

Highlights of the week



Sharia bylaws not up for debate

PSI chairwoman Grace Natalie's remark on discriminative local laws trigger the reemergence of religious narratives in the public. Fierce criticisms from political parties seeking to leverage their position ahead of the elections prove that the existence of Islamic law in several regions across Indonesia is not up for discussions.



Questioning parties' political flexibility

The Democratic Party's decision to grant its legislative candidates the freedom to support any presidential candidates illustrate the flexibility of the party. Despite the surprise following the Democratic Party's blatant pragmatism, the decision is not as controversial as it appears, particularly considering the difficulties faced by the party due to the complexity of the 2019 simultaneous presidential and legislative elections.



Tobacco taxes: mischiefs for political assurance

President Jokowi's decision not to increase the levy on tobacco products next year contradicts his government's own targets of increasing tax revenue and improving public health quality. Yet, the decision is well understood politically as it bodes well with his reelection ambition. The decision would especially please tobacco industry, the Nadhlatul Ulama and most importantly tobacco farmers and workers in East and Central Java – a big number of voters for his reelection bid next year.



Garuda-Sriwijaya partnership strengthens Garuda

National flag carrier Garuda Indonesia, through its subsidiary Citilink Indonesia, signed an agreement with Sriwijaya Air Group to take over the operation and financial management of Sriwijaya Air and NAM Air under a joint operation scheme (KSO). The KSO will provide assets for Garuda in its head-to-head competition with the mighty and aggressively expanding Lion Air Group.

POLITICS

Sharia bylaws not up for debate

When Grace Natalie, the chair of the Indonesian Solidarity Party (PSI), called for the repeal of local laws that favor one religious community over others, she was immediately talked down with fierce accusations of her being anti-Islam and now faces possible court prosecution for blasphemy. Instead of taking up the question of discrimination against religious minorities, the debate predictably focused on the messenger, Grace, who founded the party for millennials that is making its debut in the national elections in April. Not surprisingly, her harshest critics came from other political parties seeking to leverage their position ahead of the elections.

Typically in Indonesia, whenever someone tries to bring up a debate that has anything to do with religion, Islam in particular, they are attacked as the messenger, rather than the message, as valid and urgent the issue is. Bylaws that carry the label “sharia” are clearly not up for debate.

Takeaway: Despite their discriminative nature, the proliferation of religious-based local regulations in the country cannot be stopped. Indeed, issues surrounding religion-inspired laws are as old as the country itself. The adoption of Pancasila which guarantees the practice of religions in the country was seen as the most perfect solution by the founding fathers, yet such solution has not stopped the proponents of Islamic state and the sharia from achieving their objective in the country. As illustrated by the issue surrounding Grace Natalie’s remark, if religious-based laws are not debatable, it is likely that Indonesia will continue experiencing gradual fragmentation along religious lines in the future.

Background: Indonesia has seen a proliferation of bylaws that their proponents claim was inspired by sharia, or Islamic law. For political expediency, they call them “sharia bylaws.” These can be local regulations that other religious communities gladly support, such as bylaws against vice (of course in the name of Islam), but they can also be regulations on dress code (hijab for women), ban on sales of alcohol, use of Islamic attire in schools, more Quranic reading classes in school, daytime closure of eateries during Ramadan, mandatory Quranic reading tests for local government positions and zoning policies that make it almost impossible for non-Muslims to build their places of worship.

Quietly, in regions where Muslims are not in a majority, local councils are starting to pass regulations that cater to the dominant religion in the area, and often, discriminate against Muslims. Bali, a predominantly Hindu island, has passed many bylaws claimed to be in conformity with Balinese traditions although clearly Hindu-inspired. In Papua, where Christianity is the dominant religion, local governments are starting to look at Gospel-inspired bylaws. The Manokwari mayoralty declared itself a “Biblical City” and restricted the open display of symbols of other religions. The council of churches in Jayapura, the capital of Papua, has ordered mosques not to use external loudspeakers for prayer calls. Other areas where Muslims are in minority include East Nusa Tenggara (predominantly Catholic), Maluku (Protestant) and North Sulawesi (Protestant), while in North Sumatra and West Kalimantan, Muslim represent about half of the population.

Insight: The proliferation of religious-based local regulations began as soon as Indonesia decentralized the government at the turn of the millennium. Local authorities, including the

local legislative councils, can now enact laws deemed suitable for their respective regions and communities.

Aceh had already gone sharia because that was part of the package offered by the government fighting a separatist movement in a war that ended in 2005. Other regencies and mayoralities since then have pushed their own sharia-inspired legislation. London-based academic Michael Buehler in his 2016 book “The Politics of Shari'a Law - Islamist Activists and the State in Democratizing Indonesia” counted 442 sharia bylaws enacted between 1999 and 2012. This looks like a conservative number as many more bylaws have been given the sharia label.

While these are clearly discriminatory and in violation of the constitution that guarantees equal treatment for all, no one seems able, or have the courage, to put a stop to the trend.

Then-president Susilo Bambang Yudhoyono, who came under pressure to repeal sharia bylaws in the last years of his final term, ordered the Home Ministry to look into “all problematic” bylaws and repeal those found to violate the constitution. When the ministry completed its study in 2016 -- the presidency by then had changed hands to Joko “Jokowi” Widodo -- the government repealed more than 3,000 bylaws that were considered unconstitutional. Almost all had to do with investment law, and only a handful carried the sharia label. Even these few were contested in the Constitutional Court, and the petitioners could not resist the temptation of calling the government anti-Islam.

The creeping shariatization of Indonesian law is taking place at the local level. The leading proponents -- conservative Islamic figures and Islamic parties like the Prosperous Justice Party (PKS) and United Development Party (PPP) -- are making headway locally when they failed at the national level.

The debate on sharia is as old as the republic. The founding fathers agonized for weeks in 1945 to decide whether or not to declare Indonesia an Islamic state governed by sharia, given that the majority of the people were Muslim. Representatives from Bali, Maluku and East Nusa Tenggara made it clear they would not join the new republic if it declared itself an Islamic state (Papua only became part of the republic in 1969).

