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TENGGARA BACKGROUNDER

Tenggara Backgrounder is a weekly briefing service combining insights and research analysis by experts from the Centre for Strategic and International Studies (CSIS) and Prasetiya Mulya University, as well as background information from *The Jakarta Post* journalists. Tenggara Backgrounder provides you exclusive insights into what's happening behind the scenes along with insider scoops that are not published in the media.

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Highlights of the week

Should Nawa Cita be continued?

With presidential campaign approaching, Joko "Jokowi" Widodo was seen upgrading his Nawa Cita (nine goals) platform to his new vision for the upcoming term. The Nawa Cita, however, is being re-formulated to target human capital development and poverty, something that have been exploited politically by his opponents.

Jostling coalitions: legislative or presidential election?

The year 2019 holds great political significance for political parties as they have to confront two electoral battles in the same year. The political upheaval and "tacky" coalition prior to candidate registration period on Thursday reflected how the race for government and parliament may intensify.

Jonan deals blow to Chevron over IDD and Rokan

The Rokan Block operation permit handover to Pertamina from Chevron might be more controversial than just a fair business consideration. While the Block may seem as an attempt to revitalize Pertamina's financial, it was actually related to a bigger energy outlook.

Indonesia weighing possible trade spat with US

Although the US and Indonesian officials have settled the issue of generalized system of preferences (GSP), the Trump's administration apparently will not be satisfied until Indonesia at least pay the price for its continuous trade surplus with the US.

POLITICS

Should Nawa Cita be continued?

During his 2014 presidential campaign, Joko “Jokowi” Widodo and his running mate Jusuf Kalla introduced their Nawa Cita (nine goals) platform. As the end of his term approaches, President Jokowi is reportedly formulating his reelection campaign for 2019. Although the details of his campaign have not been fully disclosed, the Jokowi coalition has confirmed that the President will revive Nawa Cita as Nawa Cita II during his campaign. However, as the initial Nawa Cita (henceforth will be referred as Nawa Cita I) has proven problematic in certain aspects, should the development program be continued?

Background: President Jokowi’s Nawa Cita I heavily emphasizes development programs. Translated later into the National Mid-Term Development Plan (RPJMN), Nawa Cita I was designed to improve the country’s infrastructure and government efficiency. Nawa Cita I might have helped Jokowi win the 2014 presidential election, yet whether Nawa Cita II will gain him a second term remains to be seen.

Since its introduction, the Jokowi administration has met with a number of problems in implementing Nawa Cita I’s objectives. The lack of funding, for instance, makes it particularly difficult for Jokowi to realize the infrastructure objectives of Nawa Cita I.

Ahead of the 2019 presidential election, Jokowi’s opposition has frequently attacked the way the government has addressed mounting economic issues. His ambitious infrastructure projects have been frequently pointed to as the main cause of the country’s economic slowdown. This is probably why Jokowi will make alterations to Nawa Cita II, such as paring it down to three focal points: poverty, social inequality and unemployment. Furthermore, pressure from the country’s second largest Islamic organization, Muhammadiyah, to include a religious component to Nawa Cita II may also affect Jokowi’s upcoming campaign.

Nevertheless, the final formulation of Nawa Cita II remains unknown, as the Jokowi coalition has yet to clarify what it entails. The few snippets gleaned so far, however, may predict the success rate of Nawa Cita II.

Insight: On July 31, following his meeting with his coalition parties’ secretaries-general, Jokowi announced his intention to reinvigorate the Nawa Cita agenda and rename it Nawa Cita II for his reelection campaign. Although details of the Nawa Cita II are as yet unveiled, the coalition has affirmed that his upcoming campaign will focus on poverty, inequality and unemployment efforts.

Nevertheless, the incumbent’s campaign team will face a Herculean task in promoting Nawa Cita II. An Indo Barometer survey has found that 58.2 percent of respondents have a rudimentary or nonexistent knowledge about Nawa Cita I. Furthermore, the respondents’ overall satisfaction in the program reached just 39.4 percent. Considering the low public satisfaction rate, the President’s plan to develop Nawa Cita II seems perplexing.

According to the same survey, among the nine points of Nawa Cita I, respondents gave the highest rating to: developing the outermost islands and disadvantaged regions; improving national security and defense; and advancing human capital and social welfare. Meanwhile, they gave the lowest rating to establishing clean, effective and democratic governance.

The Nawa Cita's dwindling popularity aside, the favorable public reception for specific programs may explain Jokowi's shift in focus for his reelection campaign, particularly following the endless attacks on his economic policies, which the opposition has deemed disastrous. The sharp fall of the rupiah, which has reportedly caused about US\$7 billion in capital outflows since January 2018, and Jokowi's splurging on infrastructure projects, have often come under fire. Furthermore, China's soaring investment in Indonesia has been blamed as the primary cause of an influx of foreign workers into the country at the expense of the domestic workforce.

Given the public reception of particular programs in Nawa Cita I and the similar criticisms against his administration, it seems that Jokowi's decision to emphasize poverty, inequality and unemployment in his upcoming campaign aims to kill two birds with one stone: Nawa Cita II's narrowed focus will advance and highlight Jokowi's relative success in particular areas while also respond to the opposition's criticism.

For instance, Jokowi can claim a success with regard to poverty alleviation, a prominent theme in both Nawa Cita I and II. The Central Statistics Agency (BPS) March 2018 data shows the poverty rate has fallen to a record low, which will surely help Jokowi's campaign team counter the criticism on the President's economic policies.

When it comes to inequality, the International NGO Forum on Indonesian Development's (INFID) public perception survey on inequality has found that 84 percent of 2,250 respondents believed that inequality prevailed in five out of six areas: income, job opportunity, property, wealth and family welfare. Nawa Cita II's inequality focus allows Jokowi to rebuff any possible criticism on this issue – by demonstrating his commitment to tackling inequality if he is reelected – while offering a convincing reason for continuing his signature program. Public satisfaction of Nawa Cita I's infrastructure development projects on the outermost islands and underdeveloped regions, furthermore, will justify the President's plan to carry on his costly infrastructure projects.

Jokowi may achieve sustainable outcomes from Nawa Cita II by looking at the bigger picture of how poverty, inequality and unemployment are interlinked: unemployment leads to poverty and in turn lead to inequality, which will impede the people's access to jobs and thus exacerbate unemployment. These three issues, if not addressed comprehensively, will protract the vicious poverty cycle.

