TENGGARA STRATEGICS

BACKGROUNDER
WEEKLY BRIEFING

YOUR GUIDE TO INDONESIA'S POLITICAL & BUSINESS AFFAIRS | December 21st, 2018

Highlights of the week

E-ID cards fiasco: Will it affect the elections?

The recent discovery of illegal sale of e-ID cards in a traditional and online market has prompted a fierce debate about the possibility of fake voters infiltrating the upcoming 2019 general elections. Since the debate remains largely unaddressed, the circulation of fake e-ID cards may be used in the future to question the legitimacy of election results by particular groups.

Climate change & the powerful business as usual

Despite the considerable number of Indonesian delegations sent to the latest United Nations Climate Summit, in reality the country still generally manages climate change with pragmatism. As Indonesia aims to secure an international assistance of US$6 billion in combatting global warming and climate change, winning the supports of local power business interests and the public is the key.

Batam's problems go beyond dualistic issue

The announcement of transfer of authority from Batam Free Trade Zone Authority (BP Batam) to mayor of Batam to solve the prevailing controversial dual-governance system unveiled darker problems that lingered behind Batam's economic stagnancy. Although the transfer could solve the political tug-of-war between BP Batam and local administration, it will not necessarily make Batam an attractive investment destination again.

Contentious reinvigoration of steel industry

The decline of Indonesia steel industry became an entrance for the rising Chinese steel industry to expand beyond their borders. Chinese investors came to fill the gap of technology in Indonesia, bringing oxygen blown converter-based (OBC) technology, leaving local producers' business such as Krakatau Steel, which utilize electronic furnace-based (EF), out of the race.

Macroeconomic update: bumpy ride ahead

Failing global oil prices might be a boon and barrier for Indonesian economy. Although it eases the pressure on RI's oil and gas trade deficit, the situation signals a slower global economic growth next year, hampering efforts to boost non-oil and gas exports when Statistics Indonesia just announced that the country booked the worst trade deficit so far in 2018.

POLITICS

E-ID cards fiasco: Will it affect the elections?

A recent investigation conducted by news daily *Kompas* revealed that e-ID cards had been sold commercially by individuals. Days after *Kompas* disclosed its findings, news about the discovery of thousands of discarded e-ID cards in several areas reemerged. The ongoing saga has evoked responses from both President Joko "Jokowi" Widodo's and rival presidential candidate Prabowo Subianto's camps, with both debating whether the issues surrounding e-ID cards will affect the 2019 general elections. Will they?

Takeaway:

- Considering its financial and logistical hassles, it is highly unlikely that the illegal commercial sale of e-ID cards will alter election results as popularly believed.
- It is probable, however, that debates about issues of e-ID cards will continue. This is because it is an effective instrument to swat public sentiment, particularly on the administration's legitimacy and merit.

Background: Since its inception back in 2009, e-ID card has been mired with problems. Starting from the corruption case involving former House of Representatives speaker Setya Novanto to the recent discovery of private businesses selling official blank e-ID cards, many deem the management of the electronic citizen document as problematic.

Several politicians from Prabowo's camp have expressed their concerns over the latest e-ID card incidents. His running mate Sandiaga Uno, for instance, said that the discarded e-ID cards might potentially "harm the fairness and integrity of the upcoming elections".[1] Meanwhile, President Jokowi's team has affirmed that the elections would not be jeopardized by the latest incident plaguing the e-ID card. The secretary-general of ruling Indonesian Democratic Party of Struggle (PDI-P), Hasto Kristiyanto, said the illegal commercial trade of official e-ID cards did not mean the government's security system had been hacked as many believed. Rather, Hasto argued that the discoveries of a large number of discarded e-ID cards were strange and appeared almost staged.

The hubbub surrounding e-ID cards resurfaces as the 2019 presidential and legislative elections draw near. Responses toward the e-ID card incidents are divided; some argues that they may rig the upcoming election process, while some argue that the incidents have been blown out of proportion.

Insight: Security and political concerns emerge following *Kompas*' e-ID card investigation. In regard to security concern, *Kompas* explained that fake e-ID cards might be used in financial crimes such as corruption or money laundering.[2] The striking resemblance between genuine and fake e-ID cards enables outlaws to employ fake e-ID cards to open bank accounts, for instance, for illicit business transactions. Such mishap occurred in 2016, when former Transportation Ministry sea transportation director general Antonius Tonny Budiono accepted a bribe of Rp 2.3 billion from a bank account which had been opened using a fake e-ID card.

[1] Detik.com, "Sandiaga: e-KTP Tercecer Berpotensi Cederai Kejujuran Pemilu 2019", 12 December 2018 https://tinyurl.com/yavy55zr

[2] Kompas.id, "Blank e-KTP Trade Encourages Crime", 7 December 2018 https://tinyurl.com/yajlcemv

Other than increasing the risk of financial crimes, political threats posed by the circulation of fake e-ID cards have been heavily debated as well. Several figures from Prabowo's camp have pointed out the possibility of falsified election results due to the use of fake e-ID cards. Spokesperson of Prabowo's camp Ferry Juliantono, for instance, urged the General Elections Commission (KPU) to anticipate fake voters and to ensure the accuracy of the voters list (DPT) for the upcoming elections.[3]

Concerns over fake voters have been mounting since disagreements about the official number of voters emerged. Per Sept. 5, 2018, KPU registered as many as 185 million eligible Indonesian voters. This number, however, differed from the Home Ministry's data, which claims that there are 196 million voters.[4] To make matters worse, Prabowo's team claimed that it found indications of 1.6 million double-listed voters on KPU's list.[5] Now, after assessing and revising its initial list, KPU's recently announced DPT consists of 192 million voters.

Nevertheless, disagreements aside, looking at the massive number of Indonesian eligible voters, rigging the elections using fake e-ID cards would be cost-ineffective. If an individual or a particular group wanted to rig the election results by 10 percent, for instance, it would require 19.2 million voters, each of whom with their own fake e-ID card. As one fake e-ID card costs approximately Rp 500,000 (US$35), it would cost around US$672 million to get enough fake e-ID cards to rig the election by merely 10 percent. A cheaper alternative would be getting blank forms of e-ID card instead, which individuals can personalize as they wish. However, considering that one blank form of e-ID card costs approximately Rp 200,000 (US$14), it would still cost a hefty price of US$270 million to tamper with the election by 10 percent.

Besides the considerable amount of money required, falsifying election results using fake e-ID cards is not effective due to the large number people needed as well. Exacerbating the situation, people with fake e-ID cards could only infiltrate particular polling stations in particular regions. As people can only vote in a predesigned polling station in accordance to their place of residence, members of the same neighborhood or community often vote in the same polling station. Thus, in rural areas where members of neighborhoods and communities are close and familiar with each other, fake voters with fake e-ID cards would be easily identified. As a consequence, the most likely scenario would be implanting fake voters in areas predominated with rented houses or apartments where tenants barely know each other. Such areas, however, are limited as they are mostly located in urban regions.

Considering the inefficiency of using fake e-ID cards and fake voters to alter election results substantially, why are, then, concerns over fake e-ID cards and its potential political impacts still heavily debated?