The republican leaders found the perfect formula, a compromise: Indonesia is a Pancasila state, not a secular state but where freedom of religion is guaranteed and where religion -- but not any single religion -- plays an important role in the running of the government. They knew that an Islamic Republic of Indonesia would have been much smaller than what it is today.

While that argument is still valid today as it was 73 years ago, this has not stopped the proponents of an Islamic state and sharia from trying again and again. They tried and failed during the debate on amending the constitution in 1999-2002. Now they are deploying a strategy borrowed from Mao Zedong: “Fight from the villages, surround the cities”.

The trouble is that once these sharia bylaws are enacted, it will be hard, although not at all impossible, to roll them back. All it needs is more brave leaders, like Grace Natalie, to call them out as discriminatory, and start a national debate.

If sharia bylaws are not up for debate, the slow fragmentation of Indonesia along religious lines will continue unabated.

Freedom of pledging support: Questioning parties' political flexibility

The Democratic Party's recent decision to grant its legislative candidates the freedom to support the presidential candidate of their choice sparked controversy, considering its official support for presidential candidate Prabowo Subianto and running mate Sandiaga Uno. The party's consent for its candidates to support President Joko "Jokowi" Widodo and running mate Ma'ruf Amin raises questions on the reasons behind its political flexibility and how it may affect the landscape of Prabowo-Sandiaga's coalition.

Takeaway: The Democratic Party's political pragmatism is to a large degree caused by the complicated situation in which the party is entrapped. It is unable to support Jokowi-Ma'ruf due to prior history, reluctant to fully support Prabowo-Sandiaga after Prabowo's "betrayal" and unable to abstain from supporting any candidates as it wants to take part in the 2024 presidential election. Its current strategy, thus, demonstrates the party's attempt to balance both its short-term objective (winning the 2019 legislative election) and long-term objective (nominating AHY as a presidential candidate in the 2024 presidential election).

Background: Democratic Party chairman Susilo Bambang Yudhoyono (SBY), while debriefing the party's legislative candidates on Nov. 10, announced a policy that allows its legislative candidates to pledge their allegiance to any presidential candidate ahead of the 2019 presidential election. The Democratic Party's legislative candidates, in securing seats, have the freedom to adjust their political strategies in accordance with the political environments of their respective electoral districts; hence, candidates who compete in areas where Jokowi's political stature is strong are free to support the president's reelection bid at the grassroots level. This came as a surprise as it contradicts the party's decision to join candidate Prabowo-Sandiaga's coalition.

In explaining the party's decision, SBY said it was based on the Democratic Party's aversion to completely putting its political future in the hands of the Prabowo-Sandiaga ticket. SBY was referring to the allegedly emerging trend of a coattail effect among parties, where parties and presidential candidates mutually benefit from each other by ensuring each other's success in the 2019 presidential and legislative elections that will be held simultaneously. SBY, however, argued that the challenges faced by the Democratic Party were too complex for the party to exclusively depend on Prabowo, particularly since the legislative threshold has increased.

Nevertheless, other parties face similar challenges, yet the Democratic Party is the only player that has given its legislative candidates the liberty to support their favorite presidential candidate. What are the possible reasons behind the party's flexibility?

Insight: Since it finally announced its decision to join Prabowo-Sandiaga's coalition along with the Gerindra Party, the Prosperous Justice Party (PKS) and the National Mandate Party (PAN), the Democratic Party has been lackadaisical in demonstrating its full support for the pair. Indeed, days before the decision day, its relationship with Prabowo had been dealt a blow because of his choice of Sandiaga over SBY's son Agus Harimurti Yudhoyono (AHY) as his running mate. Following Prabowo's surprising decision, Democratic Party executive Andi Arief started the fire by referring to Prabowo as a "cardboard general". Andi accused Prabowo, a retired Army lieutenant general, of picking Sandiaga after the latter donated the PKS and PAN Rp 500 billion (US\$34,225) each in exchange for their endorsement for Sandiaga's vice-

presidential candidacy. SBY never punished Andi although his statement caused a rift between the Democratic Party and Gerindra.

That the Democratic Party decided to align itself with Prabowo, despite the latter's failure to pick AHY as his running mate, only showed that the party had very limited choices. Refraining itself from supporting any presidential candidate appeared the most apposite. Regardless, doing so would hinder the Democratic Party from competing in the 2024 presidential race as stipulated by Law No. 7/2017 on elections. Thus, abstention would thwart SBY's ambition of having AHY running for the presidency in 2024, when every potential contender will supposedly enjoy a level playing field.

Moreover, supporting Jokowi-Ma'ruf was out of question because of the long-standing personal feud between Megawati Soekarnoputri, chairwoman of the Indonesian Democratic Party of Struggle (PDI-P), which endorses Jokowi's presidency, and SBY. On several occasions, SBY and Jokowi met to negotiate the Democratic Party's possible support for Jokowi's reelection bid. As no deal was reached, SBY accused Megawati of standing in between him and Jokowi.

The first sign of the Democratic Party's wavering support for Prabowo was the declaration of several Democratic Party members, who hold regional head posts, that they would support Jokowi-Ma'ruf. The party was said to address the controversial move, with SBY planning to discuss the matter directly with the "unruly" party cadres. Now, the party's unabashed decision to give its legislative candidates the freedom to choose the presidential candidate they will support is yet more evidence of its lacklustre support for the Prabowo-Sandiaga ticket.

SBY's speech illustrates the wide gap between the presidential and legislative elections and how it affects the interests of the involved politicians, particularly at the grassroots level. In the case of the Democratic Party, it appears that the party has shifted its focus to the legislative instead of presidential election. Considering its relatively low electability rate, coupled with its damaged ties with Prabowo, the Democratic Party needs to explore all possible strategies to win votes, including granting its legislative candidates the freedom to support Jokowi-Ma'ruf if it is politically beneficial.

