

# Strategic Analysis Paper

11 July 2014

## Indonesia in 2020: Future Challenges for the New President

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### Key Points

- Indonesia's new president, likely to be Joko Widodo, faces a range of challenges in his first term, including: food, water and energy security; the need to upgrade vital infrastructure; addressing corruption; improving health and education; and increased environmental concerns.
- The key to addressing many of these challenges lies in cutting costly fuel subsidies. While subsidies sap the budget and waste funds that could otherwise be used to address these issues, passing the vital reforms will not be easy, especially given hostile responses from parliament and the public.
- Improving public services, including health and education, and eliminating corruption are important long-term goals facing the new president. While some improvements can be expected, especially if a raft of new policies is introduced, these challenges will continue beyond the new president's first term.
- Now, more than ever, the country needs good governance and sound decision-making. How the new president addresses these challenges will go a long way towards determining the future fortunes of Indonesia.

### Summary

As Indonesians prepare to welcome a new president, South-East Asia's most populous state finds itself at a crossroads once more. Having undergone a rapid transformation since the end of former president Suharto's rule in 1998, the coming years will see the country face a number of testing challenges. For whoever wins this week's election – and early indications

suggest that it will be the former governor of Jakarta, Joko Widodo – success in addressing these challenges will determine the future fortunes of the country.

In particular, an increased population will see food, water and energy security become major concerns. Indonesia's frequently woeful infrastructure, meanwhile, will have to be significantly upgraded to accommodate its people and foreign investors. The country also faces challenges in terms of corruption, education, health and the environment. Should the new president prove successful in tackling these challenges, however, then there will also be opportunities for success, especially if Indonesia's economy regains its former strength.

Understanding these challenges, therefore, will be crucial for governments, policymakers, and investors with an interest in Indonesia. This paper considers the challenges facing the incoming president, providing a broad picture of what Indonesia might look like in 2020.

## Analysis

### ***Demographic Changes to 2020***

Indonesia will remain the fourth most populous country in the world by 2020, with a population of around 270 million people. At the same time, its middle class, now estimated to be around 75 million people, will increase exponentially. The Boston Consulting Group, a global consulting firm, estimates that around 140 million Indonesians will be a part of the middle class by 2020.<sup>1</sup> Half of the country's population, meanwhile, will be aged 30 or under.

Most of these people will inhabit large cities, especially on the island of Java, as young Indonesians seek better employment and lifestyle opportunities. These demographic factors, however, will mean that Indonesia is likely to face a range of important challenges, especially in the areas of food, water and energy security.

### ***Food and Water Security***

Indonesia will face a number of food and water challenges by 2020. In particular, increased food consumption and changing dietary preferences, especially those associated with a rising middle class, are likely to pose a number of important problems for the incoming president.

Although the country currently has a low level of food insecurity, with overall food supplies adequate to feed its population, inefficiencies in distribution and productivity, and problems with affordability, often restrict the distribution of food products across the vast archipelago. Unfortunately, many of the country's poor struggle to meet their food and water needs, with the poorest spending around 80% of their household expenditure on food alone. Thus, despite recent improvements, almost 21 million Indonesians, or roughly nine per cent of the population, remain undernourished. Furthermore, the 2012 Global Hunger Index found that nearly one-fifth of Indonesian children under the age of five are

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<sup>1</sup> Rastogi, V., Tamboto, E., Tong, D. and Sinburimsit, T., 'Indonesia's Rising Middle-Class and Affluent Consumers: Asia's Next Opportunity', *Boston Consulting Group*, 5 March 2013.

underweight and many suffer from nutritional deficiencies. Not surprisingly, this contributes to a range of health issues.

The problem, as a recent [FDI Strategic Analysis Paper](#) noted, is that ‘while food supply levels are more than adequate to feed the Indonesian population, inefficiencies in distribution systems across the archipelago make it difficult to meet demand at prices accessible to all Indonesians.’<sup>2</sup> Supply chains remain highly inefficient; around 35 to 40 per cent of fresh fruit and vegetables spoil before hitting the market stalls. Meanwhile, inadequacies in vital infrastructure, including roads, ports and rail lines, can make transporting food products across the country’s 17,500 islands extremely difficult. Poor technology and farming practices also mean that Indonesian farms are not as efficient as they could be, despite an abundance of good soil and water.

