

ECONOMIC FREEDOM IN INDONESIA 2018

Review of Recent Development

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Executive Summary

At the end of 2018, The Indonesia Institute (TII), Center for Public Policy Research, has conducted a comprehensive study of Indonesia's economic freedom in 2018. This study assesses Indonesia's economic freedom by using the indexes issued by the Fraser Institute. Moreover, TII also touched on the issue of financial inclusion in Indonesia, especially accessibility for people with disabilities in financial institutions.

Economic freedom in Indonesia is increasingly showing positive progress in 2018. Referring to the Fraser Institute report, in Economic Freedom of the World (EFW) Index Indonesia is able to rise to 65th out of 162 countries or up 8 ranks compared to 2017. The similar evidence is also reflected in the Heritage Foundation report in 2018, where Indonesia's economic freedom index reaches 64.2 percent that is moderately free.

The result of the TII study reveals that there are several indicators of economic freedom which have shown progress. *First*, In general, the household consumption sector shows a considerable dominance compared to government spending throughout 2014 to enter the second quarter of 2018. Average household consumption accounts for around 60 percent of economic activity.

However, if observed, there is a positive correlation between fluctuations that occur in the growth rate of government spending and household consumption, where when there is an increase in government spending there is also an increase in the increase in household consumption. This indicates that it is very possible that economic activity in Indonesia is still very dependent on government spending.

Second, the presence of several regulations that show the government's commitment to respect and protect individual ownership rights. However, in terms of effectiveness implementation is still quite low. *Third*, the government is quite successful in preserving the rate of inflation this year that it is at a safe level or below 3.5 percent. Such this effort is very positive a certainty of doing business for business actors.

Fourth, the international trade sector becomes one of the sectors that have undergone major regulatory reforms to maintain the competitiveness of the domestic market. In 2018, the government has provided several tax incentives to exporters in the form of the discount rate on foreign exchange savings from exporting proceeds. In addition, the government tries to sustain the heavy import flows by raising taxes on 1147 types of goods. This incentive is quite suitable to enhance the current trade deficit gap.

Furthermore, there are some important notes in order to espouse individual freedom in doing economic activities. The current labor market in Indonesia still tends to be stiff due

to the ecosystem of the labor market has not shown progress in the fairness of wages, particularly between male and female workers. From 2015 to 2017, the average wage of male labor had experienced a significant growth by 7.2 percent, while women's incomes grew on average 6.4 percent per year. In other words, currently productive economic sectors in terms of mining, electricity, gas, water, and financial service are still dominated by male labor. This situation could also be a root cause of a considerable gap between the income of men and women.

Then financial inclusion programs in Indonesia have not demonstrated a serious commitment to providing space for people with disabilities. Unfortunately, the high number of discrimination cases still exist as well as many various infrastructures of financial services that are not yet accessible for people with disabilities become one of discrimination's form, which must be immediately eliminated.

The results of the study in Indonesia's economic freedom in 2018 are highly expected to have benefits as a consideration for policymakers to form relevant public policies. This is the paramount aspect of giving space for individual participation in the development process, including in the economic sector. This study also underlines the importance of economic freedom through equal opportunity and law enforcement to ensure that it will broaden the access for each individual to improve welfare.

Background

Throughout 2018, the stability of the Indonesian economy is faced with various challenges. The economic indicators are affected by global turmoil, starting from the problem of Rupiah depreciation, the current account deficit, and commodity price fluctuations. Along with the pressure that occurred on the national economy and the global economic slowdown, the government has decreased the economic growth forecast for 2018 in the range of 5.14 percent to 5.21 percent, or below the target of the 2018 National Budget of 5.4 percent (kontan.co.id, 13/9).

In the midst of the dynamics, encouraging economic freedom is often referred to as the right strategy in driving economic activity. The Bujancă & Ulman Study (2015) found that countries with institutions and regulations that consistently pushed the level of economic freedom would have a significant impact on creating more competitive economic activities. Then, the results of Fieldmann's study, H (2010) also found that economic freedom would reduce unemployment, especially against young unemployment. The analysis is based on the high level of Gross Domestic Product (GDP) which will correlate with the decline in unemployment.