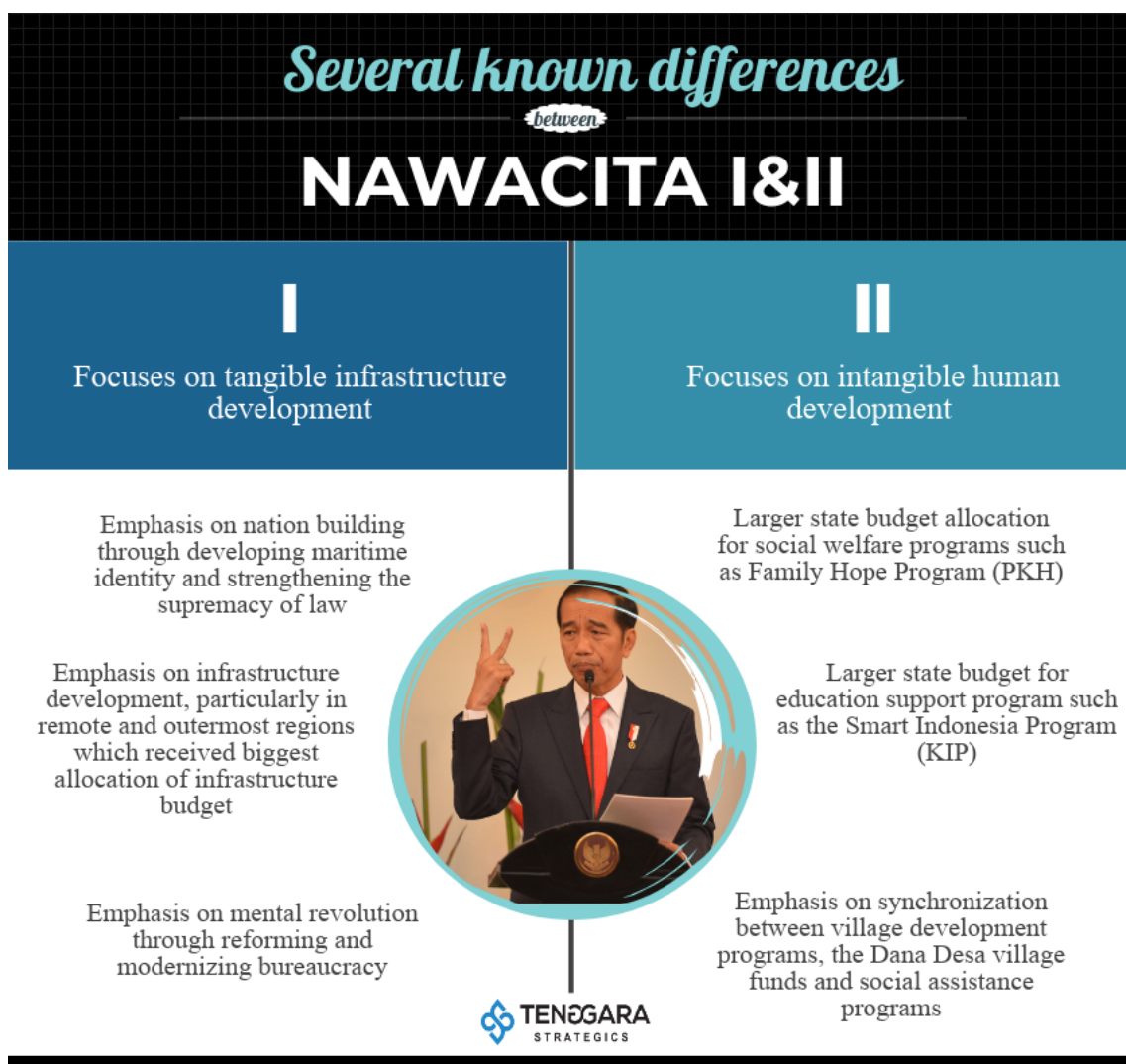
One measure that Nawa Cita II can adopt is a different approach from Nawa Cita I in eradicating poverty. While Nawa Cita I focuses on increasing the social assistance budget, which has reportedly had a great impact on reducing poverty, Nawa Cita II should instead increase the government's investment in human capital to achieve a more sustainable outcome. Nawa Cita I's emphasis on social aid programs aims to increase *equality in income*; Nawa Cita II should instead focus on *equality in opportunities* through increased investment in education and thereby level the playing field. Providing social aid programs, which helped slash the poverty rate this year, might increase equality in income, yet it will also increase public dependence on government assistance. Consequently, there is no guarantee that this approach is sustainable.

The presidential candidates of Indonesia's fledgling democracy must take up an enormous challenge in establishing political legitimacy to provide a solid basis for their administration. As public satisfaction is relatively low in Jokowi's attempt to establish democratic

governance through Nawa Cita I, Nawa Cita II should restore public trust in his political agenda. Failure to do so may raise suspicions that Jokowi's attempt to revive the Nawa Cita is merely to serve his characteristic obstinacy.

What we've heard: Members of Jokowi's coalition are competing to have their proposals included in the Nawa Cita II. The Islamic based parties, PKB and PPP, in particular have demanded Nawa Cita to include development programs for all Islamic boarding schools throughout the country, as well as empowerment programs for Islam based civil groups. It is said that including such programs in the Nawa Cita II will oblige the Jokowi's administration to allocate the state money for financing; a campaign strategy that both PKB and PPP will sell to reach out to the Muslim communities in order to win the upcoming legislative race. Meanwhile, other members in the coalition are still competing to have their proposals, which are related to the management of resources, included while some leaders from Jokowi's volunteer groups have also asked the Nawa Cita II to continue some programs that the Jokowi-Kalla administration has yet to accomplish, including the settlement of several human rights abuses. The discussion is still ongoing.

The opposition coalition is also on the process of formulating its own-version of Nawa Cita. The discussion is still ongoing but some executive members from Prabowo's Gerindra Party cited a program to deal with increasing recruitment of foreign workers as a top priority.



Jostling coalitions: legislative or presidential election?

The year 2019 holds great political significance for Indonesia, as both the legislative and presidential elections will take place. Scheduled on the same day, April 17, 2019, the run-up to the elections has caused political upheaval with parties scrambling to form coalitions. Nevertheless, mere days before the candidate registration deadline for the presidential election, neither President Jokowi nor his contender Prabowo Subianto have formed a secure coalition.

Uncertainties ahead of the elections might be the primary cause of the political quagmire. It is now up to Jokowi and Prabowo to convince the parties of their capabilities in strengthening the parties' political credentials and in attaining the objectives of each party.

Background: The General Elections Commission (KPU) will close registration for the presidential election on Aug. 10. With the deadline nearing, however, both the ruling and opposition coalitions' preparations have been marred by threats and blackmail that have put their unity at risk.

The parties' fickleness and shaky coalitions might be due to the presidential candidates' comparative failure to ensure their parties of the potential electoral prizes their coalitions offer. Consequently, the parties may have assumed that the benefits of being in either coalition were not worth their allegiance, particularly in the midst of the country's uncertain political environment.

In forming a solid coalition and commanding unswerving loyalty among coalition parties, the presidential candidates must embrace the needs of not only the major parties, but also the minor parties. Understandably, while the presidential candidates' eyes are on winning the election, they must also consider the improbability of minor parties in assuming pivotal roles during their election campaigns. Hence, the candidates must come up with other bargaining chips in forging a strong political alliance, such as by enhancing the coalition parties' prospects of gaining legislative seats.

Insight: Presumptive nominee Prabowo Subianto has faced multiple difficulties in establishing a strong coalition. Earlier this week, the National Mandate Party (PAN) threatened to withdraw its support for Prabowo. Prior to that, following rumors about Prabowo's growing ties with the Democratic Party, Prabowo's staunchest supporter the Prosperous Justice Party (PKS) also threatened to quit the coalition. This phenomenon was not exclusive to the Prabowo camp, as President Jokowi also faced a similar predicament with the parties in his coalition often issuing thinly veiled threats. This has caused frequent speculation on party switching and the establishment of a third coalition, demonstrating the precariousness of Prabowo's and Jokowi's political standing.

Stiff competition for the vice-presidential slot might be the underlying reason for the parties' uncertain loyalty, with the parties competing fiercely among themselves in proposing their own members as potential running mates.