The Democratic Party is nothing but being pragmatic. Its decision to remain independent, however, is distinctly different from other coalition members, the PKS and PAN. The three parties, however, bear a striking similarity, namely a low electability rate. According to a survey conducted by *Kompas* between Sept. 25 and Oct. 5, the Democratic Party, PAN and PKS have 4.8, 2.3 and 3.3 percent respectively. In the case of the Democratic Party and PKS, they even share a common grudge over Prabowo's decision to pick Sandiaga as his running mate. But why, unlike the PKS and PAN, does the Democratic Party lack loyalty to the coalition?

Looking at the coalition's trajectory, it is possible that the explanation lies on the practice of exchanging political favors within a coalition. In regard to the PKS, for instance, the party remains loyal, albeit cautious, to the Prabowo-Sandiaga ticket, particularly after it secured the Jakarta deputy governor seat. Similarly, for PAN, logistical assistance allegedly provided by Sandiaga, played a part in preserving its loyalty to the Prabowo-Sandiaga ticket, as reported by *Tempo* on Aug. 13.

For the Democratic Party, it remains uncertain whether it could reap benefits from its alliance with Prabowo-Sandiaga's coalition. No announcement has been made either on whether Prabowo offers the Democratic Party any strategic positions or assistance in exchange for its

loyalty. It appears that the party has foregone its ambitions for the 2019 presidential election and decided to focus on the 2019 legislative election and 2024 presidential election. Its presence in the Prabowo-Sandiaga coalition is purely to achieve its long-term goal.

Targeting 15 percent of the vote in the upcoming legislative election, the Democratic Party still has a long way to go. Its low electability rate requires the party to enforce any feasible measures to secure votes, including becoming a political chameleon. While avoiding legal barriers to contest the 2024 presidential election, the flexible approach seems to allow the Democratic Party to balance its goals for both 2019 and 2024.

What we've heard: SBY's speech reportedly had two objectives. First, SBY aimed to inform the public that the Democratic Party objected the established 20 percent presidential threshold and the simultaneous presidential and legislative elections which will be held for the first time next year. Simultaneous elections, SBY realizes, disadvantage the Democratic Party, particularly after his failure to form a coalition to nominate his son AHY as either presidential or vice presidential candidate. Indeed, SBY had attempted to establish the coalition with the Golkar Party and the National Awakening Party (PKB), but to no avail.

SBY was disappointed with Prabowo's choice of Sandiaga over AHY, yet he did not want to "beg" to Prabowo to get his party involved in the coalition and to ride Prabowo and Sandiaga's coattails. Based on two of Democratic Party's internal surveys, the party's electability rate has been steadily declining from 10 percent in August 2018 to a low 5 percent in October 2018.

Despite the difficulties, the Democratic Party, however, still holds two advantages. First, according to Prabowo's inner circle (non-Gerindra), the party's political machinery remains effective in East Java and can be reactivated by lobbying actors and parties that supported SBY back in 2009. Indeed, SBY managed to win a large number of votes in East Java that year due to support from the PKB and the non-partisan and cultural influence of Nahdlatul Ulama (NU). Prabowo is aware of SBY's strategy, therefore, he, Sandiaga and several Gerindra top figures, including his brother Hashim Djojohadikusumo, have been touring across East Java. As a result, it is forecasted that Prabowo stands a chance of winning approximately 40 percent of the vote in East Java.

The second advantage for the Democratic Party is related to SBY's international reputation. The world leaders are reportedly still taking into consideration to whom SBY's loyalty lies.

The majority of Gerindra's elite, however, deems SBY as a two-faced figure. This is why his two "advantages" are often overlooked by the coalition in formulating strategies to increase Prabowo's electability. On the other hand, the elite perceives that it is Prabowo who will benefit SBY, not the other way around.

SBY and the Democratic Party's relatively small bargaining power might be the reason why Prabowo, at the end, decided to pick Sandiaga instead of AHY as his running mate. Aware of his small bargaining position, SBY and the Democratic Party told the public about Prabowo's broken promise as a political strategy. The move was aimed to preserve the public's sympathy and support for the Democratic Party.

It is reported as well that SBY and Prabowo have re-established their communication through Democratic Party deputy chairman Syarif Hasan. Through their renewed ties, it is expected that the popularity of Prabowo, Sandiaga, AHY and the Democratic Party among the public will climb.

In fact, within a week the public often discuss about SBY, AHY, Prabowo and Sandiaga, although many times about their disunity. This is harmful because as stated by a source, a unified front is particularly needed in order to maintain SBY's, AHY's, Prabowo's and Sandiaga's good reputations in the public ahead of the 2019 general elections.

Prabowo has admitted that SBY has the ability to establish Prabowo's good reputation, particularly among civil society and military officers outside the Army's Special Forces (Kopassus). Indeed, during his presidency, SBY managed to maintain good relationship with the civil society, specifically in regard to human rights issues and democracy.

BUSINESS & ECONOMIC POLICY

Tobacco taxes: Taking mischief for political assurance

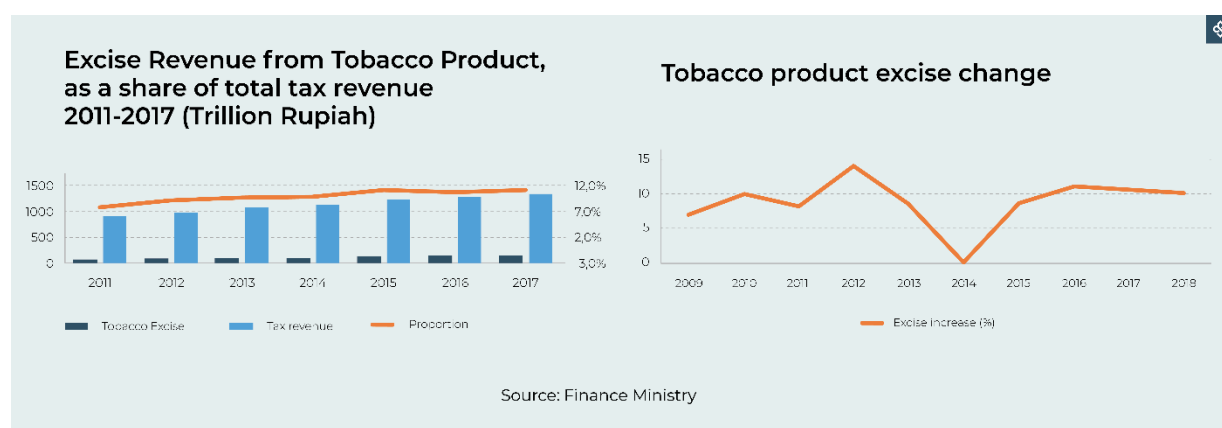
The government controversially canceled a plan to raise the levy on tobacco products in 2019 during a Cabinet meeting at Bogor Palace on Nov. 2.¹ The abrupt change of policy sparked contention because of its contradictory nature with the government's increasing target for excise tax revenue and its goal of improving public health quality.