For one, the incident surrounding fake e-ID cards can be used to question the government's legitimacy. Since *Kompas* first published its investigation, the opposition has herded the issue into the matters of legitimacy and merit, prompting the spread of public mistrust against the government. Prosperous Justice Party (PKS) politician Mardani Ali Sera, for instance, stated that the circulation of fake e-ID cards indicated the government's "systematic failure" in

[3] Tribunnews.com, "Kubu Prabowo Minta KPU Antisipasi Penggelembungan DPT Karena Bocornya Blanko E KTP", 6 December 2018 https://tinyurl.com/ycynvxvv
[4] Tempo.co, "KPU Tegaskan Tak Ada DPT Siluman Menjelang Pilpres" 14 December 2018 https://tinyurl.com/y7yv68pj
[5] Tempo.co, "Tim Prabowo Laporkan Potensi 1,6 Juta Data Ganda DPT ke KPU", 14 December 2018 https://tinyurl.com/yc3h5vtw

regulating e-ID cards.[6] Sharing the same sentiment, Gerindra Party deputy chairman Fadli Zon claimed that fake e-ID card trade coupled with the discovery of thousands of discarded e-ID cards in several regions potentially diminished public trust in the government's population data, which the KPU uses as a reference for its final voters list.[7]

Instigating public mistrust against the government's legitimacy bears one considerable significance: it provides an opportunity to later reject the election results if they do not end up as desired. By repeatedly calling the incident as a "systematic failure" or "tip of the iceberg of the government's failure", the opposition attempts to portray the circulation of fake e-ID cards as the beginning of a systematic, structured and massive fraud in the elections. Such portrayal is needed in order to challenge election results as the Constitutional Court (MK) devised a new standard in addressing election disputes: the alleged election fraud must be proven as systematic, structured and massive. Thus, hinting that the government (structured) intentionally lets a large number of fake voters with fake e-ID cards (massive) to infiltrate the upcoming elections through a failure in its regulation system (systematic) might enable the opposition to challenge the election results if it wishes.

The government has addressed the opposition's claims by stating that the circulation of fake e-ID cards was not caused by a systematic failure, but rather merely due to human error; according to the government, blank forms of e-ID card were obtained by non-governmental actors after a relative of a Home Ministry's Population and Civil Registry officer purposefully stole the forms and sold them for financial gains.[8] Regardless, although its effectiveness and its urgency have yet to be proven, it remains likely that the opposition will continue using the fake e-ID card narrative in the future to sway the public trust in the government.

[6] Detik.com, "Minta Ada Audit dari Tercecernya e-KTP, Mardani: Kegagalan Sitematis!" 11 December 2018 https://tinyurl.com/ybyv4hlc

[7] Tribunnews.com, "Fadli Zon: Kasus e-KTP Membuat Masyarakat Tidak Percaya Data Kependudukan" 11 December 2018 https://tinyurl.com/ybkx2kzq

[8] Tempo.com, "Tjahjo: Blanko e-KTP di Toko Online Bukan Karena Sitem Jebol" 6 December 2018 https://tinyurl.com/yahr4mhx

TENGGARA STRATEGICS

POLITICAL STATEMENTS ON E-ID CARD

"This is very concerning. It may potentially harm the upcoming elections' fairness and integrity.

SANDIAGA UNO
VICE PRESIDENTIAL CANDIDATE

"This is an extraordinary circumstance and needs rapt attention. Repeated incidents indicate that there is a systematic failure in managing e-ID cards. A comprehensive audit is needed. The government's reluctance to conduct an audit needs to be questioned.

MARDANI ALI SERA
PROSPEROUS JUSTICE PARTY (PKS) POLITICIAN

"I think it would be better for Tjahjo Kumolo to resign. [He's] incompetent to manage e-ID card issues, final voters lists and also population data. These are only basic problems. What has he done in the past four years?

FADLI ZON
GERINDRA PARTY DEPUTY CHAIRMAN AND
HOUSE OF REPRESENTATIVE DEPUTY SPEAKER

"God forbid there will be fake voters in the final voters list because of the government's incompetence in addressing e-ID card issues. The government must immediately solve this case lest some actors misuse government documents in the upcoming elections.

FERRY JULIANTONO
GERINDRA PARTY DEPUTY CHAIRMAN

TENGGARA STRATEGICS

POLITICAL STATEMENTS ON E-ID CARD

"My statement is clear, that the case of e-ID cards must be thoroughly investigated. Why? This is because if later President Jokowi wins the upcoming election, he might be accused of fraud.

ERICK THOHIR
CHIEF OF PRESIDENT JOKO "JOKOWI" WIDODO AND MA'RUF AMIN'S CAMPAIGN TEAM

"Principally, it is impossible that the e-ID cards were discarded purposefully by particular actors. It is impossible as well that illegal sale of blank e-ID cards can alter the final voters list (DPT). It is impossible since the list is predetermined by the voters' addresses and recorded neatly.

TJAHJO KUMOLO
HOME MINISTER

"We only record e-ID cards. If the cards get lost or stolen, let the Home Ministry address it.

ARIEF BUDIMAN
GENERAL ELECTIONS COMMISSION (KPU) CHAIRMAN

On climate change, it's the powerful business as usual

Indonesia sent a 450-strong delegation to the latest United Nations Climate Summit in Katowice, Poland, in December to show the country's commitment to cutting back on carbon emissions as well as secure international assistance for the cause. Environment and Forestry Minister Siti Nurbaya Bakar led the team that included 80 negotiators. Others were there to run the Indonesian Pavilion held throughout the Dec. 2 – 14 gathering known as the 24th Conference of the Parties, or COP 24.

Takeaway:

- The competing interests between economic development and environmental concerns may hinder Indonesia from fulfilling its commitment to reduce carbon emissions.
- Despite its promises, Indonesia needs to develop its palm oil and coal industries, which make the largest contributions to great carbon emissions, as the industries provide jobs and incomes for millions of people. The decreasing demands of coal from the market, which now mostly shifts to more environmentally-friendly alternatives, may also lead Indonesia to burn more of its massive coal supply.
- In juggling the environmental and financial interests, Indonesia may be able to stop the growths of emissions, but not to cut them back.

Background: Indonesia's strong representation at COP 24 conceals the reality back home that when it comes to fighting climate change, pragmatism prevails. The plan to cut back on emissions finds resistance from two powerful corporate lobby groups representing the palm oil and coal industries. Both sectors are among the primary causes of carbon emissions, and both also count among the country's main export earners.