Gwartney, J. et al (2018) explains economic freedom is defined as a concept of self-ownership, in which individuals have the full right to choose how to use their time and talent to improve their lives. On the other hand, every individual does not have the right to time, talent, and resources owned by other people. Thus, they do not have the right to take something from other people or demand other people to give something to them.

Based on the result of previous studies that show the role of economic freedom is so important in supporting the economic progress of a country. So far, there have been several international research institutions regularly publishing economic freedom indexes such as the Heritage Foundation with the *Economic Freedom Index* (EFI) and the Fraser Institute with the *Economic Freedom of the World* (EFW) index. In addition, the World Bank also has indicators to measure the *Ease of Doing Business* (EoDB) Index.

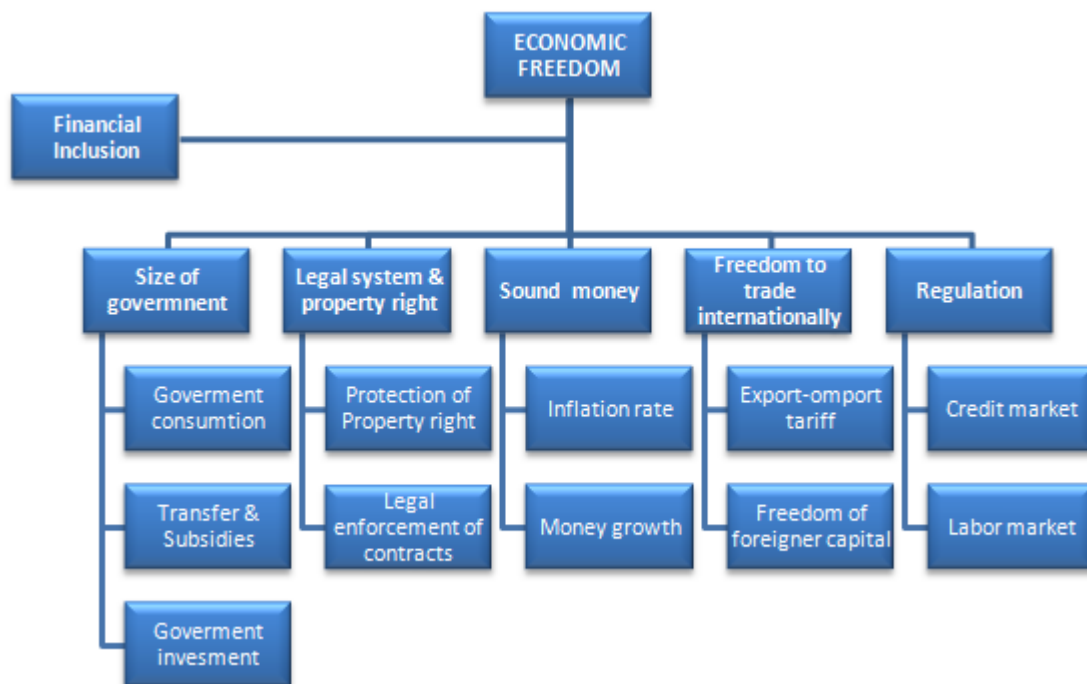
In general, Indonesia continues to experience a progress in the index of economic freedom. According to the Heritage Foundation publication and the Fraser Institute, Indonesia has the index of economic freedom that is moderately free. This predicate explains that in the measure of Indonesia's economic freedom, there is a score of 60-69 percent of all available indicators.

In 2018, the Fraser Institute publication report shows Indonesia is ranked 65th out of 162 countries. This achievement is up to 8 ranks compared to 2017, while based on the Heritage Foundation report, Indonesia in 2018 is in 69th position from 180 countries. This

achievement also increases compared to 2017, where Indonesia at the year was ranked 84th out of 180 countries.

