agenda, Jokowi will certainly continue to be in charge in all the strategic policy areas. Ma'ruf will be positioned to support Jokowi's political and economic agenda. He will be tasked with catalysing reconciliation and unifying the polarised society and elite. It remains to be seen how effectively the President can use such a figure.

Given the complexity of the coalition, Indonesia's economic policies in Jokowi's second term may look like 'more of the same'. Sustaining growth and maintaining economic stability will be the primary focus. He wants to boost the economic growth of the country, which, according to projections by PwC, has the potential to be the world's fourth largest economy by 2050. To meet that goal, Indonesia must certainly grow faster and thus needs to boost investments and exports. That won't be easy, given today's unpredictable global economy, lower commodity prices and rising protectionism around the world.

The following sections aim to analyse Indonesia's economic challenges and prospects under Jokowi's second term.
Economic challenges

Maintaining stable economic growth will be quite tricky, given expected lower overall global growth and growing external risks. Moreover, lower commodity prices have been a misfortune for the country’s exports, which are mostly commodities such as coal, crude oil, natural gas, palm oil and rubber. To grow faster, Indonesia can’t rely solely on household consumption as the growth motor. It needs to boost both investment and export growth simultaneously.

In boosting investment, the challenge is to improve Indonesia’s overall business environment. Despite improvement in the country’s rank in the World Bank’s Ease of Doing Business Index, from 120th in 2014 to 73rd in 2018 (Figure 1), Indonesia has been losing its attractiveness in the region (compared to Malaysia, Thailand and Vietnam, in particular). In line with rising trade tensions between the US and China, last year foreign direct investment (FDI) to Indonesia fell by almost 9%. This development has triggered alarm among policymakers that Indonesia might have lost its attractiveness and competitiveness in attracting FDI. Vietnam has been cited by many analysts as the main beneficiary of the ongoing trade tensions between China and the US.

![Figure 1: Ease of Doing Business Index rankings, selected economies, 2009 to 2018](image)

So, what makes Indonesia less attractive on investors’ radar? Regulation uncertainties, rigid labour regulation, lack of skilled workers and infrastructure bottlenecks are often cited as some of the main reasons why investors are reluctant to enter the economy. In addition, according to a firm-level survey, increased wages, low-quality employees, weak supporting industries, complicated and time-consuming customs clearance procedures and a higher tax burden have adversely affected firms’ performance in Indonesia.

In Jokowi’s second term, boosting investment will remain high on his agenda. He’ll use his power to simplify the complex regulatory regime. In a speech before regional leaders during the National Development Planning Conference (Musrenbangnas), Jokowi has reiterated his growing impatience with investment and export procedures in the country. He blamed long and cumbersome bureaucratic red tape for Indonesia’s sluggish investment and export performances. Undoubtedly, policy reform at the sectoral and subnational levels will be difficult, and this will remain the key obstacle to any new investment in Indonesia. There are many problematic local regulations that hinder investment. While Jokowi’s administration has tried to scrap some of them, more new and unclear regulations are emerging. In addition, Indonesia should reform its outdated labour regulatory regime in order to accommodate the development of the digital economy and new types of industries, but that will require strong political will.
Another test in relation to growth acceleration is related to progress in the revitalisation of the manufacturing industries. A recent study has shown stagnation in manufacturing growth and manufacturers’ contribution to exports. Traditional labour-intensive industries, such as textile, garment and furniture manufacturing, have become less competitive in recent years. Due to increases in wages, Indonesia has lost its comparative advantage in those industries over other low-cost countries, such as Bangladesh and Vietnam. Therefore, it should reorient itself towards new sectors, including by shifting towards more capital-intensive industries.

Keeping growth stable is critical for Indonesia to ensure sufficient jobs for around 3–4 million new workers each year, which has led to a build-up of widespread underemployment (Figure 2). A decline in unemployment from 5.9% in 2014 to below 5.3% by 2018 disguises the real state of the jobs market. More than half of Indonesia’s workers are in informal employment. Youth unemployment has reached as high as 17%, and the workforce is dominated by poorly educated and low-skilled labour. About 40% of the total workforce have graduated only from primary school. Less than 10% have university degrees.