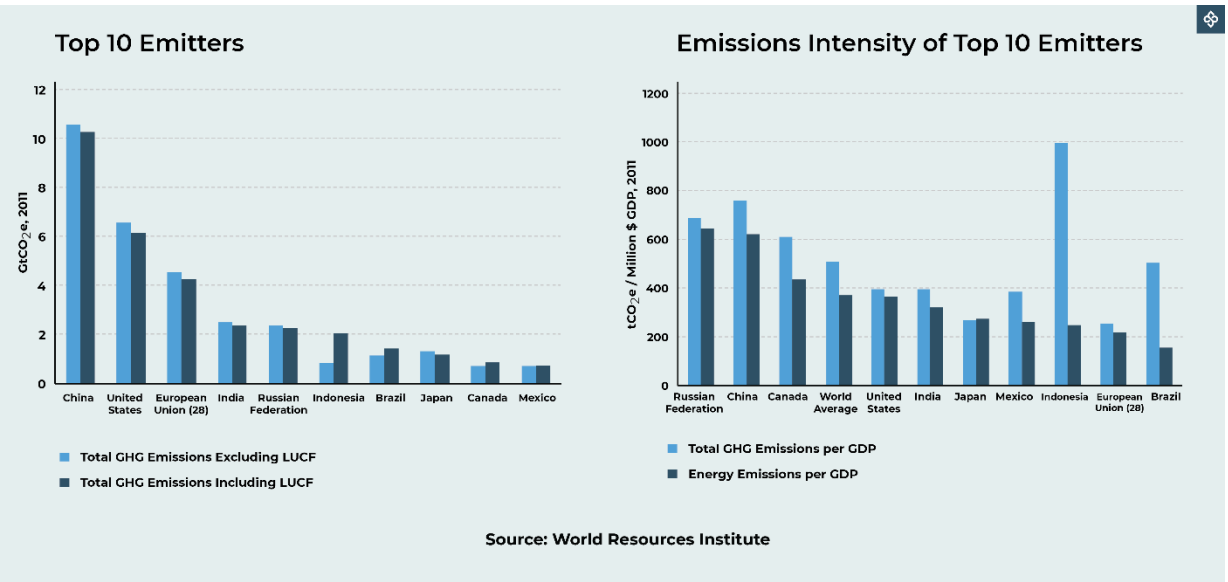
Indonesia in 2015 pledged to reduce carbon emissions by 29 percent from the business-as-usual scenario by 2030, or by up to 41 percent with international assistance. Under the Nationally Determined Contribution, as part of the Paris Agreement that Indonesia signed with 174 other countries in 2015 to limit the increase in global temperatures to 2 percent, Indonesia hopes to cut 834 million tons of carbon dioxide, or CO2.

The forestry sector is expected to contribute 17.2 percent of the proposed 29 percent cut, and the energy sector another 11 percent. But the growth of the palm oil industry has been the cause of massive deforestation. And the growing use of coal to fire powerplants has meant that Indonesia is burning even more fossil fuels, not less.

Indonesia needs to convince foreign funders that it has the ability and political will to fulfil these commitments if it wants to secure their assistance, targeted at US$6 billion. The real battle is at home, against powerful business interests and public opinion.

Indonesia is the sixth largest emitter of carbon dioxide in the world, according to a World Resources Institute report in 2014. While this is partly because of the fossil fuels it burns, a larger part of the emissions in Indonesia, unlike in other countries, comes from massive deforestation. (In the graph, LUCF refers to land use change and forestry).

But when measured by the level of greenhouse gas emissions per GDP, which is a commonly used metric of emissions intensity, Indonesia is the most intensive emitter when emissions from deforestation and land use change are taken into account.



Insight: Under President Joko "Jokowi" Widodo, Indonesia made its Paris commitment while simultaneously embarking on massive programs to develop its palm oil and coal industries.

The palm oil industry was initially developed primarily for vegetable oils, but now also as a raw material for biodiesel. The coal industry was developed to feed the dozens of power plants Indonesia is building with 35 GW generating capacity in 2015-2020.

Palm oil and coal are also Indonesia's top two export commodities, with revenues of $14.4 billion and $11.98 billion respectively in 2016. Indonesia's 54 percent share of the global palm oil export market makes it the number one exporter ahead of Malaysia, and the 18 percent of the world's coal market makes it the second largest exporter behind Australia. Both palm oil and coal are also major contributors to the government's tax revenue and provision of jobs, and hence income, for millions of people.

Developing both sectors inevitably leads to greater carbon emissions, not less. At best, the government can stop the growth of emissions, but not cut them back.

The plan to develop biofuel on a large scale, as a way of reducing the use of gasoline, means adding 4 million hectares to the existing 6 million ha dedicated to oil palm plantations. This means more conversion of forests into plantations, and deforestation.

The government earlier this year announced a moratorium on new licenses for oil palm plantations but still allowed those already holding concessions to go ahead.
Indonesia is not wrong in stressing that the palm oil sector provides for the livelihood of millions of people, and that any attempt to limit its growth would undermine the government's poverty alleviation program. President Jokowi has been handing out certificates to people living in and around forests that allow them to tap and plant oil palm trees in what has been designated "social forestry".

Strong resistance on palm oil development comes from abroad, Europe in particular, with boycotts and planned outright bans because of palm oil's impact on forests. The pressures, however, are also stemmed by business competition from other vegetable oils, including rapeseed and soybean oils.

It was in 2015 when Indonesia experienced massive forest fires with a devastating impact on lives and livelihoods. It was billed as the worst in history. The government seems to have quickly put this behind itself and moved ahead with the palm oil development plan.

The development of the coal industry is tied to President Jokowi's massive program to build power plants with a total capacity of 35,000 MW in 2015-2020, partly to bring electricity to more people, partly to fuel the manufacturing industry. Coal is the fuel of choice for most of these new power plants, simply because Indonesia has an abundant supply and it is the fastest to develop compared to renewable energy sources.

Jokowi's administration has succeeded in bringing more electricity to people, with electrification now reaching 98 percent of all households, compared to 84 percent in 2014. Indonesia can forget about clean coal for now as no country, not even the United States, has been able to develop affordable technology to burn coal efficiently.

With most countries in the world switching away from coal because of its environmental impact, Indonesia will likely go the other way to burn the massive coal supply it finds increasingly difficult to export. China, the biggest market, has been buying less coal.

The conversion to alternative renewable and cleaner sources of energy has been painfully slow. Although Indonesia is developing geothermal, hydropower, solar and wind, it is unlikely to achieve the target of making renewable energy account for 23 percent of all energy use by 2025 from 14 percent presently.

Sources of energy in Indonesia in 2016

Oil	41
Coal	36
Gas	19
Others	14

Sources: Statistical Review of World Energy 2017

Oil remains the main source of fuel primarily for transportation, even though Indonesia, once a major oil exporter, now imports most of its gasoline needs. Hence the biofuel program is part of the campaign to reduce Indonesia's dependence on oil.

The competing interests between economic development, including poverty alleviation, and conservation efforts are discussed within the cabinet. This often pits Environment and Forestry Minister Siti Nurbaya Bakar against other ministers, primarily of National Development Planning, Industry, Agriculture and Energy and Mineral Resources. Rarely has Siti Nurbaya prevailed, although she has been known for winning one or two battles, such as when she began prosecution against big companies for causing big forest fires.

But those are becoming rarer. With the election coming up in 2019, President Jokowi is unlikely to upset big business, the poor and middle class who are addicted to cheap subsidized gasoline.

Issue Update: Ma'aruf Amin's alleged health issues

Speculation has circulated about vice presidential candidate Ma'ruf Amin's failing health following recent news about him falling down at his residence. Ma'ruf's advanced age has been a frequent focus of attack in questioning the legitimacy of the cleric's candidacy.

Summary: President Joko "Jokowi" Widodo's decision to pick Ma'ruf Amin as his running mate in the upcoming 2019 presidential election raised some brows at the time. Some argued that the decision was made only aimed to achieve the short-term political objective of securing the Muslim electorate on the back of Ma'ruf's Islamic credentials.