In the Prabowo camp, PAN, the PKS and the Democrats each offered their top members as the retired general's running mate. Prabowo's meeting last week with Democratic Party chairman Susilo Bambang Yudhoyono (SBY) caused a huge uproar within his coalition, with the PKS – which had the greatest influence in the coalition prior to Prabowo's meeting with

SBY – threatening to withdraw its support for Prabowo if he showed any signs of choosing the Democrats’ top executive and SBY’s eldest son Agus Harimurti Yudhoyono as his running mate.

Now, days before the candidate registration deadline, the tide has turned with the Democrats reportedly withdrawing its support for Prabowo after he chose Jakarta Deputy Governor Sandiaga Uno as his running mate.

The see-sawing political alliances may be due to the parties’ desperation at securing the vice-presidential slot. Consequently, with each new rumor on a presidential candidate strengthening his political ties with a particular party, the other parties often protest by issuing a threat, making the coalitions highly unstable.

Furthermore, minor parties, who have comparatively small roles in the presidential election, may hesitate to pledge their allegiance to any coalition, as doing so would produce no tangible results. After all, looking at the cutthroat competition between the major parties over the vice-presidential slot, the chance that presidential candidates would select a nominee from a minor party is ridiculously slim.

In addressing parties’ fickle loyalty, the presidential candidates can adopt one solution: shift the parties’ focus from the presidential to the legislative election. Success in forming a coalition depends on the presidential candidate’s bargaining power: What can their coalition offer? Bargaining with multiple parties over the vice-presidential slot is a risky business, as only one winner will eventually emerge. This can potentially breed insecurity and contempt among the competing parties, putting the coalition on the verge of constant collapse. Thus, using the vice-presidential slot as the sole bargaining chip in forging a coalition would only result in a volatile coalition.

As in the coattail effect theory, the parties’ focus can be shifted from the presidential to the legislative election by capitalizing on how the presidential candidates’ popularity could benefit their members in winning other electoral prizes, in this case seats in the House of Representatives (DPR). The parties may thus ride the coattails of the presidential candidates in order to meet the legislative threshold.

As last year’s Elections Law has increased the legislative threshold from 3.5 percent to 4 percent, legislative candidates from parties with House seats below 4 percent, such as the PKS, PAN, Hanura and the United Development Party (PPP), risk being unrepresented in the legislature if they do not work harder in the upcoming election. The presidential candidates, thus, could gain unswerving support from these parties in exchange for using the candidate’s popularity to increase their votes to meet the legislative threshold.

Mutually beneficial cooperation is key to establishing a coalition. How a presidential candidate can benefit each coalition party is pivotal to resolving the realpolitik of the 2019 general elections. The limits of the vice-presidential slot as the sole concession to parties’ support necessitate the candidates to seek another bargaining chip. This is where legislative election comes in to play.

What we’ve heard: Prabowo’s decision to finally pick Jakarta Deputy Governor Sandiaga Uno as his running mate was aimed to maintain control over the opposition camp. The option to nominate Sandiaga, who is a Gerindra member, was prepared only several days

before the Aug. 10 deadline as an alternative to anticipate negotiation deadlocks, particularly with the Democratic Party that had insisted to nominate Agus as a vice presidential candidate.

In comparison to Agus, Sandiaga is more acceptable to PKS and PAN. Moreover, in addition to Sandiaga's willingness to finance the campaign, which will later benefit the legislative campaign of each party, Sandiaga is also seen 'safer' to party elites in the coalition as he is not seen as a "control freak", like some of them referred Yudhoyono.

BUSINESS & ECONOMIC POLICY

Jonan deals blow to Chevron over IDD and Rokan

The Energy and Mineral Resources Ministry announced on July 31 that Pertamina would take over the operation of the Rokan Block in Riau from PT Chevron Pacific Indonesia, making Pertamina the biggest oil producer, with a 60 percent share of total oil lifting by 2021.

Background: The ministry's decision was a disappointment for Chevron, which has been operating the block since 1924. Despite the disappointment, Energy and Mineral Resources Minister Ignasius Jonan in a video interview with *detik.com* tried to assure all sides that the decision was based on fair business considerations, not politics or petty nationalism (see table below).¹

Chevron's Offer	Pertamina's Offer
US\$ 33 billion in the first ten year of investment with expected production of 500,000 bph	Investment commitment fee of US\$ 500 million
	Signature bonus of US\$ 784 million
US\$ 55 billion in the next ten year of investment with expected production of 700,000 bph	Expected state revenue of US\$ 57 billion with 48 percent share under gross split contract

Source: Video Interview Detikcom with Energy and Mineral Resources Minister Ignatius Jonan

However, Deputy Energy and Mineral Resources Minister Arcandara Tahar's announcement on Aug. 6, which requires Pertamina to pursue a share down on its 100 percent participating interest, suggests that the ministry's decision on the Rokan Block is more than just what is written in the proposal. The ministry's oil and gas upstream supervising director, Ediar Usman, elaborated on the announcement further by emphasizing the requirement to find a partner, preferably the existing operator Chevron.²

Insight: The ministry's decision to award the Rokan Block to Pertamina is a message to Chevron from Minister Jonan that he was serious about his threat back in June 29 to kick Chevron from the lucrative block if it failed to make significant progress in the Indonesia Deepwater Development (IDD) project at the Gendalo-Gehem field.³

¹ Detikcom, "Blak-blakan Jonan: Pertamina rebut blok Rokan" 2 August 2018 <https://tinyurl.com/yb258td7>

² TheJakartaPost.com, "Pertamina required to share down Rokan block" 8 August 2018 <https://tinyurl.com/y838c3mj>

³ CNBCIndonesia.com, "Jonan kecam Chevron: IDD tidak jelas, blok Rokan dilepas" 29 June 2018 <https://tinyurl.com/ybzhrugk>

The Gendalo-Gehem field was discovered in February 2000,⁴ and Chevron's proposal to develop this field with \$6 billion investment was approved in 2008.⁵ At first, this project was expected to be operational by 2017 or 2018, but in 2014 Chevron announced that this project would not be on stream at least until 2020 because its 2013 front-end engineering design (FEED) found that the estimated cost of developing this field had doubled to \$12 billion.⁶ Using this finding, Chevron submitted a Plan of Development (PoD) in 2015 valued \$9 billion to \$10 billion. However, the government disagreed with Chevron's PoD and asked for a new FEED with more reasonable cost calculation.⁷ In June 28 this year, Chevron submitted a new PoD to the ministry with investment cost around \$5 billion.⁸

Despite disagreement regarding the investment cost, Chevron felt reluctant about the government's proposition to change the contract from a production sharing contract using the cost recovery scheme to a gross split scheme in 2020 for the Makassar Strait block and in 2027 to 2028 for the Ganal and Rapak blocks. Because of this disagreement, Chevron decided to withdraw from the Makassar Strait block on July 11.⁹

Chevron's withdrawal was the last straw for Minister Jonan, so he decided to punish Chevron by awarding the lucrative Rokan Block to Pertamina. Despite the harsh punishment, Minister Jonan still expects Chevron to stay in Indonesia and complete the development of the Gendalo-Gehem field. In communicating this message, the ministry offered an olive branch by requiring Pertamina to partner with Chevron in operating the Rokan Block.