Reflecting on those circumstances, this paper examines more about the development of economic freedom in Indonesia, especially in 2018. This study refers to a number of indicators in the index of economic freedom that have been made by the Fraser Institute (see Figure 2.1). In addition, to sharpen the analysis of the existing economic freedom index, this paper also includes indicators and portraits of financial inclusion in Indonesia. The following indicators used in this study of Indonesia's economic freedom in 2018 are as follows.

Figure 2.1. Economic Freedom Index indicator



Source: www.fraserinstitute.org

This paper will use six indicators to measure economic freedom in Indonesia. Five main indicators refer to the concept Gwartney, J. et al (2018) which is also used in the measurement of economic freedom index of the Fraser Institute. *First*, the indicators of government capacity are used to know about how dominant the government interferes in the development process. According to Gwartney, J. et al (2018), when the contribution of government consumption to GDP is too high, it indicates the dominance of political choice that is greater than the individual's choice. Likewise, it is related to tax matters. The higher the tax charged; it will reduce the potential income of individuals.

Second, the indicator of law enforcement is aimed to measure how the role of law provides protection against individual ownership rights. *Third*, access to money, there are at least two important points discussed in this indicator namely: the growth of the money supply and the inflation rate. The relatively stable and low inflation rate will make it easier for individuals to determine business plans. Thus, this condition provides convenience for individual doing economic activities.

Fourth, international trade in which this indicator provides an overview of international trade activities can run well when there are incentives and various distinct regulations that provide a convenience for individuals. *Fifth*, various regulations provide a convenience for individuals doing business such as access to the market credit, the labor market, and business regulation. In other words, this regulation can be a barrier to individual activities on the market, as like to exchange goods or services voluntarily

As stated earlier, this study adds indicators of financial inclusion as one indicator of economic freedom in Indonesia. Financial inclusion is a very indispensable aspect to find out how much policy in the financial industry can accommodate all levels of society, including people with disabilities. Related to this, the indicator will concentrate on how regulations related to financial inclusion and accessibility of financial services, particularly the banking and the ability of human resources (HR) in serving people with disabilities.

The study of Indonesia's economic freedom in 2018 uses a simple analysis in the form of descriptive statistics, correlation tests, and ratio analysis. This study using secondary data that is obtained through the study of documents, such as annual reports, online media, journals, and other related material. The results of this study can be used to find out how far the position of Indonesia's economic freedom in 2018, based on the indicators analyzed. In addition, the results of this study can be used as consideration for policymakers to form appropriate public policies increasing individual or society participation in the development process.

This study begins with an overview of government intervention in economic activities and is followed by other economic freedom indicators to be analyzed in the next section. Government intervention is an important indicator to assess the index of economic freedom in a country. The greater the role of government in the economy, the more it will limit individual choices.

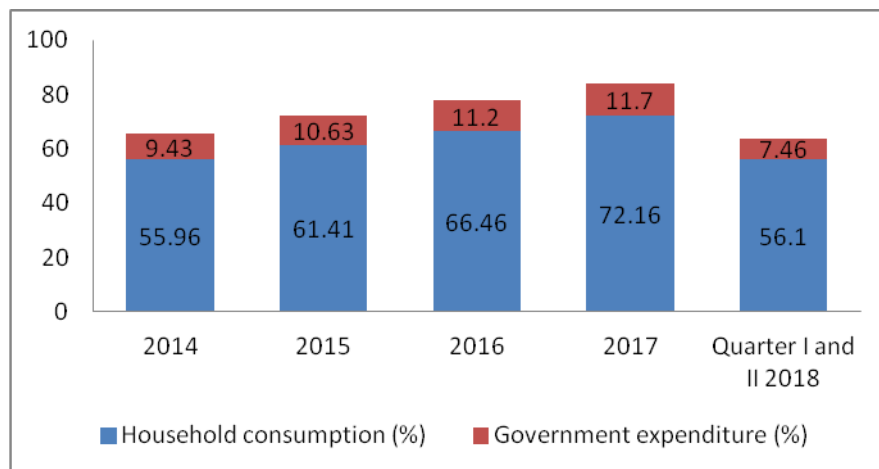
A. Government Capacity

As explained above, the capacity of the government provides an understanding of how much government interferes in economic activity. In this case, government capacity will

be analyzed in terms of government consumption, transfer expenditure, and government investment. To obtain this description, the following is an analysis of the government's capacity.