Considering his solid religious stature, many attempts have been made to discredit Ma'ruf, one of which is to point out his age. It has been said that his health would prevent Ma'ruf from fulfilling his duties as vice president if the Jokowi-Ma'ruf pair wins the election.

Now, news is spreading about him falling at home and hurting his ankle. It has been reported that Ma'ruf will be unable to follow the campaign schedule because of his injury. Ma'ruf has denied the suggestion, saying that although his feet hurt a little, he had not fallen down as was reported.

Despite Ma'ruf's denial, however, it remains likely that his age and health will continue to be targeted in the opposition's attempt to discredit President Jokowi's reelection bid.

What we've heard: According to an unnamed source affiliated with Nahdlatul Ulama (NU) and close to NU chairman Said Aqil Siradj, Ma'ruf's speedy recovery following the news on him falling down in bathroom has made some people question the validity of public speculations on his health. According to the source, Ma'ruf undertook traditional treatment in Pandeglang, Banten, and was told that he would recover in three weeks, albeit partially. This is much quicker than the doctor who reportedly examined Ma'ruf and estimated that his recovery would take months. The doctor reportedly said that Ma'ruf would be able to walk again in January.

Ma'ruf's health has been a frequent topic of discussion among NU members since his alleged accident. Ma'ruf stated at a press conference on the matter that he had only sprained his ankle. Regardless, the unnamed source said that the cleric's injury was worse than he claimed. According to the source, Ma'ruf had sustained a minor fracture to his ankle, and he had decided not to disclose this information publicly to mitigate speculations and concerns among his supporters.

It was important to issue such reassurances, as apparently the situation among the Jokowi-Ma'ruf supporters is bad. To make matters worse, an undisclosed internal survey has evidently found that Ma'ruf had not made a significant contribution to Jokowi's reelection campaign.

While it was hoped that choosing Ma'ruf as his vice president would help Jokowi secure votes in Banten – where Ma'ruf was once declared "favorite cleric" – recent coverage in *Tempo* magazine indicates the opposite. It was reported that the Jokowi-Ma'ruf National Campaign Team discussed the *Tempo* articles at the residence of Vice President Jusuf Kalla on Monday, Dec. 17.

Furthermore, it has been reported that Ma'ruf and Said are growing distant, and that their relationship is not as strong as it was when Said nominated Ma'ruf as vice president to Jokowi and the Indonesian Democratic Party of Struggle (PDI-P). The increasingly strained relationship between Ma'ruf and Said is allegedly caused by the lack of respect among Ma'ruf's supporters for Said as a fellow cleric.

Another undisclosed source, a business tycoon, reportedly visited Ma'ruf at home while he was recovering from his injury. The source confirmed that Ma'ruf's injury was worse than a sprain, as the cleric had claimed, and that Ma'ruf's injury had spread concern among his inner circle. Some people had suggested Ma'ruf use a wheelchair during his recovery, but he had rejected this suggestion in order to maintain the public perception that he was of good health. Ma'ruf apparently believes that showing any signs of physical weakness would have a negative psychological effect on his supporters. This source says that Ma'ruf will gradually start walking again around the first week of January.

BUSINESS & ECONOMIC POLICY

Problems concerning Batam go beyond dualistic governance

Economic Coordinating Minister Darmin Nasution announced after a limited Cabinet meeting on Dec. 12 that the government had decided to transfer the central government-controlled Batam Free Trade Zone Authority (BP Batam) to the mayor of Batam. The move aims to end Batam's lingering dual-governance system, which has been blamed for the island's sluggish investment and economic growth. Our findings, however, show that the problems are actually deeper than just the dual-governance issue.

Takeaway:

- Transferring the control of BP Batam to the mayor of Batam may solve the problem of dualism in Batam governance system, but it will not necessarily attract investment and boost economic growth.
- Transforming Batam from a free-trade zone into a special economic zone without House of Representatives approval may pose a legal problem, as the status of the Batam free-trade zone is governed by a number of laws.
- Deep-rooted problems with Batam relate to control of lands by politically-powerful people and corporations as well as the inability of BP Batam to rightly collect fees from its strategic assets.
- The expansion of Batam's population complicates its status as a free-trade zone island.

Background: Located just an hour's ride by ferry from Singapore, Batam is a strategic industrial and transshipment area for Indonesia. Its status as a free trade zone since 1973 is meant to attract investment in high-tech industry, boost exports and compete with Singapore. Forty-five years later, however, Batam is far from getting close to Singapore.

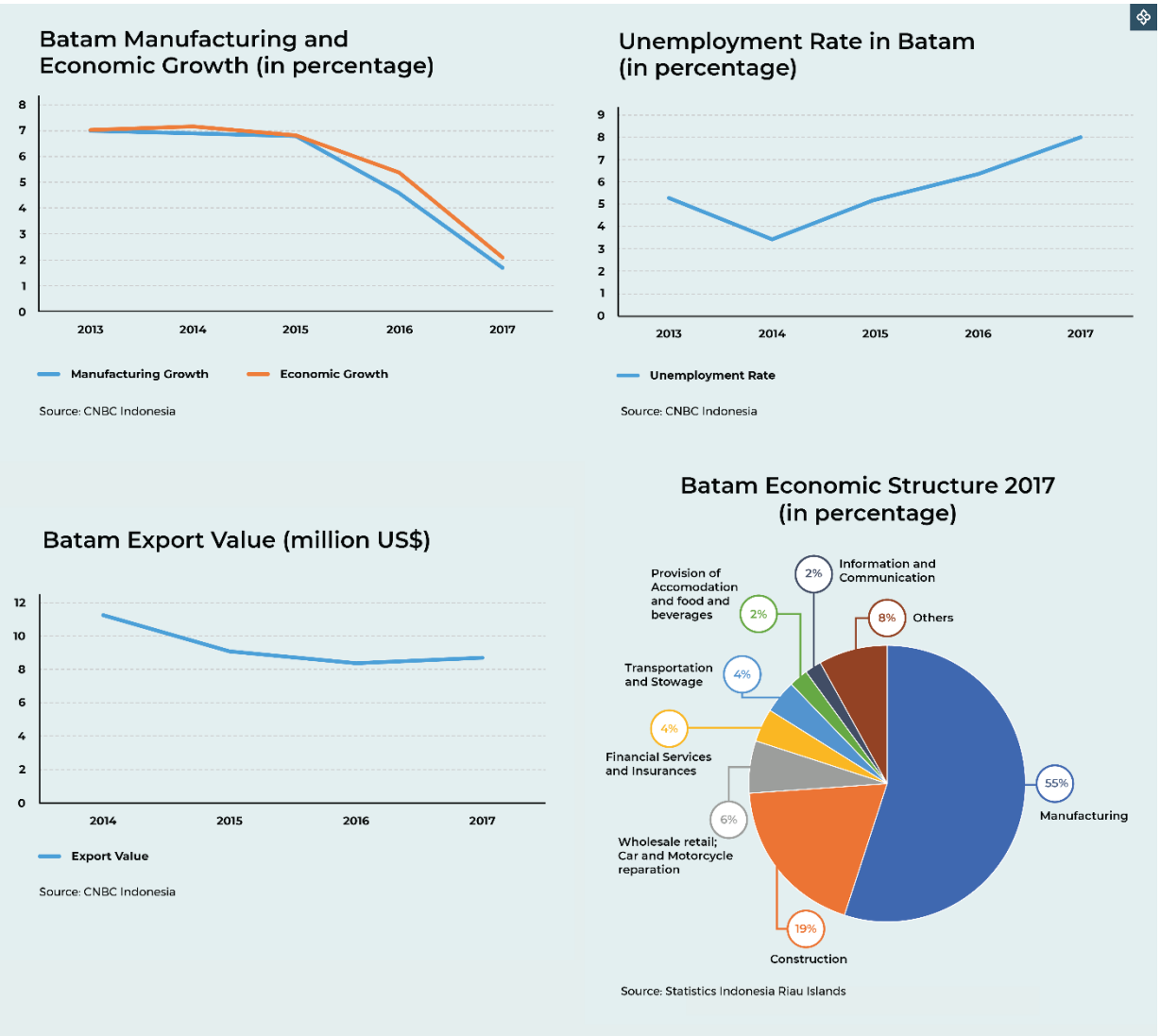
The former manufacturing and export center of Batam has had to face slowing growth of investment, exports and overall economic growth since the fall of the centralist New Order government in the late 1990s that gave birth to decentralization of power from the central government to local administrations, as well as the rise of new local administrations, including the Batam municipality, which was created based on Law No. 53/1999.