Rokan's Potential (By 2018)

Projected Oil Production Capacity in 2018	207,148 barrel per day
Projected Production in 2018	205,952 barrel per day OR 75 million barrel a year
Potential Income	Rp 72 trillion
Projected Gas Production Capacity	24.26 MMscfd
Project Consultant ADB Institute	Project Consultant ADB Institute
Projected Gas Reserve	1.15 million MTSB
Projected Oil Reserve	77.13 BSCF

Source: Bisnis Indonesia, SKKMigas

The takeaway: The ministry's decision to award the Rokan Block to Pertamina is just a negotiation tactic. However, Minister Jonan has offered the olive branch, and it is up to

⁴ Offshore-technology.com, "Indonesia Deepwater Development, Kutie Basin" <https://tinyurl.com/yamouhnd>

⁵ Reuters.com, "Indonesia approves Chevron gas field plans off E.Kalimantan" 4 September 2008 <https://tinyurl.com/y8yosbv4>

⁶ Businesstimes.com.sg, "Indonesia says Chevron gas project set back by up to 2 years" 28 October 2014 <https://tinyurl.com/ycl6r5qa>

⁷ CNNIndonesia.com, "Chevron start telaah proyek IDD Gendalo-Gehem" 14 December 2017 <https://tinyurl.com/y7e2a5v6>

⁸ CNBCIndonesia.com, "Investasi proyek laut dalam Chevron turun jadi US\$ 5 miliar" 2 July 2018 <https://tinyurl.com/yd4q5cey>

⁹ Reuters.com, "Chevron exits Indonesia's Makassar Strait block: regulator" 11 July 2018 <https://tinyurl.com/y953thby>

Chevron whether to take it and continue with the negotiation over the development of the IDD project at Gendalo-Gehem field.

What we've heard: According to some sources at the Energy and Mineral Resources Ministry, Pertamina proposed a more convincing proposal than that of Chevron to manage the Rokan oil and gas block in Riau, based on the value of signature bonus, certain working commitments and the state's potential income in the next 20 years.

To obtain the Rokan Block operating permit for 2021 to 2041, Pertamina proposed US\$1.28 billion, or Rp 18.5 trillion, for signature bonus and certain working commitments. The number does not include foreign exchange reserve savings potential due to less oil import. Meanwhile, Chevron proposed no more than \$800 million.

With such differing offers, it is hard for the government to reject Pertamina's offer. Moreover, under the current production sharing contract, with a cost recovery scheme, the government has no obligation to renew Rokan Block's operating permit to the previous contractor, Chevron. When the contract ends in 2021, all assets currently within Chevron's control would automatically become the government's assets as all assets have been paid for using the cost recovery scheme.

The next crucial issue to consider is how to maintain the Rokan Block's production at a high level. The block currently contributes 25 percent to national lifting capacity, but the block is aging.

To prevent Mahakam's case from recurring, where the block output is decreasing after being taken over by Pertamina from Total, ministry officials urged Pertamina to partner with Chevron in operating the Rokan Block, whose reserves are still high, at 1.5 billion barrels.

A Pertamina representative said the extension of Rokan concession to Pertamina is a "gift" after the state-owned oil and giant has been burdened by the energy subsidy, which caused the company's finances to worsen. By obtaining the Rokan Block, Pertamina will have the capacity to seek new loans.

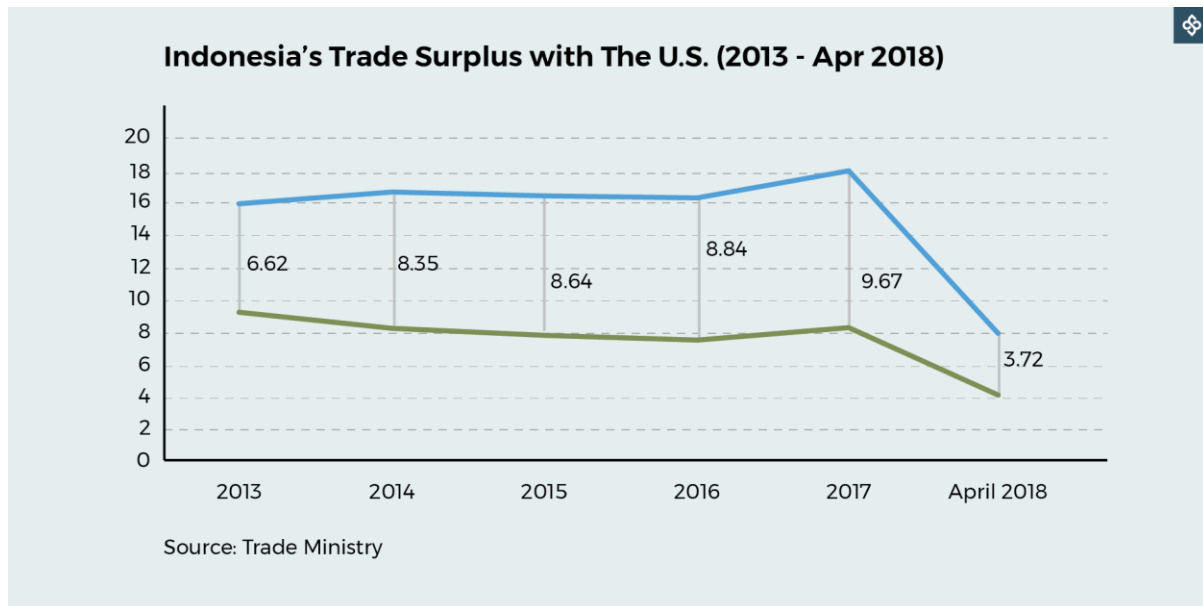
The new operating license for the Rokan Block, however, would be given under the new regime of gross split, instead of a production sharing contract. The Pertamina executive, nevertheless, noted that Pertamina is happy even with the gross split scheme, because Rokan still has big proven reserves. Oil and gas contractors usually think twice in applying the gross split scheme if the oil and gas reserves have not been proven yet.