1. Consumption Level of Gross Domestic Product (GDP)

Figure 2.2. Level of Government Consumption on GDP in 2014-2018



Source: Central Bureau of Statistics (BPS), 2014-2018

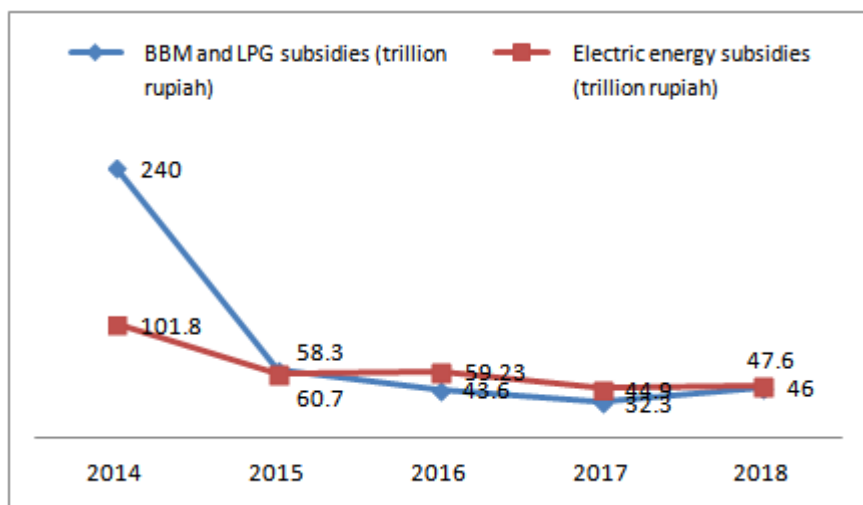
In general, the household consumption sector shows dominance compared to government spending throughout 2014 to enter quarter II-2018. Average household consumption accounts for around 60 percent of economic activity. However, if observed, there is a positive relationship between the fluctuations that occur in the growth rate of government spending and household consumption, where when there is an increase in government spending there is also an increase in the increase in household consumption. This indicates that it is very possible that economic activity in Indonesia still depends heavily on government spending.

Then, when entering in Quarter II-2018, the role of government expenditure is quite dominant compared to household consumption. Based on BPS data (2018), there was an increase in the contribution of government expenditure in the second quarter of 8.61 percent of total GDP, an increase of 32 percent compared to the same quarter in 2017. Then simultaneously the role of household consumption in GDP actually slowed down. The increasing capacity of the government's role this year is very possible because of the external turmoil that suppresses the domestic economy, so that the government carries out preventive measures in maintaining the stability of the national economy.

2. Transfer and Subsidy Funds

Subsidies are one of the government policy's mechanism in maintaining price stability. However, giving too high subsidies will limit the choice of individual or community. The following is the subsidy allocations during 2015-2018.

Figure 2.3. Development of Government Subsidies' Allocation in the Energy Sector 2014-2018



Source: Kemenkeu.go.id

The allocation of subsidies in the energy sector, namely fuel oil, liquefied petroleum gas (LPG) and electricity in the development during the administration of Joko Widodo and Jusuf Kalla in 2015 dropped significantly. There is a reduction in fuel oil and LPG subsidies that reached Rp 179.6 trillion and became Rp 60.7 trillion. The same condition also occurred in electricity subsidies that reached Rp 43.5 trillion in 2015.