Takeaway: President Jokowi's decision not to increase the levy on tobacco products next year contradicts his government's own targets of increasing tax revenue and improving public health quality. Yet, the decision is well understood politically as it bodes well with his reelection ambition. The decision would especially please tobacco industry, the Nadhlatul Ulama and most importantly tobacco farmers and workers in East and Central Java – a big number of voters for his reelection bid next year.

Background: Finance Minister Sri Mulyani explained a few days after the Cabinet meeting at Bogor Palace that the excise rate on tobacco products in 2019 would remain the same as in 2018.² This means that wholesale cigarette prices, retail prices as well as excise layers and cigarette categorization will remain the same.

Excise from tobacco products has been a major contributor to Indonesia's tax revenue. Excise from tobacco products accounted for 11 percent of total tax revenues in 2017, up from 8 percent in 2011. It made up the majority (95 percent) of all excise tax revenue. Other products subject to excise tax include alcoholic drinks.

Although tobacco industry players reported declining output of cigarettes in the last three years, excise revenues kept increasing, thanks to the increase in excise rates and lately in the simplification of excise collection.



In late 2017, the finance minister issued Finance Ministerial Regulation No. 146/2017 to simplify the "layers" of excise taxes to only three from previously 12, to reduce miscalculation and mis-taxation and impose fairer excise tax rates to small-scaled tobacco industries.

¹ Kompas.com, "Pemerintah tidak naikan cukai rokok tahun 2019," 2 November 2018

<https://tinyurl.com/ybypldnt>

² KompasTV Youtube, "Cukai Rokok Batal Naik, Defisit BPJS diperkirakan berlanjut," 4 November 2018

<https://tinyurl.com/ya6bhcbq>

This 2017 policy has resulted in higher excise tax revenues despite declining cigarette production. This suggests that the tobacco industry remains a lucrative taxable sector.

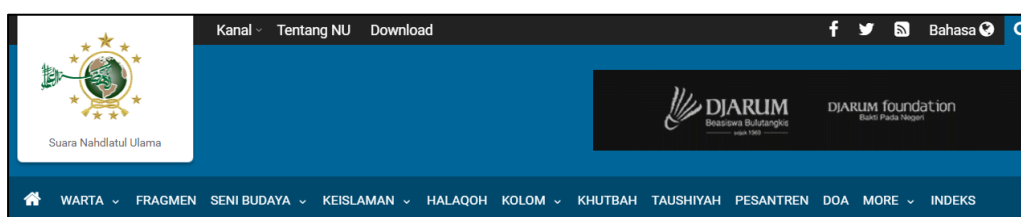
Therefore, the government continues to set higher excise tax revenue targets every year, which averaged at 8.8 percent during the period of 2009 to 2018. However, the tax rate increase was cancelled during the political year in 2014, when the presidential and legislative election were held. And again, the government decided not to increase the excise ahead of another political year in 2019.

Insight: President Jokowi's decision not to increase the tobacco product excise next year is better understood as a political, rather than economic decision. This bodes well for his reelection bid next year, but not with his government's targets to increase tax revenue and improve public health.

The decision was a result of a confluence of interests – Jokowi's reelection interests with the business interests of labor-intensive tobacco industries and surprisingly the interests of the country's largest Islamic organization, the Nahdlatul Ulama (NU), in protecting its constituents in East and Central Java.

The NU has been a strategic lobbying partner of tobacco industry players grouped under the Indonesian Cigarette Producers Association (GAPPRI). First, unlike the country's second-largest Islamic organization, Muhammadiyah, which bans smoking, the NU is a supporter of smoking. Most of its high-profile clerics are smokers. Second, tobacco farmers and most cigarette factories – such as those belonging to the biggest brands, Gudang Garam, HM Sampoerna and Djarum – are all located in the NU's strongholds of East and Central Java. Third, Jokowi's running mate, Ma'ruf Amin, was leader of the NU's supervisory body.

Such a confluence of interests between GAPPRI and the NU results in strong lobbying power. GAPPRI itself went with its own traditional way of sending letters to government officials, including to President Jokowi himself, to present its case of against the excise increase.³ The NU then provided support from civil society by organizing a public discussion in October about the adverse impacts of an excise increase on tobacco farmers and industry workers, both constituents of the NU. GAPPRI then accompanied the NU officials in presenting the results of the discussion to various government officials (see What We Heard).



The NU has been a long-time supporter of tobacco farmers and the cigarette industry. When the finance minister issued Ministerial Regulation No. 146/2017 on simplifying cigarette excise taxes to increase excise revenue, the NU voiced its opposition, arguing that the regulation could affect jobs in the tobacco industry, especially the small-scaled industry.⁴

³ CNBC Indonesia, "Cukai rokok tak naik, pengusaha: sesuai surat ke Jokowi," 2 November 2018

<https://tinyurl.com/ycrrkdae>

⁴ NU.or.id, "Berpotensi matikan usaha kecil, PBNU soroti regulasi tarif cukai tembakau," 11 October 2018

<https://tinyurl.com/y77c92wm>

The National Awakening Party – the political party affiliated to NU – is one voice with NU in supporting the tobacco industry. On several occasions, its chairman, Muhaimin Iskandar, met with tobacco farmers and even called for the government not to increase tobacco excise taxes.⁵

Therefore, it was well understood when President Jokowi finally decided not to increase the excise, despite the proposal from the Finance Ministry for the increase to meet the rising excise tax targets for next year totaling Rp 158.8 trillion, up from Rp 148.2 trillion this year.