Given this, it is not surprising that Indonesia’s farming industry, which accounts for around 40% of the total workforce, is highly fragmented. Although there are some large-scale, state-owned companies, most of the farming sector is still comprised of small-end subsistence farming. The country is the world’s largest producer of palm oil, and exports large amounts of rubber, cocoa, coffee, tea and sugar. At the same time, however, it remains heavily reliant on imports for staple foods and, increasingly, meat products such as beef. This is particularly worrisome for the country’s poor, who are vulnerable to any fluctuation in prices and possible cuts to subsidies, including for rice. Consequently, says Global Business Guide Indonesia, food security has become part of the ‘national agenda as world food prices have continued to climb.’<sup>3</sup>

In response, the government implemented a self-sufficiency plan in October 2012. Its principal aim was to meet 90% of the country’s food needs by 2014. While politically popular, the plan has failed to achieve its lofty goals, especially as productivity and farming practices remain inefficient. Rather, critics have warned that the plan is actually at odds with the goal of maintaining food security. They claim that a heavy reliance on increased domestic production is likely to make the country more vulnerable to fluctuations in supply.

Like many of the country’s policies, the plan is premised more on nationalism than best practice; this was especially so after the controversial suspension of live cattle exports by Australia in 2011. Should the incoming government continue with the failed self-sufficiency plan, food security, already a major challenge, could get much worse.

Looking ahead to 2020, therefore, the incoming president should focus on *gradually* improving farming practices and increasing productivity, rather than trying to achieve the overly-ambitious, and potentially destructive, self-sufficiency goals of the 2012 plan. That will not be easy, though.

The government has made some headway in recent times, but it remains stuck in a “catch-22” situation: to increase funding and promote better practices, it will need to cut its costly subsidies, including on fuel and some food products. That, however, will undoubtedly attract

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<sup>2</sup> Di Nunzio, J., ‘Hungry Neighbours? Indonesia’s Food Strategy and Water Security Future’, *Future Directions International*, 11 November 2013.

<sup>3</sup> ‘Agriculture Overview of Indonesia’, *Global Business Guide Indonesia*, 2012.

the wrath of ordinary Indonesians, many of whom have protested angrily against such cuts before. At the same time, moreover, increasing productivity through the adoption of modern technology and farming methods remains a contentious issue for many, especially among Indonesia's subsistence farmers. Over 80% of the country's 140 million farmers are aged 45 years or above, the majority of whom occupy subsistence farms on small plots of land. Such producers may not be receptive to new practices and, with Indonesia's youth increasingly looking towards the big cities for employment options, the production levels of Indonesian farms by 2020 could actually get worse, at least in the short term.

Over the longer term, the country's farming industry will inevitably move away from these smaller, family-run businesses, with big conglomerates accounting for a larger share of the industry. The future of its food security depends on it. Such a change, however, is likely to be generational; with many of the older farmers unwilling to leave behind their ancestral land and traditional way of life, such a shift is unlikely to be seen before 2020.

Similarly, despite abundant supplies, many Indonesians lack access to reliable water sources. Major infrastructure development, including better irrigation and potable water systems, will be needed to ensure improved water security in 2020.<sup>4</sup>

### ***Energy Security***

Until recently, energy security was not a major concern for Indonesia. An abundance of natural resources, including oil, had meant that the country had ample energy supplies. Now, however, with its oil supplies significantly down, the country, formerly a member of OPEC (Organisation of the Petroleum Exporting Countries), has become a net importer of oil. It became a net importer in 2004 and it is estimated that the country will become the world's largest gasoline importer by 2018). While Indonesia is still a net exporter of energy resources overall, due largely to exports in gas and coal, its reliance on oil imports poses a number of challenges.

The most obvious of these is that while both of the presidential candidates promised to cut the costly fuel subsidies, little in the way of concrete plans was actually announced. The issue was notably absent from many of the presidential debates leading up to the election.

[Fuel subsidies have been cut before](#), but further cuts, at least in the short term, appear unlikely. Political populism should mean that the subsidies, which amount to nearly US\$12 per day per driver, or 20% of the annual budget, remain in place for now. But, with economists warning that the trillion-dollar economy must eventually wean itself off the costly subsidies, the incoming president will soon have to face the music. This is especially so if he wants to reach a budget surplus and rein in a growing current account deficit. Mr Widodo, the likely winner of the 9 July election, has spoken of cutting the subsidies steadily over five years. That may ease some of the financial strain likely to be faced by ordinary Indonesians, and could go some way to limiting the backlash.