It is this law that creates dualism in the governance of Batam. Article 21 of the law stipulates that the new Batam municipality should include the Batam Authority in its decision making. The same article also said the working relations between the Batam municipality and BP Batam would be governed by a government regulation to be issued within one year and yet the implementing regulation for this article has never been enacted, which eventually created the governance dualism problems.

Both existing and new investors have reportedly been confused by the dual permit handling and licensing procedures. The businesses were especially concerned about uncertainties and

doubled costs.[9] Combined with the issue of increasing labor costs,[10] some investors chose to leave and settle in more competitive locations, such as Vietnam or Malaysia.
Batam's manufacturing growth rate plunged to only 1.76 percent in 2017 from 7.07 percent in 2013 because of minimum investment. The situation triggered a snowball effect on Batam's economy as the manufacturing sector contributes more than 50 percent to Batam's total gross domestic product (GDP). As a result, Batam's economic growth dropped to 2.19 percent in 2017 from 7.18 percent in 2013.

Batam mayor Muhammad Rudi blamed the slowing economy to the dualism in the governance of Batam that resulted in higher costs for investment and trade. He eventually called on President Joko "Jokowi" Widodo to intervene and resolve the dualism.



Insight: The government's decision to transfer authority over BP Batam from the central government to the mayor of Batam is likely to solve the problematic dualism in Batam's governance system, which has cost investment and economic growth on the island. However, that is still a far cry from addressing the deep-rooted problems of Batam as a free-trade zone.

[9] CNBC Indonesia, "Semoga sang 'Singapuranya' Indonesia tak lagi tertinggal jauh," 13 December 2018 https://tinyurl.com/yabwtm7z
[10] Bisnis.com, "Mengembalikan kejayaan industri Batam," 29 April 2018 https://tinyurl.com/y8pnsyue

Batam is both a free-trade island and a municipality in the province of Riau Islands. Batam is managed by two authorities: BP Batam, which has the authority to issue land titles and business licenses for industry as well as develop infrastructure, and the municipal administration, which is in charge of public services and administrative affairs.

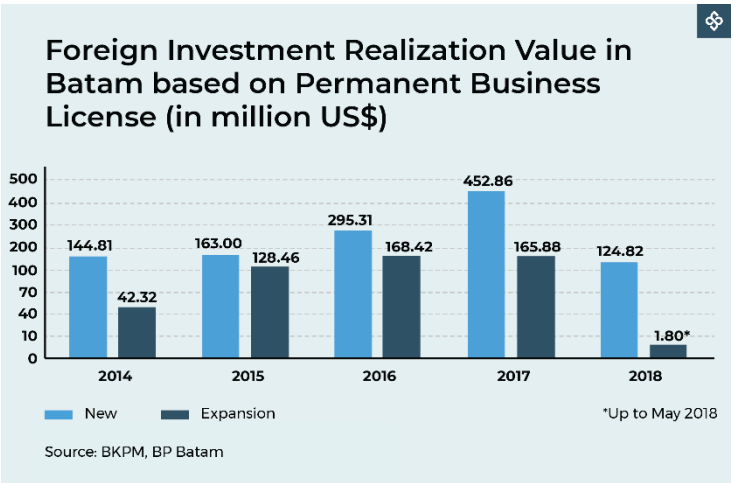
To build a factory, for example, an investor must secure a land allotment from BP Batam, while at the same time applying for a building permit from the municipal government and paying the permit fee and building taxes to the municipality. For a matter as simple as putting up a billboard, BP Batam would designate the location and the Batam municipality would collect the taxes. Such dualism is a headache for business people.

According to Darmin, a number of businessmen have conveyed their dissatisfaction with Batam governance directly to President Joko "Jokowi" Widodo and Vice President Jusuf Kalla. President Jokowi then wanted a fast resolution to the problem, to end the dualism in Batam by putting BP Batam under the Batam municipality and transforming Batam from a free-trade zone into a special economic zone.

The decision, however, has drawn criticism from some quarters, including from businessmen themselves. Cahya, head of the Indonesian Employers Association (Apindo) in Riau Islands, argued that the decision would only benefit politicians in Batam rather than businesses. Transforming Batam from a free-trade zone (FTZ) into a special economic zone (SEZ) would increase production costs, as businesses would no longer be exempted from value-added and luxury goods taxes. Moreover, changing Batam's FTZ status will put smaller local businesses at a disadvantage, because the minimum investment in a SEZ is Rp 500 billion.[11]

The government's decision would likely create legal problems too, as there are a number of laws, especially Law No. 44/2007 and Law No. 46/2007, that govern the special status of Batam as a free-trade zone and a free port, which is why a change in the status of Batam to a special economic zone has to go through the House of Representatives. Even the appointment of the Batam mayor as the ex-officio head of BP Batam has run up against legal hurdles. Darmin said the government would prepare a government regulation to legally allow the appointment of the Batam mayor as the head of BP Batam.

Let's assume that all the legal hurdles could be settled properly, putting BP Batam under the Batam municipality may end the problem of dualism in governance, but it would not automatically attract investment and boost exports, as the problems actually go deeper than just the dualism in governance. The deeper problems include vested interests who control Batam's lucrative resources.



[11] CNN Indonesia, "Pengusaha tolak Batam jadi kawasan ekonomi khusus," 4 June 2018 https://tinyurl.com/ydd8sb5j

One of the main problems inhibiting Batam's growth concerns the allocation of land for industrial purposes. According to prevailing regulations, BP Batam is the sole authority to allot land to investors under a lease basis, and the land must be developed within nine months; if it is left unattended after nine months, BP Batam can retake the land. In practice, however, BP Batam is toothless in enforcing the regulations, as 7,682 hectares of land – or about one third of the available land for industries – is under the control of politically powerful people or corporations for years, without any activity on the land. Many of these people and/or corporations do nothing with the land but use their land titles as collateral to get loans.