Hence, Jokowi's decision not to increase the excise will likely affect the collection of excise revenues not only for next year but also for this year. According to the Customs and Excise Directorate General's technical and excise facility director, Nugroho Wahyu Widodo, the decision will cancel the "forestalling" momentum and threaten the tax office's ability to meet its annual tax revenue target for this year.⁶

Forestalling is a strategy used by tobacco industry players to massively accumulate excise ribbons with old levies after the government usually sets a levy increase at the end of every year. This forestalling is usually utilized as a tax revenue booster by the tax office to meet its annual target.

The lower tobacco excise revenue would similarly reduce the available funds to cover the Healthcare and Social Security Agency's (BPJS Kesehatan) deficit. President Jokowi has decided to allocate a portion of excise tax revenues to cover the BPJS deficit. By November 2018, the agency booked a deficit of Rp 16.5 trillion, which had resulted in unpaid health services and payment delays for suppliers.⁷

Besides its financial implications on the state budget, the decision also undermines the government's commitment to improving public health quality. Jokowi is perceived as not aggressive enough in controlling smoking.

The latest Health Ministry report on the nation's state of health in November showed that access to unhealthy choices of lifestyles– smoking, drinking, junk food consumption – remains prevalent during Jokowi's presidency. The same report also suggested that smoking was a major element that swayed people to adopt an unhealthy lifestyle.

A World Health Organization report on the global tobacco epidemic in 2017 showed that cigarettes in Indonesia were still highly consumed despite the prevailing excise hike. The number was still followed by growing smoking prevalence of three or more cigarettes, and 10 or more cigarettes per day. A similar report in 2016 ranked Indonesia at 13th for having the most affordable cigarettes among 70 countries surveyed, even though the excise rate increase during that year was the highest in the last five years. Someone could obtain a pack (12-15 rolls) of premium brand cigarettes for US\$2.16 and the cheapest brand for less than 50 cents.

All those reports indicate that smoking is still a big problem in Indonesia. It requires strong will from the President to address the problem. President Jokowi's decision to cancel the excise increase for 2019 indicates that he is not serious about tackling this very important issue.

⁵ Republika, "In Picture: Cak Imin Minta Pemerintah Tidak Menaikkan Cukai Rokok" 9 Nov 2017. <https://www.republika.co.id/berita/nasional/umum/17/11/09/oz57wv283-cak-imin-minta-pemerintah-tidak-menaikkan-cukai-rokok>

⁶ Bisnis Indonesia, "Duty elimination for tobacco products may cut tax income, at least by Rp 2 trillion: Tax Office," 14 November 2018, p.3

⁷ Merdeka.com, "BPKS Kesehatan defisit, rakyat dan rumah sakit jangan dibebani," 18 September 2018 <https://tinyurl.com/y85b5p6v>

What we've heard: Some sources in the government said the Finance Ministry had prepared the scenario for increasing cigarette excise rates in 2019. The Finance Ministry's Fiscal Policy Office (BKF) had conducted an in-depth study on the implications of raising tobacco product excises.

The BKF even developed a tobacco products road map until 2021, where excise calculation on tobacco products was simplified to improve accuracy in excise calculation. The road map was finalized on the sidelines of the Annual Meetings of the International Monetary Fund and World Bank Group in Bali on Oct. 10.

The road map, however, has met opposition from tobacco industry players, especially from those who have been exploiting the loophole in the current excise scheme.

In a Cabinet meeting at Bogor Palace on Nov. 2, Finance Minister Sri Mulyani presented the scenario to raise tobacco product excises by 10 to 40 percent based on the types and amount of production. The finance minister's proposal for an excise increase next year met opposition from a number of Cabinet ministers, especially from Industry Minister Airlangga Hartarto, who asked that the plan be postponed, arguing that it would damage the national tobacco industry. Coordinating Political, Security and Legal Affairs Minister Wiranto also suggested that the plan be postponed until after the general election in April 2019.

A source attending the meeting said President Joko "Jokowi" Widodo stopped the debate by making a decision to cancel the plan to raise excise taxes on tobacco products. Some sources in the government explained that the cancellation was related to business lobbying, especially by industry players grouped under the Association of Indonesian Cigarette Producers (GAPPRI). The association has teamed up with the country's largest Islamic organization, the Nahdlatul Ulama (NU), in lobbying the government.

With support from industry players, the NU organized a public discussion about the implications of a tobacco product excise increase in October. The NU argued that the excise increase would affect tobacco farmers and industry workers, who were located mostly in the NU-stronghold of East Java and Central Java.

A week after completing their study, NU and GAPPRI visited the office of the Presidential Advisory Board (Wantimpres) to discuss their findings on the impacts of increasing the tobacco product excise. The result of the meeting was then delivered to the President himself. Another source said GAPPRI had also lobbied an executive at the Executive Office of the President (KSP), where in turn the KSP recommended that the President halt the excise increase because of its impacts on the tobacco industry and its adverse electoral effects ahead of the presidential election.

Garuda-Sriwijaya partnership gives Garuda boost in fierce competition with Lion Air

National flag carrier Garuda Indonesia, through its subsidiary Citilink Indonesia, signed on Nov.9 an agreement with Sriwijaya Air Group to take over the operation and financial management of Sriwijaya Air and NAM Air under a joint operation scheme (KSO).

Takeaway: The KSO agreement between Garuda Indonesia Group and Sriwijaya Air Group will benefit Garuda more than the latter. Sriwijaya's competitiveness in the domestic and international flight market is an asset for Garuda in its head-to-head competition with the mighty and aggressively expanding Lion Air Group.