It's just that in 2018, subsidies in both sectors actually show an increase simultaneously. Fuel oil subsidies rose by Rp 13.7 trillion and electricity subsidies rose by Rp 2.7 trillion compared to 2017. Although the number of subsidies in 2018 is not as large as during 2014-2016, subsidies have the potential to put a heavy burden on the fiscal. This condition is inseparable from the global turmoil that hoisted world oil prices increased to reach USD 80.39 per barrel (detik.com, 12/10). The result of the study by Budiantoro and Saputra (2014) from *The Prakarsa*, argued that subsidies in the energy sector have the potential to increase debt interest. In addition, energy subsidies that should be directed to provide access for the poor people are in fact still largely, enjoyed by middle-and-upper-income people.

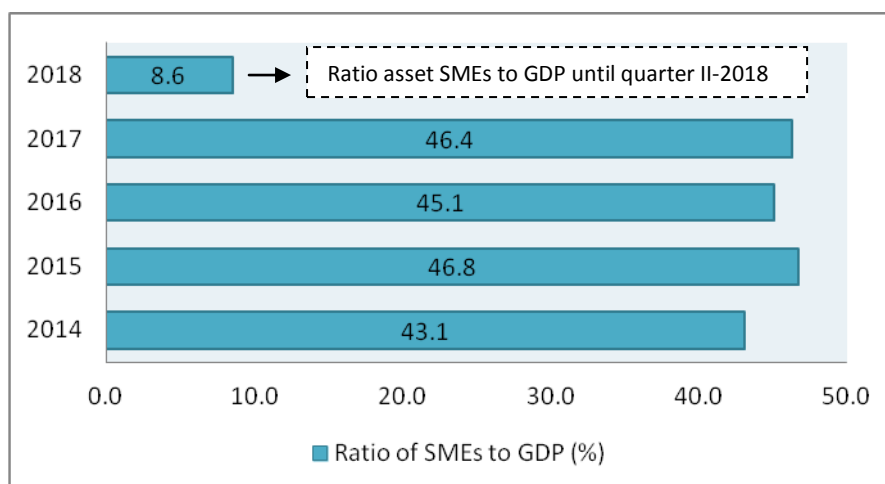
In the context of economic freedom, the decline in subsidies, which is specifically directed at the consumer sector, does need to be suppressed. Moreover, in fact, the current energy subsidies are still not on the target. One of the government's efforts to reduce the amount of subsidies through innovation in the energy sector in 2018 is fairly positive. If referring to the Presidential Regulation (*Peraturan Presiden - Perpres*) No. 66 of 2018 concerning the Second Amendment to Perpres No. 61 of 2015 on Collection and Use of Palm Oil Plantation Funds, the expansion of B-20 biodiesel use is applied to all sectors of Public Service Obligation (PSO) and non-PSO. Through this policy, it is expected that fuel prices in the market will be more stable given that raw resources utilize the wealth of local resources.

3. Government Investment

One of the investment capacities from the investment side is the comparison of the ratio gain of State-Owned Enterprises (BUMN) assets to GDP. In accordance with the principle of economic freedom, the more increasing assets of BUMN to GDP have implications for the smaller space for the private sector to engage in economic activities and vice versa.

Figure 2.4 below highlights that the comparison of BUMN's assets to GDP gains at current prices tends to fluctuate throughout 2014-2017. Then in 2018, the ratio of BUMN assets to GDP is 8.6 percent. This value is still low if compared to the previous year considering that the value has not been accumulated until the end of 2018.

Figure 2.4. Comparison of BUMN Assets to GDP in 2014-2018



Source: Ministry of BUMN and BPS, 2017-2014

However, the authorization of government assets in BUMN still has not shown a consistent decline. It means that the government has not yet fully committed to providing space for private investors to participate in every government investment project.

For an example, in working the 65 dam project throughout 2015-2019, all developers come from BUMN. Meanwhile, the construction project of Adi Sucipto Airport in Yogyakarta that involves 10 developers in the auction process, and all of them are from BUMN (okezone.com, 29/3).