When Hatanto Reksodipoetro was chairman of BP Batam from 2016 to 2017, he tried to enforce the regulation by requiring all the rightful owners of the neglected lands to report to BP Batam, only to find out that many of these owners only paid a fraction of the land lease to BP Batam. He also asked the Finance Ministry to increase the land leasing fee, which had been kept low for years. His move drew furor among land owners, who demanded his replacement, and eventually he was sacked from his post.[12] His replacement, Lukita Dinarsyah Tuwo, faced the same problem, saying he was exasperated by the land problem. [13]

Another deep-rooted problem plaguing Batam is the fact that BP Batam cannot collect the right fees from important or strategic assets, such as Batam's Batuampar Port and Hang Nadim International Airport. Despite its status as a free-trade zone and transshipment, Batuampar performance has been way below par, when compared to its neighbors Singapore or Malaysia's Johor Bahru. Batuampar handles around 400,000 to 500,000 twenty-foot equivalent units (TEUs) a year, compared to Singapore's more than 30 million TEUs.

Report suggested that the port did not possess permanent cranes – a crucial element of an international transshipment port.[14] Our source said that elites in Jakarta were exploiting BP Batam's port management by supplying mobile cranes in return for service fees in a similar way people pay parking fees for cars, earning the crane owners hundreds of millions of rupiah from loading and unloading activities.

The central government's failure to clear the water between the Batam municipality and BP Batam has produced several complex sociocultural and environment issues. Unclear boundaries and overlapping authority, for example, have led to an uncontrollable influx of migrants to Batam – allegedly tied to political agenda especially during election years. A case in point is Baloi Kolam, where the omission of unregulated housing in a conservation area has destroyed a major clean water source.

The population of Batam has grown exponentially, from around 6,000 people in 1973 to around 600,000 before the creation of the Batam municipality in 1999 and 1.3 million people now. This has caused problems in itself for the free-trade zone. Moreover, with the creation of the Batam mayoralty, the administration has to serve 1.3 million people. For those who control lands in Batam, property seems more attractive than building factories. Then it creates complexity when the area is declared a free-trade zone. Former BP Batam chairman Hatanto, for example, questioned whether it was fair to exempt the 1.3 million people in Batam from

[12] Batamnews.co.id, "Mengapa BP Batam seolah jadi public enemy," 14 June 2017 https://tinyurl.com/y9bk3xou
[13] CNN Indonesia, "BP Batam gemas lihat banyak lahan nganggur di Batam," 24 January 2018 https://tinyurl.com/ybe26k2x
[14] ANTARAKepri, "Pengoperasian dermaga utara Batuampar tunggu pengadaan crane," 22 May 2017 https://tinyurl.com/y9d68hln

value-added tax and luxury tax, while people in other parts of the country had to pay those taxes.[15]

It all comes back to what Indonesia wants from Batam, whether it wants to stick with the original objective of developing Batam as the center of Indonesia's high technology industrial hub as well as one of Indonesia's export centers or not. After all, Batam still has all the potential. It's close to Singapore. It has an airport with the longest runway in Indonesia (at 4,000 meters even longer than Singapore's 3660-m runway). Besides its economic potential, Batam is also of geopolitical importance, given its proximity to Singapore, Malaysia and the South China Sea. Therefore, it deserves a sound policy from the government and not a half-baked policy that would harm the island.

What we have heard: According to several officials from the Office of the Economic Coordinating Minister, President Jokowi was upset in a special cabinet meeting on Dec. 12 over the slow response to the problem in Batam, i.e. the dual governance system and the slow transformation of Batam's status into a special economic zone.

Jokowi has reportedly received several letters from Batam Mayor Muhamad Rudi, who questioned and complained about the overlapping authority in Batam that results in complications in licensing for potential investors.

Jokowi expressed his disappointment during the Cabinet meeting and considered a proposal to disband BP Batam, but Economic Coordinating Minister Darmin Nasution suggested BP Batam not be disbanded but merged with the Batam municipality, which was the course of action subsequently chosen.

Another source from the Office of the Economic Coordinating Minister said Lukita Dinarsyah Tuwo's appointment as BP Batam head replacing Hatanto Reksodipoetro in October 2017 was intended to speed up the transition of Batam from a free trade zone into a special economic zone. However, Lukita met complex problems in the field, including problems with land control, and could not complete the task.

Lukita could not accelerate the establishment of a special economic zone because some of the lands were owned by business elites in Jakarta. Those lands were left unproductive, without ever being developed into industrial complexes. Land scarcity was the reason why investors were struggling to invest in Batam.

The same source also said that under Hatanto Reksodipoetro, BP Batam had tried to regulate those undeveloped lands, totaling 7,682 hectares. Hatanto's move met with resistance from those who control the land. This was one of the reasons why Hatanto Reksodiputro was replaced by Lukita.

[15] Rekso Reksoedipoetro, Bisnis Indonesia, "Batam & Industri Tehnologi Tinggi Indonesia," 9 June 2018

Chinese FDI brings OBC technology and reinvigorates Indonesian steel industry

The State-Owned Enterprises Ministry appointed Silmy Karim on Sept. 6 as the new President Director of PT Krakatau Steel, which has recorded financial losses for six years straight.

Takeaway:

- In spite of growing national steel consumption, locally owned electronic furnace-based (EF) steel mill production has been declining since 2008.
- Chinese FDI came to fill this gap by developing oxygen-blown converter-based (OBC) steel mills, shifting the main production technology from EF to OBC.
- OBC technology is widely used in major steel producing countries like Japan, South Korea, Russia, Germany and Brazil. India and the US have OBC-based steel mills too, but EF-based steel mills are still dominating their steel industries.

Background: The new President Director did not like to waste his time. On Nov. 23, he signed an agreement to supply 1 million tons of steel to construction sector SOEs like Waskita Karya, Adhi Karya, Wijaya Karya, Hutama Karya, Nindya Karya and PT Pembangunan Perumahan (PP) for various infrastructure projects.[16]

Besides signing a lucrative business agreement, Silmy also went on the offensive against steel imports from China. He has repeatedly been warning the Trade Ministry that Chinese steel importers have been manipulating Trade Ministry Regulation No. 22/2018 on iron and steel imports. Using a legal loophole in the regulation, Chinese importers declare alloy steel to be carbon steel to make their goods eligible for import duty exemption.[17]

Silmy's campaign against Chinese steel is also aimed at Chinese foreign direct investment (FDI) in Indonesia. He warns the government and local consumers that enterprises receiving Chinese FDI use induction furnace technology to produce cheap low-quality steel, selling them as construction materials for residential and infrastructure projects. This product is unsafe and suspected as the cause of various building collapses in Padang during the 2017 West Sumatra earthquake.[18] While admonishing his competitors, Silmy promotes the quality and reliability of Krakatau Steel with its electric furnace arc technology.[19]

Insight: As a rapidly growing economy, Indonesia has strong demand for steel products. Between 2008 and 2017, the country's steel consumption increased from 10.59 million to 16.32 million metric tons (MMT). However, local production cannot meet the country's growing demand for steel. Rather, Indonesia's steel production, which uses electronic furnace-based (EF) steel mills, had been decreasing from 3.92 MMT in 2008 to 2.64 MMT in 2013.