Indonesia weighing possible trade spat with US

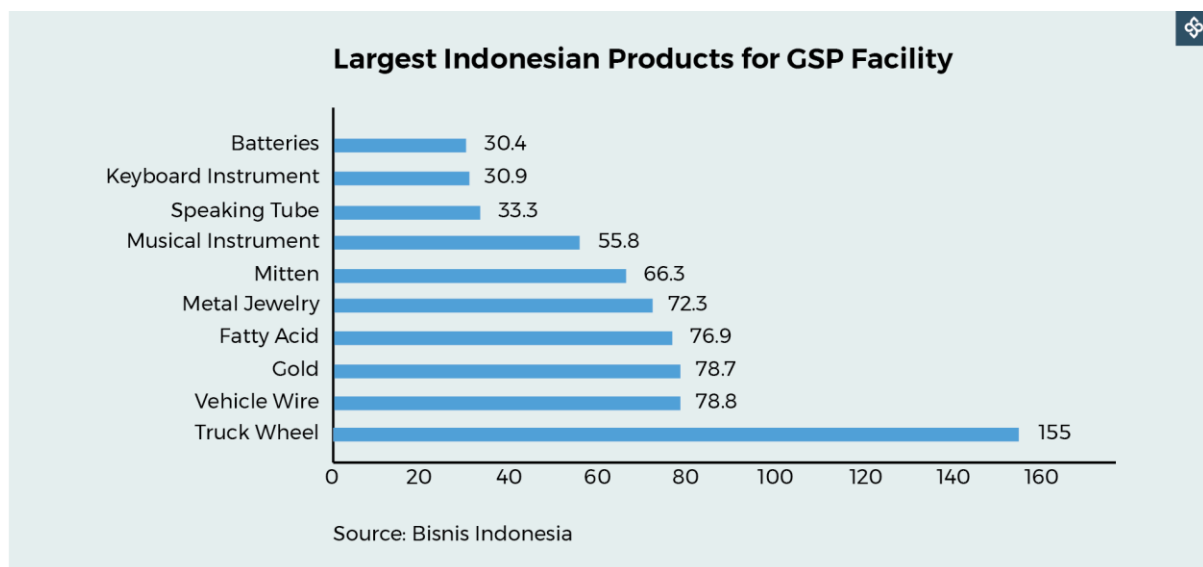
United States Secretary of State Mike Pompeo visited Jakarta on Aug. 4 and 5 to meet with President Joko "Jokowi" Widodo and Foreign Minister Retno Marsudi to discuss several issues, including the ongoing bilateral negotiation on Indonesia's inclusion in the US' Generalized System of Preferences (GSP). Earlier, Indonesian Trade Minister Enggartiasto Lukito visited the US and met with the Office of the US Trade Representative (USTR) from July 23 to 27 in Washington to negotiate the GSP.

Background: The USTR announced last April that it was reviewing eligibility of its GSP facility on Indonesia, India and Kazakhstan. For Indonesia, the review is based on US

concerns related to Indonesia's market access and investment restriction. Another reason is widening trade deficit between the US and Indonesia (see figure below).



Indonesia itself ranked only fourth among the countries that gain advantage of the GSP facility program with US\$1.95 billion of benefit value in 2017, much lower than India (\$5.6 billion), Thailand (\$4.2 billion) and Brazil (\$2.5 billion). There are around 700 Indonesian goods (using eight-digit HS code) benefiting from the facility. As a proportion, 10.7 percent of Indonesian exports to the US use the GSP facility, or 7.5 percent from Indonesia-US total trade.



Although the numbers are not really high, it is important for the government to put an effort to keep the facility amidst a widening Indonesian trade deficit in 2018. In the first semester, Indonesia already recorded a trade deficit of \$1.02 billion, or Rp 7.7 trillion, according to Central Statistics Agency (BPS) data.

The visit of Trade Minister Enggartiasto and some Indonesian business association representatives to Washington to meet with USTR Ambassador Robert E Lightizer and US

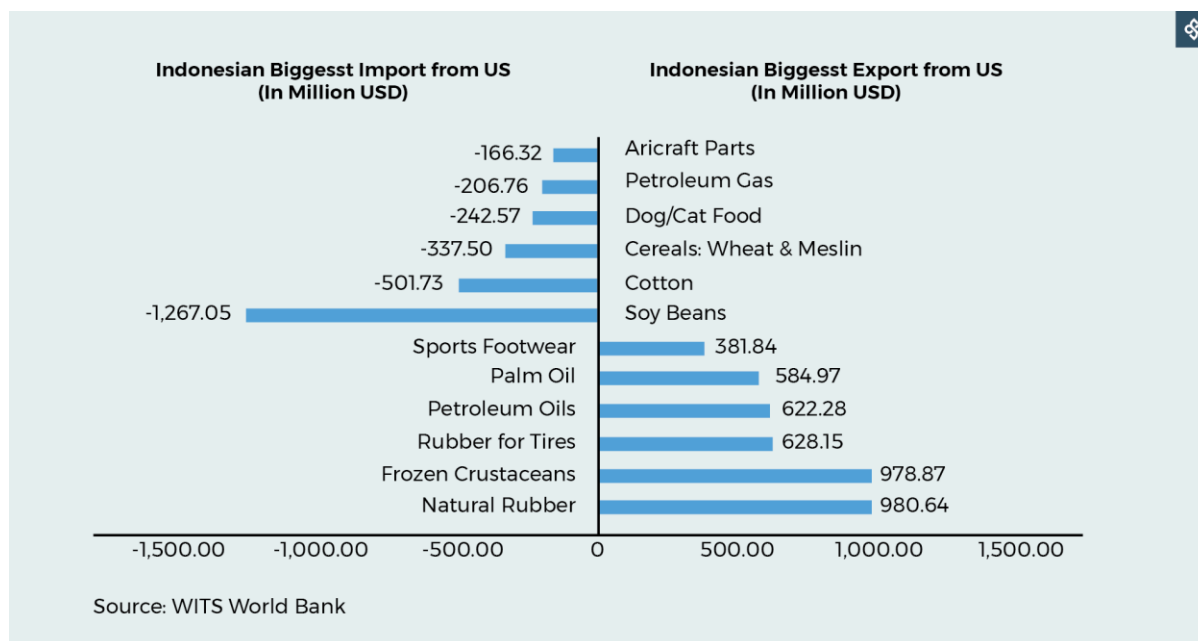
private sectors has indeed given a positive signal that the US would likely retain Indonesia on the list of the US GSP facility recipients. After the meeting, the two ministers signed a memorandum of understanding (MoU) in which Indonesia and the two countries agreed to add an extra \$1.01 billion to bilateral total trade, which will be dominated by Indonesian importation of more agricultural products from the US, especially cotton, soybean, wheat, horticulture products, fruits and dairy products. In addition, the agreement has been reached to create a roadmap for doubling bilateral total trade value to \$50 billion in 2020.

Insight: There are some interesting points under this agreement. First, most of these goods that the US has demanded Indonesia to import more of are those products that have been targeted by China's retaliation program against the US. China has responded to the US trade war initiative by adding a 25 percent tariff on US export goods such as fresh and frozen beef, pork, fishery products, dairy products, fruits and vegetables, nuts, soybean, wheat, rice, tobacco and vehicle machinery. It indicates that the US government is trying to find another potential market of those products as a result of the US-China trade war. This momentum should be taken by the Indonesian government to pursue further negotiation for a bilateral trade agreement with the US. By pursuing this, Indonesia should no longer rely on the GSP facility, which can be revoked anytime by the US government.

Another interesting point is related to the settlement of the lawsuit brought by the US to the World Trade Organization (WTO) against Indonesia's trade restriction on agricultural products, livestock, beef and chicken. On Aug. 6, the US sought \$350 million in sanctions after winning a trade dispute in the WTO Dispute Settlement Body. The US demanded the sanctions after learning that US exporters of agriculture produce still face restrictions in Indonesia following the WTO verdict that faulted Indonesia in November 2017. By seeking this sanction after Enggartiaso's meeting with the USTR, it indicates the US does not only want to increase export to Indonesia but also liberalize Indonesian import regulation especially in horticulture, beef and chicken products. By doing so, the US will potentially gain more export to Indonesia.

So, how will all this GSP drama impact Indonesia's trade deficit? Revoking the GSP facility or signing the MoU to import more from the US certainly will not reverse the current trade situation, where Indonesia enjoys a big surplus of around \$9.6 billion in 2017 and \$3.72 billion in 2018 (Jan-May period).