Yet, recent history suggests that Mr Widodo, even with his long-term phase out, will find cutting the subsidies tough. Widespread riots over proposed cuts and parliamentary

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<sup>4</sup> For more on water security, see note 1.

deadlocks have been seen before, and may well play out again when the new cuts are proposed. Inflation and a rise in the overall cost of living will accompany the unpopular, but vitally important, reforms, too. Deep structural changes will also be needed. This will prove a difficult task for the incoming president, although the experience of China, which managed to cut subsidies while keeping its economic growth humming along, may offer a valuable blueprint. Mr Widodo may lose some political popularity as a result, but the overall economy, which has slowed in recent times, will be much better for the cuts in the long run.

Indonesia's heavy reliance on oil imports also makes it especially vulnerable to disruptions in global supplies and spikes in prices. Insecurity in the Middle East, and especially Iraq, the second-largest OPEC member, have destabilised oil markets and driven up prices in recent times. While this is unlikely to be a long-term trend, it highlights just how susceptible big oil importers are to global events. Even if the crisis in Iraq soon reaches an impasse, Indonesia will still be at the mercy of other geopolitical shocks around the world.

Given that, the country has tried to address its growing demand for oil. Its burgeoning middle class has seen the demand for oil increase by roughly four per cent per year and, by 2018, it will be the largest importer of gasoline in the world.

Moves towards natural gas have started. Since 2005, natural gas production has increased by more than a third. Still, improvements in infrastructure, transport and overall government support, including greater co-ordination across the country, are needed to produce enough gas to reduce the dependence on oil. To be sure, natural gas is shaping up as a viable long-term solution, especially with [an abundance of shale](#). But, with problems such as those previously mentioned, any action is likely to take years, if not decades.

There are also plans to harness renewable energy in Indonesia. Encouragingly, some projects are already underway: in June, Indonesia made headlines for the construction of the world's largest geothermal power plant, the US\$1.5 billion facility in Sarulla. After years of delay, construction is underway and the plant should generate around 300 megawatts per year over 30 years. Officials are hoping that the new station will be just the beginning. As a result of volcanic geology, Indonesia has around 40% of the world's geothermal resources, which could potentially deliver 28,000 megawatts. By 2025, the country aims to produce 9,000 megawatts of geothermal power. This seems an ambitious, if perhaps unrealistic goal, especially as long delays are a fact of life in Indonesia. If achieved, however, it would make the country the world's largest geothermal energy producer, accounting for roughly five per cent of its energy needs.

### ***Infrastructure***

Whoever wins the election will also need to boost Indonesia's lacklustre infrastructure. Both Mr Widodo and Prabowo Subianto said that they would push forward infrastructure projects in a country which badly needs better roads, transit networks and ports, as well as internet access and technology. This is especially so if Indonesia is to ensure its food and energy security, attract further foreign investment and achieve its ambitions of becoming a regional manufacturing hub. But doing that is easier said than done.

Any major infrastructure projects are unlikely to be funded until the government has reined in the costly fuel subsidies currently crippling government expenditure. Outgoing president Susilo Bambang Yudhoyono had promised a range of grand infrastructure projects during his two terms, but was unable to fund them as he could not get cuts to the fuel subsidies to pass parliament. Now, more than ever, the country must cut the subsidies, and this should happen sometime before 2020. In theory, at least, this should free up funding and go some way to addressing Indonesia's infrastructure woes.

It would also help to boost foreign investment. So far, the country's poor infrastructure has made doing business in Indonesia unnecessarily difficult and costly. Tim Hewett, of the Australian Trade Commission, says that, 'infrastructure development is one of the key challenges facing Indonesia ... this is still one of the most expensive countries in the world to move a shipping container, despite wages being incredibly low.' He says that investment across the board – including airports, roads, ports and telecommunications – is required to attract much-needed foreign investment.

Both presidential candidates promised a raft of new infrastructure projects, including railways, roads, bridges and airports. Much will depend, however, on how quickly the incoming president can cut fuel subsidies which, as well as being hugely unpopular, is likely to again run into opposition in a fragmented parliament. With private companies unlikely to shoulder the costs of any new infrastructure projects, especially given Indonesia's shaky investment climate, how this plays out will be critical. Although cuts to fuel subsidies can be expected before 2020, this is no certainty given the level of opposition such reforms are likely to face.

