Indonesian president abolishes fuel subsidy

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Indonesian President Joko Widodo's January 1 decision to abolish the country's fuel subsidy sent a clear signal to the money markets and international investors that his government, installed last October, is embarking on an extensive pro-market "reform" of South East Asia's largest economy.

The fuel subsidy announcement, made without fanfare, means that pump prices will be in line with the internationally determined cost of crude oil. A small subsidy of 1,000 rupiah (eight US cents) per litre will remain on diesel used by public transport operators and the country's largely impoverished fishermen.

In 2014, the fuel subsidy cost the government 250 trillion rupiah ($US19.6 billion) or 15 percent of the state budget. The subsidy kept fuel prices low in a country where around half its 250 million people live at or below the United Nations poverty line of just $2 per day.

Last November, Widodo reduced the subsidy by 31 percent for petrol and 36 percent for diesel, but his actions were met with historically muted protests. In 1998, when the military-backed dictatorship of President Suharto was forced by the International Monetary Fund during the Asian financial crisis to introduce pro-market measures, fuel subsidy cuts helped trigger the strikes and protests that played a part in the regime's collapse. Subsequent cuts by Widodo's predecessor, Susilo Bambang Yudhoyono, also produced widespread demonstrations.

Widodo was able to capitalise on his promotion during last year's presidential election campaign as a pro-poor and democratic reformer, untouched by the corruption of the detested oligarchies that make up the country's ruling circles. Above all, however, the global fall in fuel prices insulated the impact of the subsidy cut. Even without the subsidy, petrol this month was selling for 7,600 rupiah per litre, compared with the subsidised price of 8,500 in December.

The Indonesian and international financial press were quick to endorse the subsidy abolition, hailing it as a sign that the government is committed to meeting the demands of the financial markets for massive infrastructure spending and other pro-business "reforms." Widodo is seeking to further open up Indonesia's natural resources to exploitation by global corporations, as well as its potential low-cost labour force.

In his infrastructure program, Widodo has announced five deep sea and 24 smaller feeder ports, 10 airports, 25 dams, 2,000 kilometres of roads and 10 industrial parks. These are not attractive in themselves to international investors. Investment fund managers are demanding that the government play a major role in financing the projects. To do so, it must achieve a "better fiscal position," that is, impose austerity measures on the population and free up government revenue for other spending. The abolition of the fuel subsidy is regarded as a first step.

A *Jakarta Post* opinion piece on January 6, entitled "Ending rhetoric politics, gasoline subsidy abolished," praised Widodo. "In the midst of the global economic slowdown," it wrote, he "finally took real action, not rhetoric, to prevent the national economic situation getting worse."

The London-based *Economist* on January 10 called the measure "a good scrap" that would make the economy's "fiscal prospects brighten." A Reuters article on January 6 said it was a "landmark" that would be a "boost for Indonesia."

There are signs that the majority of the ruling elite will support Widodo's pro-market measures. On January 8 the two warring factions in Golkar, the party of the former Suharto regime and the major party in the parliamentary opposition, agreed not to disrupt or bring down the government for the next five years.

Widodo has set an economic growth target of 7 percent, but behind the optimistic forecasts there is an air of panic over the country's economic position. Growth is slowing, and the current account deficit widening, due to weak external demand, lower commodity prices and poor export performance. In November, exports fell by 14.57 percent, year-on-year, to $13.62 billion, producing a merchandise trade deficit of $425.7 million, despite a fall of 7.3 percent in imports. Manufacturing production contracted for the third month in a row in December.

In mid-December, the rupiah devalued 3.8 percent over three days, to 12,900 to the US dollar, the lowest level since August 1998, during the Asian financial crisis.

The Bank of Indonesia (BI) had encouraged an undervalued currency in order to boost exports and was keeping a reserve stock of dollars to cope with the financial pressures produced by expected US interest rates hikes in 2015. But as global fund managers dealt with growing risk by moving money out of "emerging economies" such as Indonesia, the BI intervened to defend the rupiah in the foreign exchange markets. From December 1 to December 11, there was a capital outflow of $869.22 million.

The BI intervention brought the rupiah back to 12,500 to the dollar by December 19, but that depleted its reserves. Even before the recent events, and despite previously good capital inflows, Indonesia's foreign reserves ratios were the lowest in the region. Indonesia has sufficient funds to cover just 6.4 months of imports and debt repayments, compared with eight months for Malaysia and India and 11 months for the Philippines.

Last October, the BI began to move on the "worrying" high levels of foreign private sector debt, fearing the combination of low reserves and high debt was beginning to resemble the 1998 situation that led to default. Foreign private sector debt had reached $161.3 billion, representing 54.8 percent of total external debt.

The BI introduced regulations requiring companies to have a hedge of 20 percent of short-term dollar debts and 25 percent by 2016, and a liquidity ratio of 50 percent if they want to borrow dollars. On January 8, the BI issued further regulations stipulating stricter reporting requirements on borrowing. All companies must now provide reports when their net gap between dollar liabilities and assets exceeds $100,000.

Widodo's administration may have been able to avoid a political storm over abolishing the fuel subsidies, but external shocks and economic upheavals could well spark the underlying social tensions that wrack the country.