Meanwhile, the roadmap to double total bilateral trade in the next two years will probably change the proportion of trade between the two countries. While contents of the roadmap are still unknown, the Indonesian government needs to be thorough in looking at this opportunity in order to increase Indonesia's total exports and having more investment to create job opportunities. The government needs to look closely which sectors contribute the most for exports, which sectors have a comparative advantage against the US and which products Indonesia will need to import more as raw materials or capital goods that can assist Indonesian export competitiveness.



The takeaway: Although the monetary benefit of the GSP facility is not relatively high, Indonesia still needs the facility to help Indonesian export competitiveness. Indonesia should also pursue a bilateral (free) trade agreement with the US to deepen bilateral trade so that Indonesia will no longer rely on the GSP facility as it could be removed at any time.

What we've heard: According to a number of officials, what has prompted the United States administration to review Indonesia's status under its Generalized System of Preferences (GSP) is Indonesia's limitations to importation of American products, especially agriculture products as well as Indonesia's increasing limitation to foreign participation in its economy.

The US especially is concerned with 10 products that face limitations in entering Indonesia, mostly agricultural products such as fruits, soy and dairy products. On the issue of limitation to foreign participations, the US pointed at Indonesia's implementation of the National Payment Gateway (GPN), local content requirement (TKDN), limitation on foreign ownership of insurance companies and violation of intellectual property rights.

On the trade side, US officials consider Indonesia to be practicing unfair trade on their agriculture products. The US pointed out that Indonesia has not returned the favor that it has been giving through the GSP, which annually cuts US\$1.85 billion worth of tariffs and provided Indonesia with a \$9.6 billion trade surplus last year.

The Office of the US Trade Representative (USTR) noted that the Indonesian Agriculture Ministry often issues import recommendations on US agricultural products such as apples, grapes and lemons, when they are not within harvesting season. The USTR became infuriated after the ministry also issued a limitation that prohibits some US products from entering Indonesia under the argument of food security and local farmer empowerment. The USTR, together with New Zealand, then brought Indonesia's limitation on imports to the World Trade Organization (WTO) in 2015.

According to the same source, the US was also dissatisfied with the ministry's plan to revive soybean import tax. The ministry has drafted a regulation that would regulate national soybean commerce, while 98.3 percent of the national soybean supply came from the US.

An Indonesian senior economic minister has actually reprimanded the agriculture minister for issuing regulations limiting agricultural products importation in July after the WTO convicted Indonesia based on the US and New Zealand lawsuit.

After the WTO ruling, the Indonesian government eliminated restrictive regulations, but the US government insisted that US fruit exporters still faced difficulties in exporting their products to Indonesia. This has become the source of the US' demand for a \$350 million sanction.

In addition to trade issues, the USTR also brought the GPN issue onto the table, saying its implementation marginalized Visa Worldwide and Mastercard. Based on Bank Indonesia's new regulations, Visa and Mastercard have to cooperate with a local GPN institution located in Indonesia to help process their domestic credit and debit transactions. Visa and Mastercard can also become a GPN institution, but they have to establish a local entity, with local ownership of 80 percent. The regulation also requires Visa and Mastercard to own branch offices instead of representative offices.

On another non-trade issue, Indonesia and the US have eventually gone into discussions to address rampant violation of property rights. Both countries have been reported to agree on a road map as a solution to the existing problem.

Meanwhile, Indonesian Trade Minister Enggartiasto Lukita led a trade envoy to the US last July to address issues surrounding the GSP. During the visit, Enggar met with a number of business people who have big interests in Indonesia to ask for their help lobbying the US government to resolve the problems.

One of the businessmen Enggar met was Boeing vice president for international government relations Mark Lippert, thanks to the help of Lion Air founder Rusdi Kirana. It is important to note that Indonesian airlines have bought \$77 billion worth of Boeing products.

As one of Boeing's biggest markets, Enggar threatened to switch to Airbus if Boeing could not support Indonesia's trade settlement with the US government. The trade minister specifically asked Boeing to lobby the US government so that Indonesia's steel export to be exempted from duty by underlining the fact that Indonesian steel export to the European Union is free of duty.



US-INDONESIA Horticulture trade: Fact Sheet

Regulations obliging ministerial recommendation to import horticulture products

- Permentan 60/2012
- Permentan 47/2013
- Permentan 86/2013
- Permentan 16/2017
- Permentan 38/2017
- Permentan 24/2018

*Permentan: Agriculture Minister Regulation

Regulations on the requirements to import horticulture products

- Permendag 60/2012
- Permendag 16/2013
- Permendag 57/2013
- Permendag 30/2017
- Permendag 43/2013
- Permendag 95/2017
- Permendag 16/2018

*Permendag: Trade Minister Regulation

WORLD TRADE
ORGANIZATION



Total Sanction:
US\$350 million



8 issues on Indonesian horticulture import regulation

- Limited application windows and validity periods
- Periodic and fixed import terms
- 80% realization requirements
- The harvest period requirements
- Storage ownership and capacity requirements
- Utilization, sale, and distribution requirements, for horticultural products
- Price reference for chilies and fresh shallot for consumption
- Six months harvest requirements

Timeline summary

2014
Dispute Settlement Case in WTO No 477/478: New Zealand and US reported serious problem on 18 measures of Indonesian importation regulation for Horticulture products, Livestock, Beef, and Chicken on 8 May 2014.

2017
Indonesia appealed on 17 February 2017 to Appellate Body, but the panel rejected on November 2017

2017
Reasonable Period of Time (RPT) for 8 months since 22 November 2017 was being given to Indonesian government change the disputed regulations

2018
Appellate Body and Panel found 18 measures were inconsistent with Article XI:1 of the GATT 1994 on 22 December 2018. US and New Zealand won the lawsuit.

2018
Deadline to change the regulation: 22 July 2018

Macroeconomic Update: Indonesian economy shows sign of recovery

The Central Statistics Agency (BPS) announced on Aug. 6 that the Indonesian economy grew by 5.27 percent in the second quarter of 2018, higher than Bank Indonesia's (BI) forecast at 5.15 percent.