[16] Tempo.co, "Krakatau Steel pasok baja ke BUMN Karya untuk infrastruktur." 23 November 2018 https://tinyurl.com/ybpy7uad
[17] Kontan.co.id, "Krakatau Steel (KRAS) minta revisi aturan Permendag 22.2018." 21 October 2018 https://tinyurl.com/yb6qtqal
[18] Harianhaluan.com, "Kasus besi non-SNI mulai disidang." 22 May 2018 https://tinyurl.com/y8axpbrg
[19] Tempo.co, "Dalam cengkraman baja induksi." 15 December 2018. https://tinyurl.com/y95u6zys

Chinese FDI came to fill this gap by establishing oxygen-blown converter-based (OBC) steel mills. In 2014, Chinese-owned OBC-based steel mills produced 1.9 MMT, 43 percent of national steel production. The production of Chinese-owned OBC-based steel mills expanded to 2.92 MMT in 2017, which accounted for 56.2 percent of Indonesia's steel production. Meanwhile, the production of locally owned EF-based steel mills fell further to 2.27 MMT.

OBC technology is widely used in China. In 2017, for instance, 91 percent of steel was produced in OBC-based steel mills. Other major steel-producing countries such as Japan, South Korea, Russia, Germany and Brazil also use OBC as their main production technology. In Germany, for example, OBC-based steel mills produce 70 percent of the country's steel. India and the United States have this technology too, but EF-based steel mills still dominate their steel industries.

In Southeast Asia, EF-based steel mills are more common. In fact, there were no OBC-based steel mills until 2013, when Chinese investors operated the first ones in Vietnam. Although OBC-based steel mills were first introduced in Vietnam, more than 60 percent of Vietnamese steel is still produced in EF-based steel mills.

Steel Production Capacity in Major Steel Producing Countries

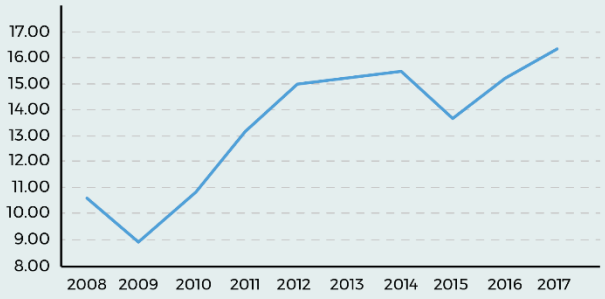
Country	2017	
	Production	Share
China	831.63	49.4%
Japan	104.66	6.2%
India	99.02	5.9%
United States	81.61	4.8%
Russia	71.49	4.2%
South Korea	71.03	4.2%
Germany	43.30	2.6%
Brazil	33.87	2.0%
World	1,685.01	

Steel Production Capacity in Southeast Asian Countries

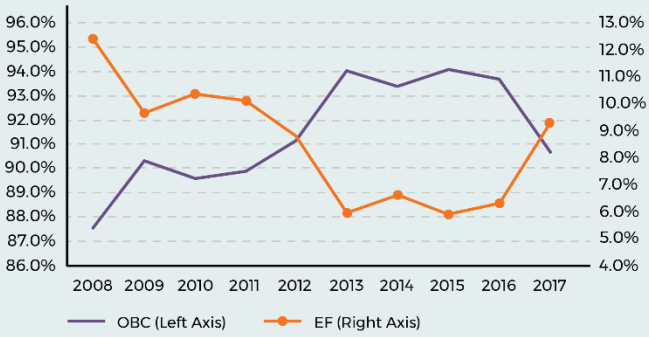
Country	2017	
	Production	Share
Vietnam	10.33	0.6%
Indonesia	5.20	0.3%
Thailand	4.47	0.3%
Malaysia	3.22	0.2%
Philippines	1.38	0.1%
World	1685.01	

Source: Steel Statistical Yearbook 2018, World Steel Association

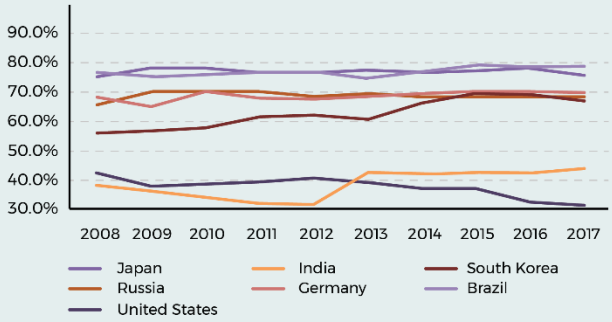
Apparent Steel Use (Crude Steel Equivalent) in Indonesia, in MMT, 2008 - 2017



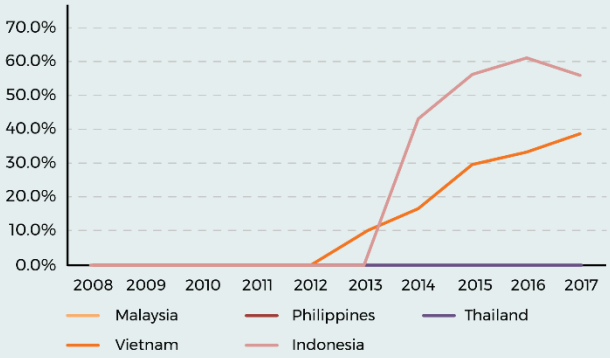
Share of Steels Produced by OBC and EF Technology in China, 2018-2017



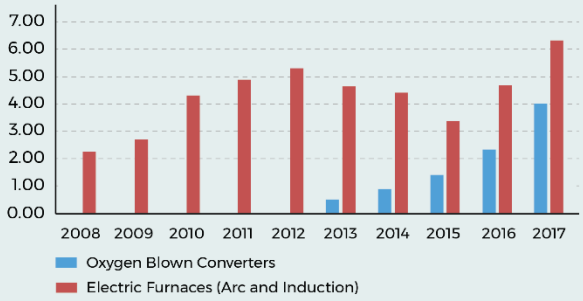
Share of Steels Produced with OBC Technology in Major Steel Producing Countries excl. China, 2008 - 2017



The Usage of OBC Technology in Major Steel Producing Countries, excl. China, 2018-2017

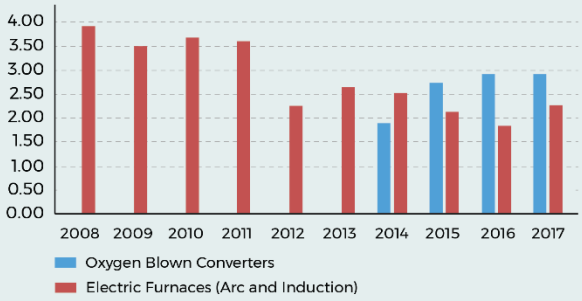


Steel Produced with OBC and EF Technology in Vietnam, in MMT 2008-2017



Source: Steel Statistical Yearbook 2018, World Steel Association

Steel Produced with OBC and EF Technology in Indonesia, in MMT 2008-2017



Source: Steel Statistical Yearbook 2018, World Steel Association

Source: Steel Statistical Yearbook 2018, World Steel Association

MACROECONOMIC UPDATE

Macroeconomic update: Widening trade deficit, bumpy ride ahead

On Dec. 17, Statistics Indonesia (BPS) announced that the country booked a US$2.05 billion trade deficit in November, the worst monthly trade deficit so far this year.