Figure 2: Share of employment, by sector, 2004 to 2017 (% of total employment)

![Graph showing employment share by sector from 2004 to 2017](image_url)

Source: BPS via CEIC.

The Indonesian workforce needs to respond to a structural change in the labour market. In the past decade, there’s been a shift out of the agricultural sector into mostly low-skilled jobs, such as retail trader, ride-sharing driver and so on. The future challenge is to train and equip the Indonesian labour force so that workers can respond and adapt to rapid technological change, especially in IT-related activities. However, despite significant increases in education funding over the past decade, the country’s educational performance continues to lag.

Given the pressing need to improve Indonesia’s human capital, for his second term, Jokowi has promised that he’ll pay more attention to human resource development and institutional building beyond hard infrastructure. While that doesn’t mean that he’ll reduce the budget for infrastructure, it will grow much more slowly than the allocations for education and health (Figure 3).
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Figure 3: Budget allocations for key sectors, 2013 to 2019 (Rp trillion)

Source: Ministry of Finance via CEIC.

As investing in human capital will become Jokowi’s priority, the challenge is to ensure the effectiveness of various social protection programs in improving people’s welfare and productivity. This will require better targeting and monitoring mechanisms for those programs, including the Indonesian health card (Kartu Indonesia Sehat), the Health Insurance Scheme (Badan Penyelenggara Jaminan Sosial), the Smart Indonesia Card (Kartu Indonesia Pintar), and the conditional cash transfer program for the poor (Program Keluarga Harapan). While there is anecdotal evidence indicating the benefits of such populist programs for the people, to date there’s been no clear assessment of their effectiveness in mitigating poverty.

One can expect that financing will become a big constraint on increasing public spending commitments for infrastructure, social programs and subsidies during Jokowi’s second term. Indonesia’s taxation regime is structurally weak. Its tax-to-GDP ratio is relatively low compared with those of neighbouring countries, at about 10.3% (Figure 4). Without improvements in tax revenue collection, the administration will find it difficult to implement various policies and programs on time and effectively. Consequently, Jokowi’s administration must rely more on international borrowing. Although Indonesia’s public debt is comparatively low by international standards, a rapid increase in debt may increase financial risk in the country.

Figure 4: Tax revenue as a percentage of nominal GDP, selected countries, 2004 to 2018 (%)

Source: Ministry of Finance via CEIC.
Economic prospects

What will be the prospects for Indonesia's economy during President Jokowi's second term? During his campaign, he offered a manifesto similar to his 2014 nine-point development program (Nawacita). For his second term, Jokowi's economic manifesto will focus on:

- the continuation of infrastructure development plans, with a special focus on supporting the digital economy and urban development
- the diversification of Indonesia's industrial base, the promotion of the tourism sector, Islamic financing and e-commerce
- support through fiscal incentives for companies that fund digital education or are export oriented
- the development of regional economies through infrastructure programs.

From the manifesto, infrastructure development will clearly continue as Jokowi's major priority area. However, as mentioned above, we won't see significant increases in infrastructure expenditure due to the economy's limited fiscal space. To support his infrastructure ambitions, Jokowi will seek alternative financing, including by inviting financing from China's Belt and Road Initiative (BRI). In addition to financing, Jokowi also sees the BRI as an opportunity to promote industrialisation and foster technology transfers, which of course remain to be seen. While so far no official BRI project agreement has been signed by Beijing and Jakarta, there is one high-profile Chinese-built project underway: the Jakarta–Bandung high-speed railway project, which may be completed during his second term (completion is scheduled for 2021). We can expect more Chinese-built projects in the infrastructure area, especially involving smelters, power plants and industrial parks. Nevertheless, I argue that China's BRI won't be the major source of finance compared to other traditional sources (the World Bank, the Asian Development Bank and Japan).

Jokowi’s ambitious Tol Laut (Sea Highway) project may be at risk due to financing difficulties, given a wide imbalance between the supply of and demand for ships to transport goods between Java and the outer islands. The high subsidy given for the Tol Laut project is barely sustainable from a budgetary perspective.