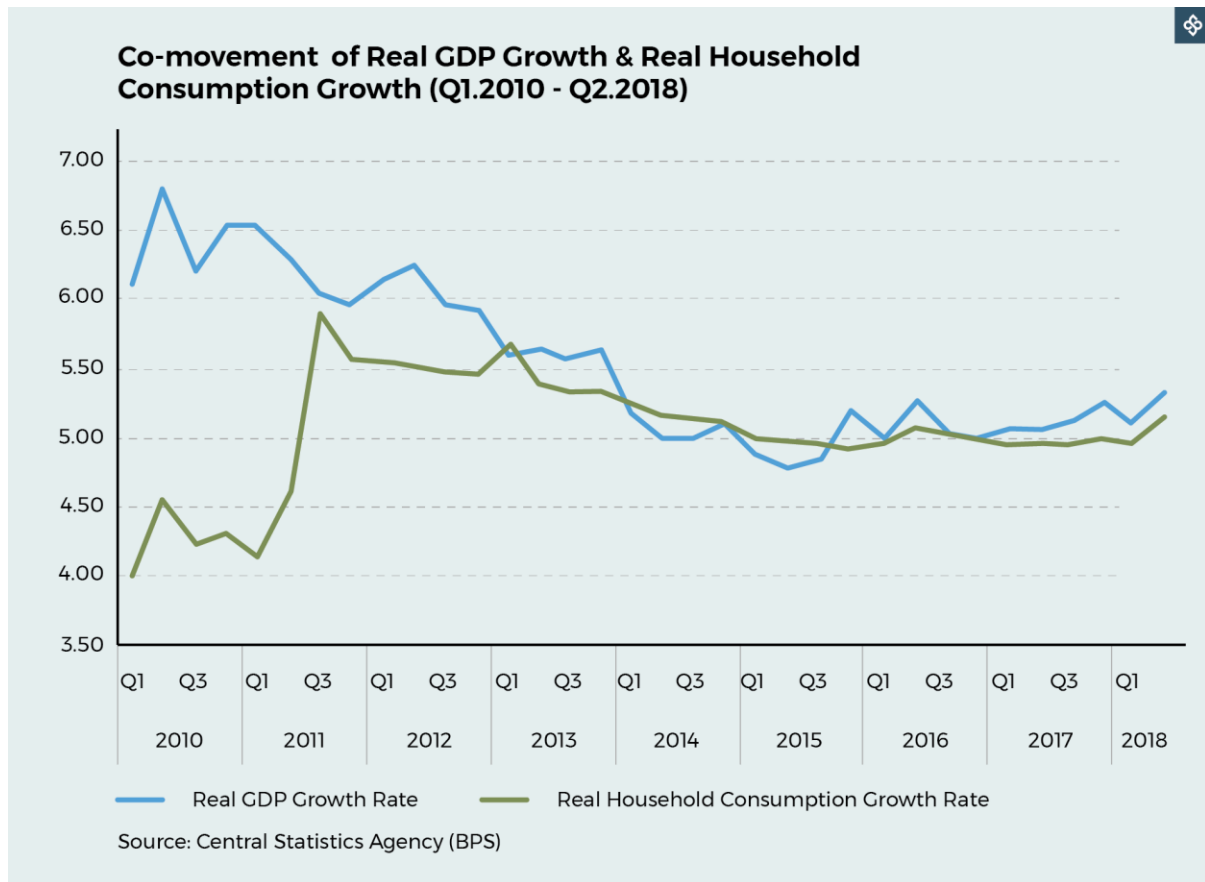
Background: The announcement is surprising, because nobody expected strong economic performance in the second quarter of 2018.¹⁰ (See table below)

Economist	Institution	Prediction
Myrdal Gunarto	Maybank Indonesia	5.19%
Josua Pardede	Bank Permata	5.15%
David Sumual	BCA	5.12%
Eric Sugandi	Project Consultant ADB Institute	5.2%
Lana Soelistianingsih	Samuel Aset Manajemen	5.14% - 5.16%
Aldian Taloputra	Standard Chartered Bank Indonesia	5.1%
Febrio Kacaribu	LPEM FEUI	5.1% - 5.2%

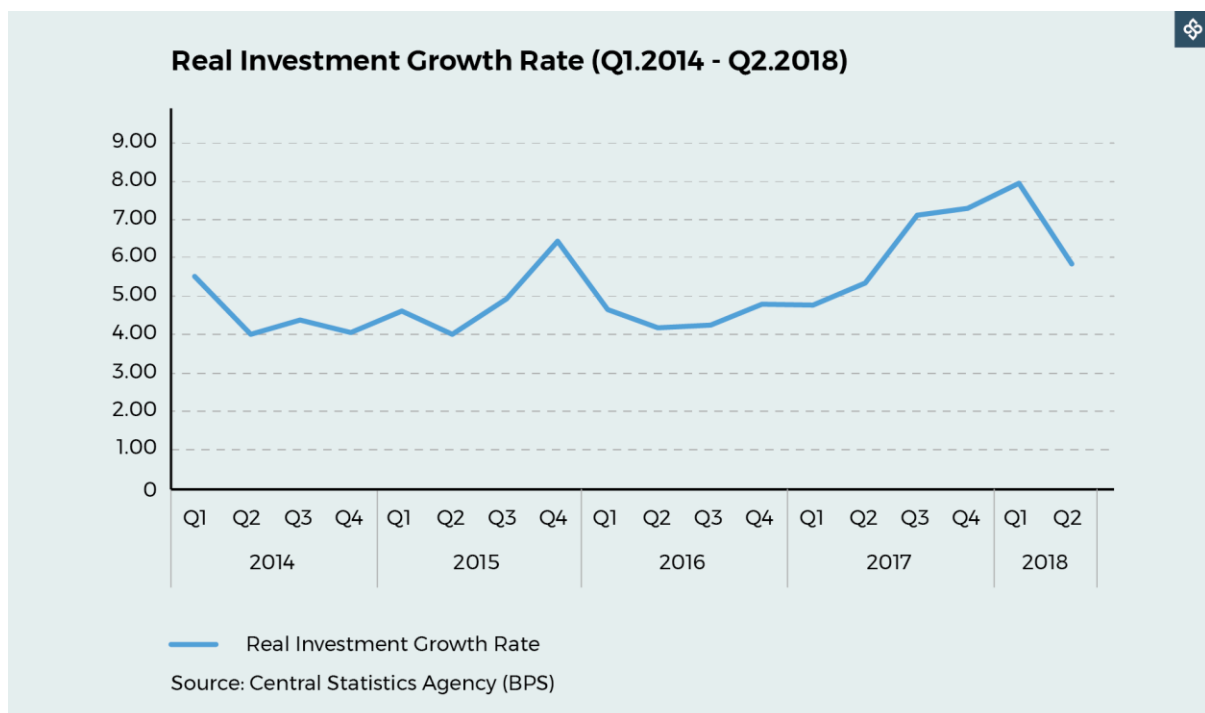
Source: Koran Kontan 04 Agustus 2018

Coordinating Economic Minister Darmin Nasution and Finance Minister Sri Mulyani Indrawati quoted strong household consumption growth at 5.14 percent as the main driver of last quarter, higher than expected real economic growth (see figure below).