### **Corruption**

Corruption [remains endemic in Indonesia](#). In December 2013, a survey by Transparency International, a Berlin-based research organisation, ranked the country at 114 out of 170 countries, worse than other Indian Ocean Region countries such as Ethiopia and India. Though encouraging signs are slowly emerging, including the establishment of an independent Corruption Eradication Commission (*Komisi Pemberantasan Korupsi*, or KPK), in 2002, corruption will nonetheless be a major challenge for the incoming president.

In this respect, Mr Widodo was the more vocal of the two candidates and his record in governing Jakarta suggests a brighter future. Having said that, however, outgoing president SBY was elected on a broad platform of stamping out corruption. Not only did he fail to reduce graft and bribery, but his party was later embroiled in a number of corruption scandals during his final term.

The KPK, meanwhile, is still very much a work in progress. One of the major problems facing the incoming president is that other administrative arms, including the legislature and the judiciary, often undermine the KPK in a bid to preserve the status quo. Other political parties, meanwhile, can be insincere in their attempts to stamp out corruption, treating it as a point-scoring tool, rather than a challenge that needs to be addressed. Given that, the medium- to long-term prospects for corruption in Indonesia are unlikely to change. By 2020,

some inroads may have been made, but companies will still have to carefully weigh up the situation before investing in Indonesia and some may choose to boycott it altogether.

### ***Health and Education***

Indonesia also faces significant health and education challenges. In January this year, Jakarta began to roll out its much-anticipated universal healthcare programme. The initiative aims to have every Indonesian covered by health insurance by 2019, with nearly 20 trillion rupiah (\$1.8 billion) allocated to cover premiums for the poor in 2014 alone. Yet, while the rollout of the universal healthcare system, which began on 1 January, was met with public enthusiasm, it will not be easy to implement. Already concerns have been raised about funding and delays in payments. Thus, although it is undoubtedly a worthy initiative, making sure every Indonesian is covered by health insurance by 2019 will prove a difficult task for the new president.

There are also disparities between healthcare in urban and rural areas. While Indonesia has 25 health workers per 100,000 people, which meets the World Health Organization's minimum of 23, they tend to be concentrated in urban areas, leaving many parts of the archipelago without adequate healthcare. The Health Ministry, meanwhile, is aiming to have 40 doctors per 100,000 people in the future, up from 33 now. But unless doctors and healthcare workers in rural areas receive comparable wages to those in the cities, disparities in healthcare will continue.

Indonesia must also improve its education system, currently one of the worst in the world. A study undertaken by the Economist Intelligence Unit in late 2012 ranked Indonesia as one of the worst 50 countries assessed, along with Brazil and Mexico. Only one-third of Indonesian students, out of around 60 million in total, complete basic schooling. [Both presidential candidates said](#) that they would raise the minimum school leaving age from nine to 12. But other reforms and more funding will be needed, especially if the country is to harness the potential of its youthful population; one-third of which is under 14 years of age. As always, corruption remains a major impediment to better education outcomes, as do poor teaching standards.

### ***Environmental Challenges***

A booming population and rapid industrialisation will see Indonesia continue to face a number of environmental challenges. These include: deforestation and [forest burn-offs](#) (most of them illegal); over-fishing of marine resources; air pollution; traffic congestion; and [rubbish management](#) and waste water services.

Measures to address these issues have been undertaken, but many are deeply-rooted cultural practices. Slash-and-burn farming, for instance, has been a common practice since at least the 1980s. With many farmers unable to afford expensive earthmoving machines, millions of people will continue to set forests alight, despite it being illegal. Equally, waste dumping is another deeply entrenched practice which, as well as polluting the country's cities and villages, can block waterways and cause widespread flooding. Long-term solutions

to these challenges lie in changing perceptions and making people aware of the consequences. As such, these challenges will continue through to 2020 and beyond.

***Conclusion: Indonesia 2020***

Indonesia's next president – seemingly Joko Widodo – faces a number of challenges in his first five-year term. Chief among these is energy security, where cutting costly fuel subsidies is the key to addressing a range of other issues, such as infrastructure. This, in turn, will prove crucial to ensuring food and water security, attracting further foreign investment, and keeping the Indonesian economy, now the tenth-largest in the world, humming along. A booming population and rising middle class will boost South-East Asia's largest economy in the next few years, but demographic factors alone will not determine Indonesia's destiny. Now, more than ever, the country needs good governance and sound decision-making.

Addressing these challenges will not be easy, especially in a country of over 250 million people and a notoriously fractious parliament. But, if Indonesia's new president proves to be successful in tackling these issues, then the country, so often held out for its potential rather than its performance, could well live up to expectations.

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