In addition, an ambitious 35,000-megawatt electricity project may need to be scaled down, given the financial constraints and lower growth projections for the economy (implying less demand for electricity). While scaling down the project is critical, it’s also important to rethink or redesign the type of power plant to be constructed. The project is dominated by coal-fired power plants, which is in contrast to Indonesia’s international commitment to promote renewable energy and to lower the country’s greenhouse gas emissions. It will be interesting to see Jokowi’s energy policy in his second term. Given current low international oil prices and the low inflation rate in Indonesia, he has room to shift fuel price subsidies towards renewable energy generation.

Jokowi also aims to promote Indonesia’s digital economy, e-commerce and ‘Industry 4.0’. The president released IT-related economic policy packages in his first term, and it’s likely that he’ll focus on the implementation and acceleration of those packages in his second. In fact, investment in this area has been increasing and has disrupted the traditional retail, manufacturing and transportation sectors.

Indonesia will certainly place greater emphasis on the Islamic or sharia economy. In fact, during their campaign, Jokowi and Ma'ruf promised to further promote Indonesia's sukuk products (or sharia bonds) and Islamic banking, capital and insurance products.

A sharia economic development body will be established to promote halal products and tourism, which have shown rising demand in Indonesia in recent years.

Jokowi’s administration has been trying to promote more FDI in Indonesia. There’s been a significant increase in Chinese FDI since 2016, yet it remains small compared to FDI from other traditional investors, such as Japan and Singapore. In view of this, any expectation that Chinese FDI will dominate the country’s investment landscape is a rather misplaced belief. Moreover, rising trade tensions between the US and China have affected China's growth, so its investments in Indonesia declined by 29% to $2.4 billion in 2018. This is further cause for doubt that Chinese FDI will soon surpass that from other traditional FDI sources in Indonesia.
While opening itself to Chinese investment, Indonesia is also cautious about the inherent risks related to that investment, such as a debt trap, foreign control, an invasion of migrant workers and environmental degradation. The Jokowi administration has reiterated that, like other foreign investment, Chinese investment (including in BRI-related projects) must also use environmentally friendly technology, train local workers, gradually phase out foreign workers, encourage higher value-added exports and stimulate technology transfer.23

Likewise, to reduce the risk of being too dependent on one source of investment, Jokowi’s administration has been diversifying its investment promotion campaign to attract FDI from other sources.

Jokowi’s Trade Minister is likely to continue a domestically oriented trade policy that’s partly aimed at controlling inflation (for staple foods), creating jobs and supporting local industries and small and medium-sized enterprises (SMEs). Given Indonesia’s track record, it’s hard to expect it to end its protection of local industries, farmers and SMEs.

However, to some extent, the country will be forced to adopt a give-and-take approach under regional and international trade initiatives, such as ASEAN’s Regional Comprehensive Economic Partnership. As the coordinator of negotiations for the partnership, Indonesia must play a leadership role to push the long-delayed project along. Jakarta’s diplomacy will need to be astute if it’s to get the group’s members to agree on rules of origin, people movements, investor–state dispute settlement, intellectual property rights, trade remedies, electronic trade and other matters.

Indonesia will prioritise bilateral trade and investment deals that are considered beneficial for its domestic economy. A case in point is the Indonesia–Australia Comprehensive Economic Partnership Agreement (IACEPA), which was signed by the trade ministers of both countries in March 2019. If it’s ratified by both countries, that will certainly boost bilateral trade, as it will exempt them from duties and remove non-tariff (technical and regulatory barriers) for virtually all goods traded between them.

Indonesia’s exports to Australia have been declining since the end of the commodities boom, while its imports from Australia have been increasing (Figure 5). As a result, its trade deficit with Australia has been growing. Indonesia’s main exports to Australia consist of mineral fuels; mineral oils; wood products; electrical machinery and equipment; and iron and steel products (Figure 6). Australia’s main exports to Indonesia consist of mineral fuels, mineral oils, cereals, cattle and dairy products (Figure 7).

Figure 5: Indonesian exports to and imports from Australia, 2004 to 2018 (US$ billion)

Source: BPS via CEIC.
Figure 6: Top commodity exports from Indonesia to Australia, 2014 to 2018 (US$ billion)

Source: BPS via CEIC.