Background: Sriwijaya Air Group has been in financial trouble due to fierce competition in the low-cost carrier market and sharp rupiah depreciation since the beginning of the year. As a result, the group faces difficulties in servicing its US\$24.3 million (Rp 355 billion) debt to PT Garuda Maintenance Facility Aerosia, one of Garuda Indonesia's subsidiaries that provide airline maintenance service.⁸

To sort out its debt with Garuda Indonesia Group, Sriwijaya Air executive director Chandra Lie agreed to establish a strategic alliance with Citilink Indonesia. The alliance involves several agreements. First is the special prorated agreement signed in May this year, which allowed Garuda and Citilink Indonesia to offer flight services for routes operated by Sriwijaya Air but not by Garuda Indonesia Group and vice versa. Next was the codeshare agreement that was also signed in May. The codeshare agreement would integrate flight routes operated by either Garuda or Sriwijaya. For instance, Garuda could integrate its Jakarta-Semarang flight with Sriwijaya's Semarang-Sampit route.⁹

The last one is the Garuda-Sriwijaya KSO agreement. This agreement also provides an opportunity for Garuda Indonesia Group to buy Sriwijaya Air Group shares.¹⁰ These agreements, specifically the latest, has significantly boosted investors' optimism toward Garuda Indonesia, reflected by a 22 percent increase in Garuda Indonesia stock price on Nov. 15 following the announcement of its partnership with Sriwijaya.¹¹

Transportation Minister Budi Karya Sumadi also welcomes Garuda-Sriwijaya partnership because it might drive down cut-neck competition in the low-cost carrier market.¹² Nevertheless, the Business Competition Supervisory Commission (KPPU) is concerned with this partnership. KPPU spokesperson Guntur said the commission would investigate the cooperation agreement, particularly on how the airlines were going to set their prices and conduct their marketing campaigns.¹³

⁸ Kompas.com, "Operasional diambil alih Citilink, berapa utang Sriwijaya Air ke Garuda Indonesia Group?" 15 November 2018 <https://tinyurl.com/y8yar8en>

⁹ TheJakartaPost.com, "Garuda Indonesia, Sriwijaya Group announce codeshare agreement." 16 May 2018 <https://tinyurl.com/yb4mmwr5>

¹⁰ Kumparan.com, "Garuda buka opsi beli saham Sriwijaya Air Group." 14 November 2018 <https://tinyurl.com/ya3bk5fr>

¹¹ Kontan.co.id, "Harga saham Garuda (GIAA) melonjak 22% akibat rencana akuisisi Sriwijaya Air." 15 November 2018 <https://tinyurl.com/y8tecwee>

¹² Kompas.com, "Menhub: sinergi Garuda dan Sriwijaya Air bisa minimalkan perang tarif." 15 November 2018 <https://tinyurl.com/yae2rm5b>

¹³ TheJakartaPost.com, "Commission to look into airline merger." 21 November 2018 <https://tinyurl.com/yc6jlc3z>

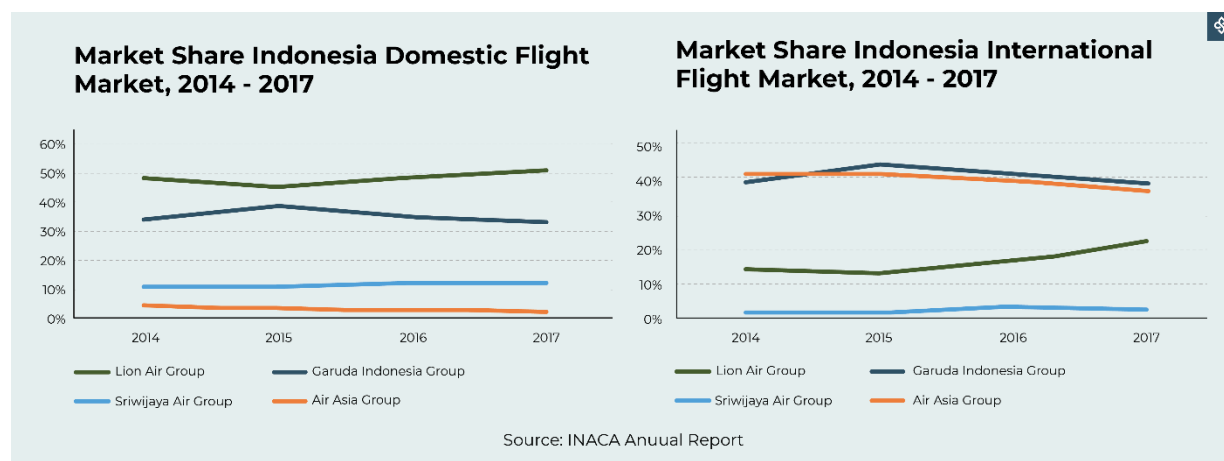


Insight: The strategic alliance between Garuda Indonesia Group and Sriwijaya Air Group is a boon for the flagging state-owned enterprise. Despite its best efforts, Garuda Indonesia has been losing its market share in the domestic flight market. After a brief increase in its market share to 38.3 percent in 2015, Garuda's market share had fallen to 32.9 percent in 2017. On the other hand, Sriwijaya Air Group has been expanding its market share, which increased from 10.8 percent in 2015 to 12.6 percent in 2017.

Besides improving Garuda's declining market share, this alliance is also a boost for Garuda in its head-to-head competition with market leader Lion Air Group, which has the lion's share of Indonesia domestic flight market.

Although Garuda is still the market leader in the international flight market – thanks to its ability in operating long-haul flight service, Garuda Indonesia, together with its main competitor the Air Asia Group, has been losing its market share to Lion Air Group. After a brief increase in its market share to 43.8 percent in 2015, Garuda's market share decreased to 38.8 percent. In contrast, Lion Air Group has been able to expand its market share by 9.2 percent to 22 percent in the aforementioned period.

Sriwijaya Air Group's market share in the international flight market is still miniscule, but it has recorded a remarkable performance. In 2014-2017, Sriwijaya's market share doubled from 1.3 to 2.5 percent. Sriwijaya's competitiveness in the international flight market could become an asset for Garuda in dealing with the aggressively expanding Lion Air Group.



