

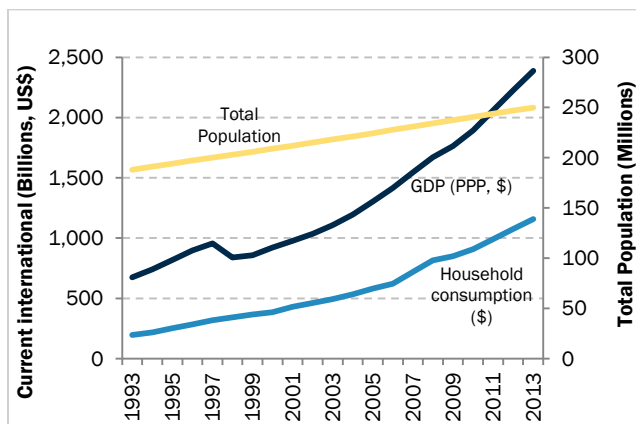
Indonesia: A Rising Giant

With the fourth largest population and growing economic clout, Indonesia as a nation is increasingly confident and assured about its place in the world. After a hard won election in 2014, expectations for new President Joko Widodo are high. However, he will have to deal with substantial challenges as he seeks to improve the welfare of the Indonesian citizenry and deal with bottlenecks that restrain higher growth. The approach that Joko Widodo takes towards the challenges he faces will determine the success of the ASEAN Economic Community ("AEC").

Moving From Commodities to Consumer Spending

A country blessed with rich volcanic soil, Indonesia has its abundance of natural resources — cash crops, such as crude palm oil, rubber and coffee, and mineral resources, such as coal and natural gas — to credit for much of its economic growth since independence. Coveted spices that grew in the Maluku islands in Eastern Indonesia drew traders to the archipelago in the 16th century and commodity-driven trade has been a mainstay of the Indonesian economy ever since.

While exports of commodities from extractive industries and cash crops remain a vital part of the Indonesian economy, a growing middle class and higher levels of domestic consumption have also supported growth in recent years. Household consumption now accounts for more than 50% of GDP in the country. The expanding middle classes form the core of domestic consumption. Indonesia is also coming into what has been called a "demographic goldmine" with its 250 million strong population, most of which is under the age of 29.



Under the stewardship of former President Susilo Bambang Yudhoyono, the country's attractiveness as an investment destination increased as the government further liberalised foreign investment and Yudhoyono presided over a period of relatively high political stability. These factors, combined with the commodity boom and demographic trends, yielded rich rewards. Over the past decade, the country has recorded high and stable GDP growth levels that have barely dipped below 5%. Income levels have almost doubled in the ten years since 2004.

Despite these gains, not all is rosy in Indonesia. Population growth has outpaced job creation and almost half of all households live just above the official poverty line — making them vulnerable to shocks such as an increase in food prices and environmental disasters. While economic growth has been strong, provinces such as Aceh and Papua have been largely excluded from growth. On the investment front, there has been an uptick in economic nationalism, manifested in a series of government regulations and policy rollbacks, which tightened existing limits on foreign ownership in areas such as banking and resulted in contract renegotiations with mining giants Freeport and Newmont.

New Leadership, Old Challenges

It is against this backdrop that Indonesia's seventh president, Joko Widodo — Jokowi, as he is widely known — assumed office on 20 October 2014, following a tightly contested election in July. Indonesia's next president is unlike his predecessors in many ways. He has no familial connections to the elite and minimal connections to big business. He is seen as the everyman, in contrast to the traditional ruling class.

Jokowi's rise to the presidency could well be called meteoric — he started out as a successful furniture businessman who succeeded in becoming the mayor of a medium-sized city in Jawa, before becoming the Governor of Jakarta in 2012, the role which brought him into the national spotlight. Less than halfway into his term as Governor, he ran for President as the candidate of the Indonesian Democratic Party ("PDI-P").

Jokowi's win in the July elections returned some measure of calm to the political landscape. While expectations are high, the challenges involved in navigating Indonesia remain considerable and, for Jokowi, executing the reforms he has promised to overcome these challenges will be no easy task.