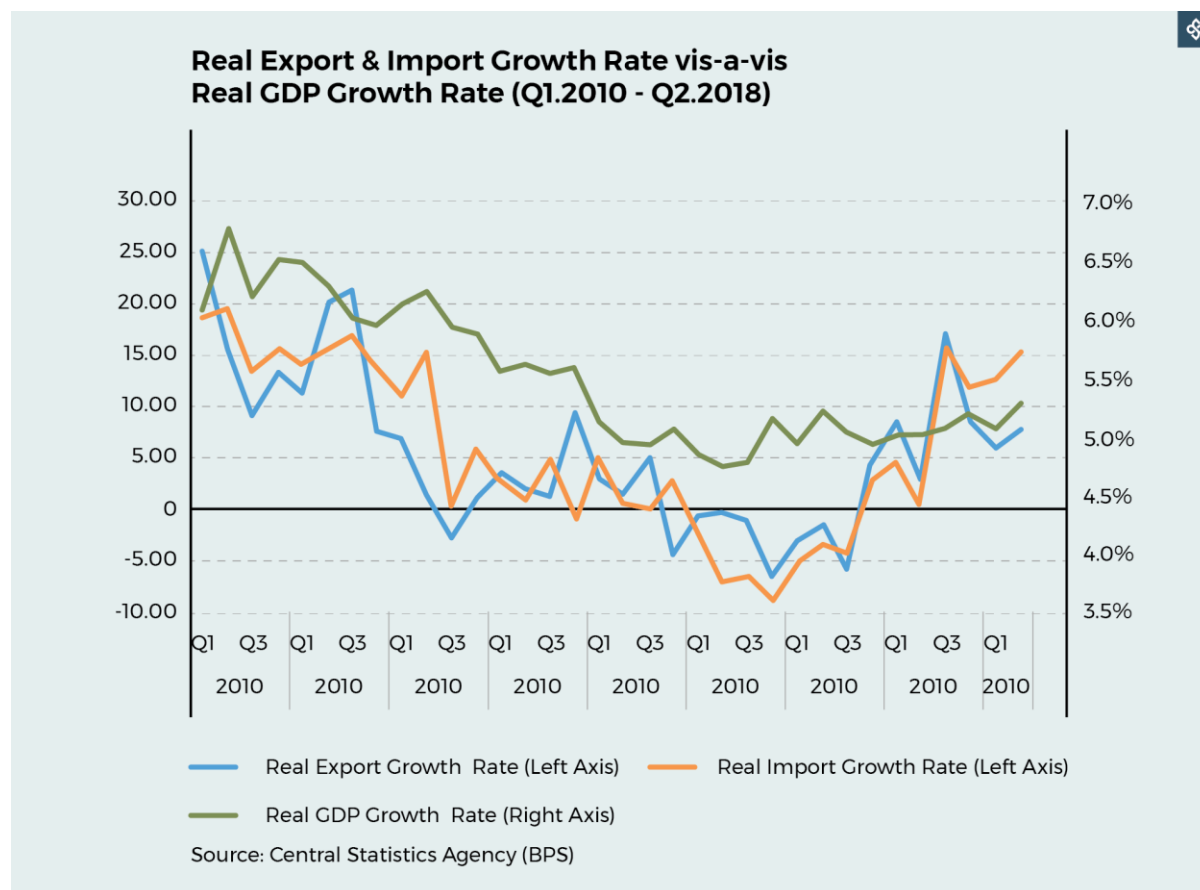
¹⁰ CNBCIndonesia.com, "Konsensus pasar: kuartal II, ekonomi RI diramal tumbuh 5.125%" 2 August 2018
<https://tinyurl.com/yaugtmbm>



Nevertheless, investment growth fell from 7.95 percent in the previous quarter to 5.87 percent (see figure below) due to BI's aggressive seven-day reverse repo rate hike by 100 basis points to 5.25 percent on three occasions between May and June.



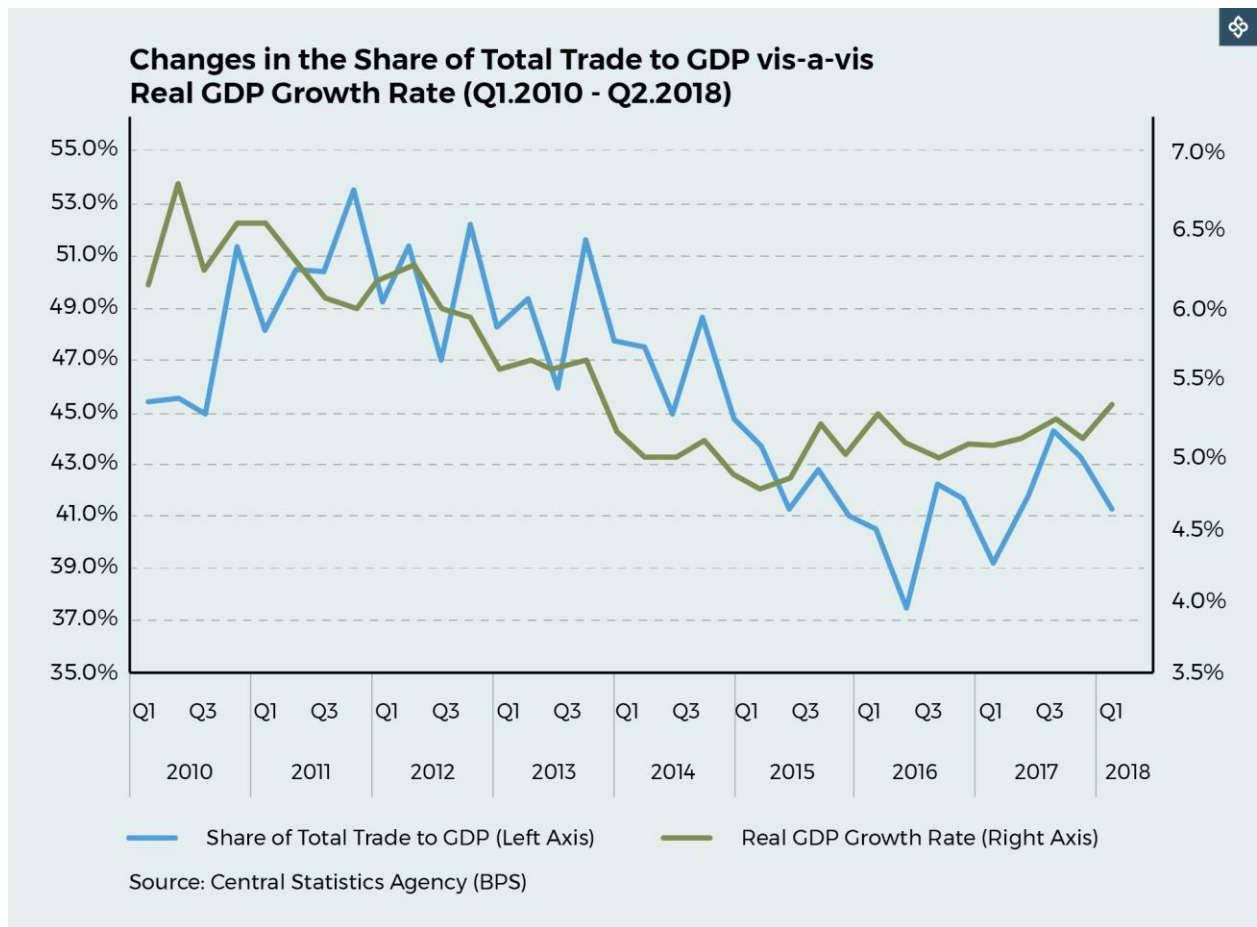
Insight: Many economists, such as Institute for Development of Economics and Finance (Indef) director Enny Sri Hartati and Gadjah Mada University's Tony Prasetyantono, argue that higher than expected last quarter economic growth is temporary because its source is strong household consumption growth driven by the seasonal Idul Fitri holiday.¹¹ Although this argument seems plausible, a deeper look at Indonesia's trade data suggests that the upward trend in Indonesia's real economic growth might be permanent.



As shown by the figure above, the movement of real quarterly gross domestic product (GDP) growth interlinks with the movement of real quarterly export and import growth. When real export and import growth rates decrease, real economic growth falls and vice versa. Besides following the growth pattern of export and import, the growth pattern of quarterly GDP follows the movement of the share of total trade to GDP (see figure below).

¹¹ Kontan.co.id, "Laju ekonomi triwulan II-2018 dinilai semu" 8 August 2018 <https://tinyurl.com/y79bhx9m>

Based on these patterns, it could be said that recent improvements in Indonesia's international trade performance signal the beginning of economic recovery in the coming years.



The takeaway: Improvements in export and import performance that began in 2017 suggest that the Indonesian economy has entered the early phases of economic recovery.

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