Figure 7: Top commodity imports from Australia to Indonesia, 2014 to 2018 (US$ billion)

Source: BPS via CEIC.
Under the IACEPA, the Indonesian Government must remove a number of non-tariff measures (in the form of import permits) for many types of farm produce and several other manufactures. This will certainly be hard to sell in the parliament, as those measures are perceived as important to protect domestic producers, and thus local jobs. Therefore, it seems unlikely that Jokowi will gain full support from his coalition government to remove them. Some technical ministries, such as the agriculture and industry ministries, as well as farmers and some industry associations, might oppose the ratification of the agreement for similar reasons. Moreover, rent-seekers benefiting from red tape will be likely to lobby against the implementation of the agreement. These domestic critics are likely to have considerable weight in the parliament in opposing the ratification and the implementation of the IACEPA.

China is another important trading partner for Indonesia. It’s been Indonesia’s number one trade partner since 2012, when it overtook Japan and Singapore. The trade balance has been tilted towards China, which has enjoyed a growing trade surplus over time (Figure 8). Indonesia’s main exports to China consist of mineral fuels; mineral oils; animal and vegetable oils; iron and steel; and mineral ores (Figure 9). Indonesia’s main imports from China consist of electrical machinery and equipment; reactors and boilers; and iron and steel (Figure 10).

Figure 8: Indonesian exports to and imports from China, 2004 to 2018 (US$ billion)

Source: BPS via CEIC.
Figure 9: Top commodity exports from Indonesia to China, 2014 to 2018 (US$ billion)

Source: BPS via CEIC.

Figure 10: Top commodity imports from China to Indonesia, 2014 to 2018 (US$ billion)

Source: BPS via CEIC.
As Indonesia imports significant amounts of machinery and equipment for its infrastructure and construction projects, we can expect its trade deficit with China to keep growing. There's been some effort to postpone some infrastructure projects in order to constrain the deficit. However, ongoing projects will still require significant volumes of imported materials.

Indonesia is also likely to start opening up its services sector due to strong domestic demand for a wider variety of higher quality lifestyle, educational and health services. Under the IACEPA framework, there are a number of trade and investment opportunities for Australian companies in the sector. In tourism, for instance, Australian investors will be allowed to have 100% ownership of three-, four- and five-star hotels and resorts. The agreement will allow Australians to own 67% of various accommodation services, restaurants, cafes, bars, travel services and tourism consulting services.

The university sector will also be opened to 67% Australian ownership. Education services are an important Australian export to Indonesia. Last year, they were valued at US$668 million. Currently, more than 15,000 Indonesian students are studying in various degrees and programs in Australia. However, according to Indonesian law, foreign education providers are currently not allowed to have majority control in Indonesian universities. They're allowed to offer only limited programs, which are determined in line with the government's operational regulations.

During Jokowi's first term, environmental issues received quite serious attention. His administration achieved some noticeable progress in controlling ‘slash-and-burn’ practices in the plantation sector, conserving forests and preventing forest fires. Nevertheless, there's been little development of new (and stronger) environmental legislation. Specifically, law enforcement in this area remains weak. This is quite apparent in the light of rampant illegal deforestation and illegal fishing. It will be interesting to see whether, in his second term, Jokowi's administration can come up with a stronger and more coherent environmental policy. His political commitment on renewable energy development will be tested by the implementation of his B20 biofuel policy. Given current low international oil prices and the low inflation rate in the country, he might have a chance to shift fuel price subsidies to renewable energy production, which would provide incentives to attract private investment in that sector.

One question that's currently being debated in the media is the plan to move the capital away from Jakarta. Jokowi's administration has been preparing a master plan to build a new capital outside Java. Two main reasons are cited as the drivers of this initiative: the under-capacity of Jakarta to support rapid economic growth and a growing population, and the need to promote development outside Java to reduce regional inequality (Java versus the rest of the country). While there are many questions and much speculation about the motives for the plan, Jokowi has shown his seriousness by making official visits to survey cities in Kalimantan and instructing Bappenas (the National Development Planning Ministry) to conduct a feasibility study.

Obviously, moving the capital is an enormous political decision, so it will require lengthy debate and discussion so that the public can understand the rationale and support the government’s plan. Several cities in Kalimantan, including Palangkaraya in Central Kalimantan Province, have been proposed as the prospective new capital. Clearly, the choice of the location is not simple. The cities in Kalimantan have been perceived (not proven) to be safe from natural disasters such as sinking, earthquakes and tsunamis. There are other cities on the list as well, such as Banjarmasin, Pontianak, Palembang, Lampung, and even some locations in Java and Sulawesi. There are pros and cons for each location, so there's a need for a proper analysis of this issue, including the long-term implications of the move for the region and the country in general.