What we've heard: Sources in the airline industry said Sriwijaya had been aggressively looking for investors since early October to sell both Sriwijaya Air and Nam Air. The

management had been facing financial difficulties after its subsidiary, Nam Air, was at risk of going bankrupt following a price war with Lion Air. The airline is known for its feeder routes that reach remote areas which directly competes with Lion Air.

A source familiar with Sriwijaya's financial situation said the company had initially sought out Garuda Indonesia to become a "messiah" that could save the company from bankruptcy. Sriwijaya seemed to be in favor since Garuda had US\$ 9.3 million receivables from the latter.

Another source said Sriwijaya's proposal to Garuda received a quick response following the national airline's attempt to expand its domestic routes. An official from the State-Owned Enterprise Ministry explained that the expansion was part of Minister Rini Sumarno's instruction to Garuda to revamp the company's profitability.

According to the same source, the acquisition was Garuda's effort to go head-to-head with Lion, after Garuda and Citilink had reached their service limits. The acquisition gives the state-owned company an expanded armada and increases its flight permit limit.

The crashed Lion Air flight JT610 was said to have further fueled Garuda to commence its plan to control domestic flight routes.

Sriwijaya's safety and security quality were reportedly part of the reason why Garuda was willing to acquire the company. The quality of which some Lion Air pilots hailed.

As part of the deal signed on Nov. 9, Garuda will reportedly acquire Sriwijaya's debt, which amounted to Rp 2 trillion. The state-owned airline has delegated the task of fixing Sriwijaya's operations and financial situation to its subsidiary, Citilink.

Separately, Sriwijaya's owners, Hendry Lie and Chandra Lie, personally asked Garuda's management to maintain the Nam Air name. Both of them wanted to maintain their parent's legacy since Nam was named after their father, Lo Kui Nam.

MACROECONOMIC UPDATE

Liberal economic stimulus proposal sparks controversy

Coordinating Economic Minister Darmin Nasution said the government's planned revision of the Negative Investment List (DNI) was necessary to solve the widening current account deficit, disregarding the fact that the policy was politically sensitive in the face of the 2019 presidential election.¹⁴

Takeaway: Because of Indonesia's worsening current account and trade account deficits, Darmin decided to pursue a liberal and pro-foreign investment economic stimulus package. Darmin's stimulus proposal, however, has caught everyone flat-footed and sparked controversy among President Jokowi's supporters and opponents. Given the President's decision-making track record and reputation as an economic populist, there is a high possibility that President Jokowi will backtrack from Darmin's stimulus proposal.

Background: Bank Indonesia (BI), the Finance Ministry and Office of the Coordinating Economic Minister are concerned about the widening current account deficit, caused by rapid growth in oil and gas imports from US\$19.5 billion between January and October 2017 to \$25 billion between January and October 2018, as well as growth of 22.2 percent in non-oil and gas imports to \$131.4 billion in the same period. Combined with lackluster export performance, rapid import growth has resulted in a \$5.5 billion trade deficit this year.

To solve this problem, the Office of the Coordinating Economic Minister together with BI, the Financial Services Authority (OJK), the Finance Ministry and Industry Ministry proposed a liberal economic stimulus package (economic policy package No. XIV) on Nov. 16 to encourage foreign investment in export-based manufacturing and rapidly growing digital economy sector.¹⁵

As part of the proposed economic stimulus package, the government will revise Finance Ministerial Regulation No. 35/2018 on tax holidays by adding two sectors: digital economy related services and agri-processing industry as beneficiaries, and Presidential Regulation No. 44/2016 on DNI by allowing 100 percent foreign ownership in 28 industries – with a potential addition of 26 sectors that are still under ministerial review.¹⁶

Besides revising the tax holidays and DNI regulations, the government will also provide tax incentives for natural resource extraction companies that repatriate their export earnings. If a company fails to repatriate its export earnings, however, the government will impose punishments, such as revoking the company's export license.¹⁷

¹⁴ TheJakartaPost.com, "DNI revision to address structural problems, govt says." 21 November 2018
<https://tinyurl.com/y9b3o6fn>

¹⁵ Detik.com, "Jokowi perbaharui paket kebijakan ekonomi ke-16." 16 November 2018
<https://tinyurl.com/y97wyhts>

¹⁶ Tirto.id, "Paket Kebijakan Ekonomi Jilid XVI akan diikuti revisi dua regulasi." 16 November 2018
<https://tinyurl.com/ycnqrugb>

¹⁷ CNBCIndonesia.com, "Menkeu: langgar aturan DHE, perusahaan bisa dilarang ekspor!" 16 November 2018
<https://tinyurl.com/yayb9h38>



Insight: Despite its good intention, the proposed economic policy package No. XVI has stirred controversy. It began with criticism from presidential election challenger Prabowo Subianto, whereby he and his campaign team criticized the proposed stimulus package as unpatriotic¹⁸ and inconsistent¹⁹.

The challenger's criticism seems to have hit the mark. Indonesian Democratic Party of Struggle (PDI-P) secretary-general and Joko "Jokowi" Widodo-Ma'aruf Amin campaign team secretary Haryo Kristiyanto acknowledged that Darmin's proposed stimulus package was inconsistent with the President's Nawa Cita agenda.²⁰ House of Representatives member from the PDI-P, Maruarar Sirait, also criticized the proposed stimulus package, emphasizing that it was not President Jokowi's, but Darmin's idea.²¹

Although Industry Minister and Golkar chairman Airlangga Hartarto supported the proposed stimulus package, his party member and House Speaker Bambang Soesatyo opposed the idea, having said that the package was inconsistent with President Jokowi's vision.²²

Besides the political fallout, the proposed stimulus package has also failed to gather support from various business communities. Indonesian Young Entrepreneurs Association (Hipmi) tax center leader Ajib Hamdani criticized the stimulus as unsupportive toward local micro, small and medium enterprises (MSMEs).²³ Similarly, Indonesian Chamber of Commerce and Industry (Kadin) chairman Rosan Roeslani has urged the government to delay the implementation of economic policy package No. XVI, because Kadin members are worried about the impact of DNI deregulation on local MSMEs.²⁴ Amid these various objections, Indonesian Employer Association (Apindo) chairman Hariyadi Sukamdani has advised the