Corruption remains a major problem in Indonesia. Despite President Yudhoyono's strengthening of an anti-corruption body, graft remains widespread in both the institutions of government and the private sector. The continued existence of "mafias" — informal alliances of rent-seekers who arrange for favourable treatment of private individuals or businesses — in the judiciary, the finance ministry, and the oil and gas ministry facilitates leakages and perpetuates a system which is seen to

favour the wealthy and well-connected. The extent to which corruption pervades Indonesia's institutions has been highlighted in recent months, with various high-profile cases involving a chief justice and the ministers for energy, religious affairs and sports.

Infrastructure is another sore spot despite government attempts to draw more investment to this area. Electricity outages are a semi-regular occurrence as generation capacity continues to lag behind demand. Indonesian roads, especially in major cities and on the densely populated island of Jawa are notoriously congested, resulting in lower productivity as a result of lost time. While efforts to construct a highway that traverses Jawa have been underway since 1994, this project has been stalled by problems surrounding land acquisition.

The challenges involved in acquiring land for infrastructure projects relates closely to Indonesia's regulatory framework, which is characterised by extensive overlap between government agencies and laws that effectively deter investors. Bureaucratic procedures are often unreasonably complex and create needless delays for investors and regular citizens. The complexity of official procedures creates an incentive for corruption as applicants for one permit or another seek to speed up and simplify procedures.

Uncharted Waters

Jokowi has promised to address all of these problems, echoing earlier vows made by his predecessor, who succeeded in making inroads in matters such as corruption — although much more remains to be done. Unlike Yudhoyono and other presidents before him however, Jokowi has neither the support of the majority of parties in the DPR (the People's Representative Council known in Indonesia as the Dewan Perwakilan Rakyat) nor is he the principal figure in the political party that supports him.

The coalition of political parties that do support him occupy less than 50% of seats in the DPR required to pass bills. While this could change in the months to come (the adage about not having permanent friends nor enemies holds true for the party with the second-largest number of legislative seats, Golkar) the current state of affairs means that Jokowi will find it difficult to push through the legislation needed to bring about reforms, including reducing fuel subsidies. Garnering sufficient votes to approve a budget amendment that would reduce fuel subsidies will require extensive political bargaining, a tactic that Jokowi has disavowed although he will not have any choice if he is to follow through on his promises. Already Jokowi's presidency has been dealt with a blow by his opposition, which in the last days of Yudhoyono's administration pushed through an amendment to eliminate

direct local elections — the very system which brought Jokowi and a number of other promising grassroots leaders to the fore.

In addition to challenges from external parties, Jokowi faces challenges from his own political party. The PDI-P's founder Megawati Soekarnoputri remains the party's principal figure and may undercut Jokowi's leadership of the country, should she opt to withhold her support for his policies. Megawati was notably absent for much of the campaign period and affirmed Jokowi's candidacy only at the eleventh hour. Contradicting statements about who would determine the composition of the cabinet emerged with Megawati's proxies saying that her input will play a large role, while Jokowi said that no one but himself will determine who becomes a minister (the final composition of the cabinet showed compromise between the two). While such contradictions may not appear unusual in other countries, in Indonesia, open disagreement is a sign of weakness and raises concerns about Jokowi's ability to exercise leadership — if he is unable to secure the committed support of his own political party, can he hope to gain the wider political support that he will need to pursue his reform agenda?

Indonesia and the ASEAN Economic Community: A Compatible Match?

One of Jokowi's core programs is to ensure that Indonesia is self-sufficient in matters such as energy, food and financing. This in itself is hardly new — calls for the country to be self-sufficient (*mandiri*) have been a recurring theme since the Sukarno era (Indonesia's first president, in office from 1945 to 1967). However, the goal of self-sufficiency and the trend towards economic nationalism raises tensions with those of the AEC — ie. the free flow of goods, services, investment, and labour.

Among the ASEAN countries, Indonesia has made the most use of non-tariff measures which restrict trade in goods as diverse as sugar and machinery. While foreign investment has been mostly liberalised during the Yudhoyono presidency, some sectors — notably banking, energy and mineral resources — have been subject to a tightening of foreign ownership limits while a recent law would cap foreign investment in the plantation sector.

As the largest member of ASEAN, Indonesia's cooperation and willingness to abide by the spirit of the AEC will be crucial to the economy grouping's success. Jokowi's term as President comes at a crucial time for the AEC and much of its success rides on whether he will choose to fully integrate Indonesia in the regional economic community or whether he will adopt a more inward-oriented focus.



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