Takeaway:

- Falling global oil prices might ease pressure on Indonesia's oil and gas trade deficit, but it also indicates slower global economic growth next year, hampering efforts to boost non-oil and gas exports.
- Three aspects behind the global economic slowdown: US-China rivalry in trade and information technology, deep political turmoil in the eurozone slower US economic growth next year.

Background: President Joko "Jokowi" Widodo's import restriction policies, such as discouraging imports through tax on import income (PPh 22)[20] and the mandatory 20 percent biodiesel fuel mix (B-20)[21], have failed to deliver the intended outcome. As a result, the year-to-date (ytd) trade deficit widened to $7.6 billion.

The main cause of this year's trade deficit is President Jokowi's reluctance to increase domestic fuel prices in the lead up to the 2019 presidential election.[22] Because of his reluctance, oil and gas trade booked a $12 billion ytd deficit, $4.5 billion higher than last year's deficit between January and November.

Another cause of worry is the sharp decline in non-oil and gas trade surplus from $17.5 billion in 2017 to $4.6 billion this year. The decline was caused by weak non-oil and gas export growth, 8.6 percent year-on-year (yoy) compared to 20.6 percent yoy import growth.

Insight: The widening oil and gas trade deficit is the main cause of the widening trade deficit. However, falling global oil prices might ease this pressure. After two years and nine months of a bullish trend, the Brent crude oil price took a dip from $80.47 per barrel in October 2018 to $65.17 in November 2018, and fell further to $57 per barrel on Dec. 20.

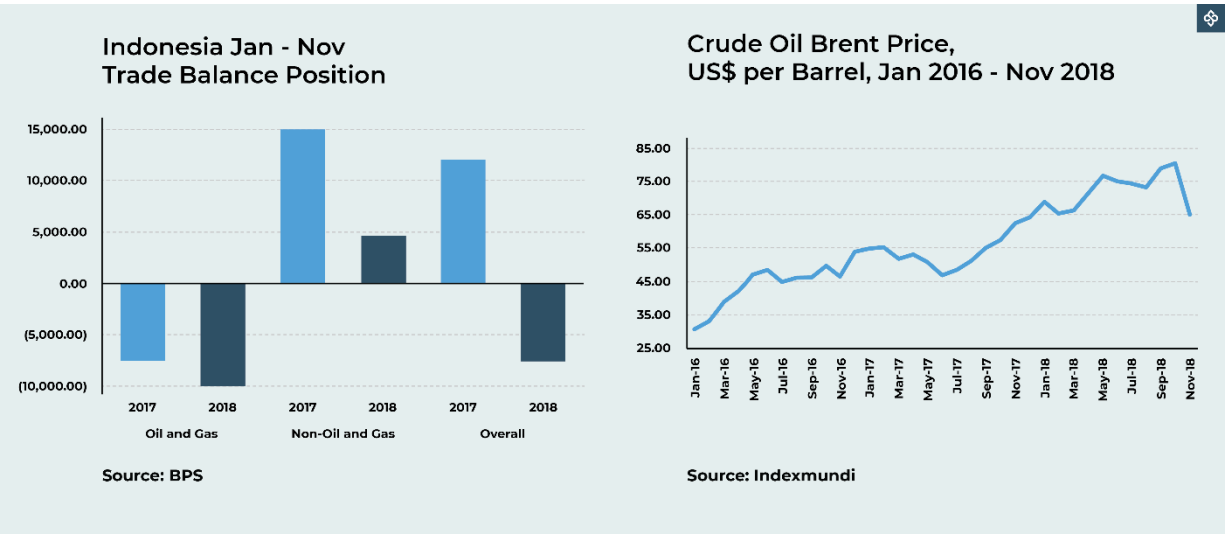
Although falling global oil prices is good news for President Jokowi, who insists on keeping fuel prices at the current level until after the 2019 presidential election,[23] it also indicates a slowdown in the global economy that could hamper efforts to increase Indonesia's non-oil and gas exports.[24] The slowdown is driven by three things. First is China's slowing economic

[20] Kemenkeu.go.id, "Galakkan industri dalam negeri, tariff PPh Pasal 22 disesuaikan."5 September 2018 https://tinyurl.com/y9qnme94
[21] CNBCIndonesia.com, "Jokowi tekenaturan B20, negara hematRp 28 T tahunini." 15 August 2018 https://tinyurl.com/y7uv8ul2
[22] Kompas.com, "Jokowi batalkankenaikanharga Premium, miskoordinasiataucarisimpati?" 11 October 2018 https://tinyurl.com/y8xomcqv
[23] Kumparan.com, "Hargaminyakanjlok dan menguatnya Rupiah untungkan Jokowi." 21 November 2018 https://tinyurl.com/ycwlxdg3
[24] FT.com, "Oil prices slide on supply and growth concerns." 19 December 2018 https://tinyurl.com/ycrmpcr4

growth due to a trade war with the United States. China and the US called a truce in their trade war following a high-stakes meeting between President Donald Trump and President Xi Jinping during the G20 Summit in Buenos Aires, Argentina.[25] However, the arrest of Huawei's chief financial officer and heiress Meng Wanzhou sent mixed signals on whether the US wanted to escalate its trade war with China.[26]The arrest was possibly motivated by national security concerns, such as protecting US proprietary technologies from the Chinese.[27]

The next aspect is the political uncertainty in the European Union. A month long *gilets jaunes* protest put a halt to President Emmanuel Macron's economic reforms, damaging his credibility to lead EU-wide reform.[28]Meanwhile, a no-deal Brexit has become a real possibility.[29]In a bitter compromise to appease Euroscepticism on the continent, the European Commission allowed the Eurosceptic Italian government to raise its 2019 budget deficit to 2.04 percent, down from the initial Italian government demand of 2.4 percent, but 1.2 percentage points higher than the recommendation by EU finance ministers in July.[30]

Last is slower US economic growth next year. According to the Fed newest forecast, US economy will grow by 2.3 percent next year, 0.2 percentage points lower than its September forecast at 2.5 percent.[31] As a consequence, Indonesia would face slower export demand growth in 2019, making the effort to fix trade account deficit more difficult.



[25] SCMP.com, "US and China reach 90-day trade tariff ceasefire after China agrees to buy 'very substantial' amount of American goods." 2 December 2018 https://tinyurl.com/yco8f2p5
[26] Yahoo.com, "Why the Huawei arrest is a huge problem for U.S.-China trade relations." 6 December 2018 https://tinyurl.com/y7f24ee3
[27]The-American-Interest.com, "The wireless great power rivalry." 11 December 2018 https://tinyurl.com/y8xvzb6n
[28] Bloomberg.com, "Emmanuel Macron's Euro Zone dream died this week." 12 December 2018 https://tinyurl.com/yamut2y3
[29] BBC.com, "Brexit: Cabinet 'ramps up' no-deal planning." 18 December 2018 https://tinyurl.com/y9crdrav
[30]Politico.eu, "Fears of Euroskepticism blunt Brussels' budget threats against Rome." 19 December 2018 https://tinyurl.com/y88k48qn
[31] Washingtonpost.com, "Federal Reserve cuts its outlook for U.S. economy, stocks plunge." 19 December 2018 https://tinyurl.com/ycr6m93z

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