¹⁸ Kompas.com, "Prabowo: keluarkan paket kebijakan ekonomi, tanda kita menyerah pada asing." 21 November 2018 <https://tinyurl.com/ybmr3dd2>

¹⁹ CNNIndonesia.com, "Tim Prabowo sebut paket kebijakan ekonomi jauh dari Nawacita." 19 November 2018 <https://tinyurl.com/y8ass22d>

²⁰ CNNIndonesia, "Kubu Jokowi akui Paket Ekonomi XVI di luar Nawa Cita." 19 November 2018 <https://tinyurl.com/y97j6bv8>

²¹ Tirto.id, "PDIP klaim Paket Kebijakan Ekonomi XVI bukan ide Jokowi." 19 November 2018 <https://tinyurl.com/y9xd3vr8>

²² Tempo.co, "Bambang Soesatyo: relaksasi DNI tidak sesuai dengan visi Jokowi." 22 November 2018 <https://tinyurl.com/yaxzr95m>

²³ Kontan.co.id, "Hipmi menolak pemerintah undang investor asing dengan revisi DNI." 22 November 2018 <https://tinyurl.com/y793exxq>

²⁴ Bisnis.com, "Kadin minta penundaan Paket Kebijakan XVI, terutama terkait DNI." 21 November 2018 <https://tinyurl.com/ycluav6d>

government to hold a public dialogue over DNI revisions, while giving his support to the other economic stimulus initiatives.²⁵

The proposed economic policy package No. XVI has stirred controversy among supporters and opponents alike, because it sends confusing signals about President Jokowi's economic policy stance. As demonstrated by the President's previous policy decisions, President Jokowi is an economic populist. Hence, his ministers' liberal and pro-foreign investment economic stimulus proposal has caught everyone flat-footed.

Then, the question arises whether President Jokowi will follow through with his ministers' liberal stimulus package. Given President Jokowi's decision-making track record, there is a high possibility that the President would overturn his ministers' stimulus proposal such as in the cancelation of fuel prices and tobacco excise hike, further damaging his credibility in policy decision-making.

Industries Eligible for Tax Holidays	
No.	Under Finance Ministry Regulation No. 35/2018
1	Basic Metals Manufacturing
2	Petroleum Products Manufacturing
3	Petrochemicals from Petroleum and Coke Manufacturing
4	Inorganic Chemicals Manufacturing
5	Organic Chemicals Manufacturing
6	Basic Pharmaceuticals Manufacturing
7	Semiconductor and Computer Manufacturing
8	Telecommunication Equipment and Smartphone Manufacturing
9	Medical Equipment Manufacturing
10	Machinery Components Manufacturing
11	Auto Components Manufacturing
12	Robotic Components Manufacturing
13	Ships and Boats Components Manufacturing
14	Aircraft Components Manufacturing
15	Railway Locomotives Components Manufacturing
16	Electrical Equipment Manufacturing
17	Infrastructure Construction Services
Proposed Industries for Tax Holidays	
No.	Under Economic Package No. XVI (2018)
1	Agri-processing Industry
2	Digital Economy Related Services

Source: Finance Ministry Regulation No. 35/2018 (<https://tinyurl.com/y9n5lyez>), and Tirto (<https://tinyurl.com/ycnqrugb>)

➔ See next page for list of excluded industries

²⁵ CNBCIndonesia.com, "Apindo nilai relaksasi DNI tidak perlu." 22 November 2018
<https://tinyurl.com/y9t9mc73>

Industries Excluded from the Negative Investment List (DNI)			
No.	Economic Package No. X (2016)	No.	Planned for Economic Package No. XVI (2018)
1	Crumb Rubber Industry	1	Textile Printing Manufacturing
2	Toll Road Management Services	2	Knitted and Croached Fabrics Manufacturing
3	Non-hazardous Waste Disposal	3	Sawmilling, >2000 Meter Cubic Production Capacity
4	Direct Selling	4	Veneer Manufacturing
5	Cold Storage	5	Plywood Manufacturing
6	Future Exchanges Brokerage Services	6	Laminated Veneer Lumber Manufacturing
7	Restaurant	7	Wood Chips Production
8	Bar	8	Wood Pellet Production
9	Café	9	Oil and Gas Construction Services
10	Sport Facilities	10	Power Generation Services, >10 MW Capacity
11	Film Studio Services	11	Kretek Ciggarates Manufacturing
12	Film Laboratory Services	12	White Ciggarates Manufacturing
13	Voiceover Services	13	Other Ciggarates Manufacturing
14	Film Printing Services	14	Paper Pulp Manufacturing
15	Film Shooting Services	15	Crum Rubber Manufacturing
16	Film Editing Services	16	Construction Machinery and Equipment Rental Services
17	Film Subtitling Services	17	Unclassified Machinery and Equipment Rental Services
18	Film Making Services	18	Art Gallery
19	Cinema Services	19	Art Performance Building
20	Recording Studio Services	20	Job Training Services
21	Film Distribution	21	Pharmaceutical Manufacturing
22	Call Shop	22	Class B Health Equipment Manufacturing
23	Telecommunication Device Testing Services	23	Class C Health Equipment Manufacturing
24	B2C E-commerce Services	24	Class D Health Equipment Manufacturing
25	Pharmaceutical Raw Materials Manufacturing	25	Cell Bank and Laboratory
26	Hospital Management Consultancy	26	Data Communication and Networking Services
27	Medical Equipment Rental Services	27	Acupuncture
28	Clinical Laboratory Services	28	Retail Sales via Mail Order or Internet
29	Health Check-up Services		
30	General Practitioner Services		
31	Specialist Physician Services		
32	Dental Care and Services		
33	Paramedic Services		
34	Traditional Health Care Services		
35	Pension Fund Services		

Source: Okezone (<https://tinyurl.com/yarvhl2>), and Kontan (<https://tinyurl.com/y8qz2rll>)

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