The plan won't be cheap either, as Bappenas has estimated that the total cost might reach Rp 466 trillion (US$33 billion). Given Indonesia's limited fiscal space, it's difficult to see the plan being implemented soon. Also, in a democratic country, this decision will need to involve the public. The government will need to calculate the overall risks involved, including potential speculation in land, the cost of moving state personnel and building the infrastructure, and other social and environmental impacts. The only feasibility study available so far was conducted by Bappenas and isn’t widely available for public discussion. It needs to be complemented with second or third studies by independent agencies.
During Jokowi’s first term, due to several terrorist attacks against police officers and concern about growing radicalism, his administration gave high priority to improving the capacity of the security agencies. There was a rapid increase in the police budget relative to the military budget between 2014 and 2018 (Figure 11), but there’s been some change in that trend going into Jokowi’s second term, in which he might try to improve his relationship with the military. This could be done not only by giving key appointments to commanders within his personal network but also by increasing their budget to improve military equipment. However, overall, Indonesia’s military spending remains relatively low at 0.7% of GDP (Figure 12). Jokowi’s opponent, Prabowo Subianto, has criticised the low military budget, which has contributed to Indonesia’s weak capabilities to protect and assert its sovereignty (including its maritime security). However, given the limited fiscal space and other higher priorities, it seems unlikely that Jokowi’s administration will be able to significantly increase funding for the military in the near future.

Figure 11: Indonesia’s military and police budgets, 2013 to 2019 (Rp trillion)

![Military and Police Budgets Graph]

Source: Ministry of Finance via CEIC.

Figure 12: Ratio of military budget to GDP, 2013 to 2019 (%)

![Military Budget to GDP Graph]

Source: Ministry of Finance via CEIC.
Conclusions

The 2019 election demonstrated that Indonesia remains committed to its democratic system and the rule of law. Higher than expected voter turnout is a good indication that Indonesians want to participate in determining the future of their country. Jokowi’s supporters must be relieved that Indonesia hasn’t moved significantly in the direction of authoritarianism like other parts of the world, although there are also concerns about the Islamisation tendency, especially given the high degree of religious identity politics in the election.

Jokowi has now secured his second term and has the opportunity to consolidate his legacy. The President needs to unite the nation after a polarising election. That task won’t be easy, but, with support from Vice President Ma’ruf Amin and the NU, there’s a chance for success. Jokowi has been building an alliance of technocrats, former generals and influential clerics in which he is the key figure. His appointments of cabinet ministers will indicate whether he’ll be bolder in his second term, and it will be interesting to see how he can control the cabinet. If he surrenders to political pressure from his coalition partners, his ability to control key political and economic policies will be compromised.

All in all, Jokowi’s second term will be ‘more of the same’, as he promised during the campaign. He’ll continue to focus on solving pressing domestic economic issues (infrastructure, jobs and human capital). He’ll continue his practical approach to moving things quickly, including by cutting red tape.

While Indonesia’s ranking in the Ease of Doing Business Index has been improving, it’s still underperforming compared to neighbouring countries and it needs to do more to make itself more attractive to international investors. Amid current US–China trade tensions, it hasn’t been well placed to attract significant benefits from the relocation of manufacturers away from China to Southeast Asia. Foreign investors find some of Indonesia’s neighbours, most notably Vietnam, more attractive as new production bases.

In the near future, the country needs to accelerate its fundamental structural reforms in the area of human resources, infrastructure and institutions in order to improve its future position in the global economy. Jokowi knows that, for Indonesia to become one of the world’s most competitive economies, he’ll need to spend serious political capital and demonstrate adept management of his governing coalition to tackle those fundamental challenges.
Notes

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Acronyms and abbreviations

ASEAN  Association of Southeast Asian Nations
BRI    Belt and Road Initiative
FDI    foreign direct investment
GDP    gross domestic product
IACEPA Indonesia–Australia Comprehensive Economic Partnership Agreement
NU     Nahdlatul Ulama
SMEs   small and medium-sized enterprises

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