The dominance of BUMN in every government project causes the role of the private sector that is still narrow. However, the private sector should be involved in several government investment projects because they have a high orientation to compete continuously through the best performance that will clearly provide benefits to the government. Thus, when the government could open a wide opportunity for private parties in the development, it will generate the benefits that may potentially be enjoyed by various parties.

In the following discussion, this study will focus on law enforcement on private ownership rights.

B. Law Enforcement in Intellectual Property Rights

Providing protection on ownership rights for individuals is greatly needed to give them a sense of security as well as incentives in doing business. So far, the government has demonstrated its commitment to respecting intellectual property owned by individuals. It is proved that the government's commitment issued in Law No. 28 of 2014 regarding Copyrights. This regulation is as a substitute for Law No. 19 of 2002 about Copyrights.

The presence of this latest regulation has made changes to Copyright regulations. Referring to the Kurnianingrum study (2014), the existence of new regulations related to copyright has given a positive signal in providing protection and development of the creative economy. He adds that the renewal of regulations related to copyright contained in Law No. 28 of 2014, including: the extended period of copyright protection; traditional cultural arrangements; collective management institutions.

Then, Donandi, S (2016) mentioned important changes to the Copyright regulation, including: the protection of economic rights that increasingly favor the copyright holders; more effective dispute resolution; the existence of collective management institutions; and copyright can be a fiducial's guarantee.

Various changes governing the ease of filing Copyright have an impact on increasing the number of registrants. According to the data from the Directorate General of Intellectual Property, the number of copyright registered in 2017 reached 6548 copyrights, up 11 percent compared to 2016.

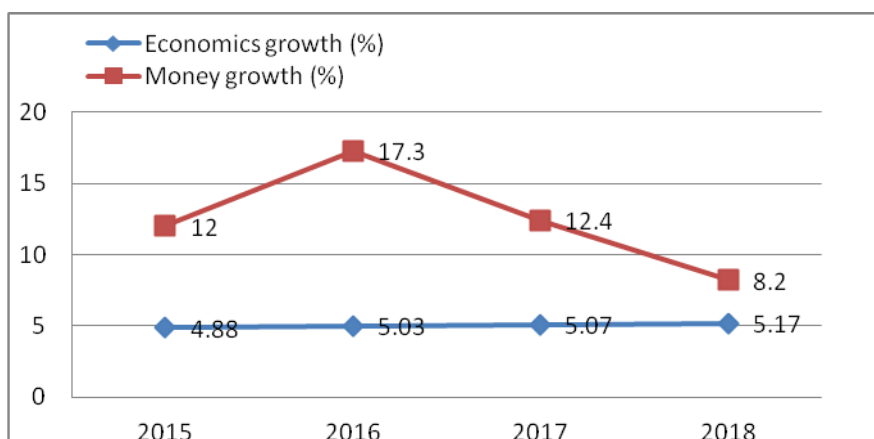
Meanwhile, the same thing also happened an increase in the number of patents in Indonesia. however, the problem is that the local community is still low on patent registration. Referring to data from the Directorate General of Intellectual Property of Kemenkuham, data on patent owners for the local community is only around 11 percent and the remaining 89 percent are foreigners who have registered their patent rights.

This condition implies that besides the lack of public awareness regarding the importance of the position of patents and copyright, on the other hand there is still a low process of education and socialization by the government to also become one of the issues. The community really needs to understand the importance of using intellectual property rights because this aspect is very capable of providing economic added value.

C. Access to Money

In 2016 the money supply in the community (M1) such as currency and demand deposits had experienced significant growth with a percentage of 17.3 percent, in comparison of the previous year. However, when entering 2017 until June 2018 the money supply in the community is only able to grow slowly. More can be seen in Figure 2.5 below.

Figure 2.5. The Growth of Money Supply and Economic Growth



Source: Bank Indonesia, 2015-2018

The current conditions are indeed inseparable from the global turmoil, occurring throughout 2018. The household consumption sector is the biggest contributor to GDP

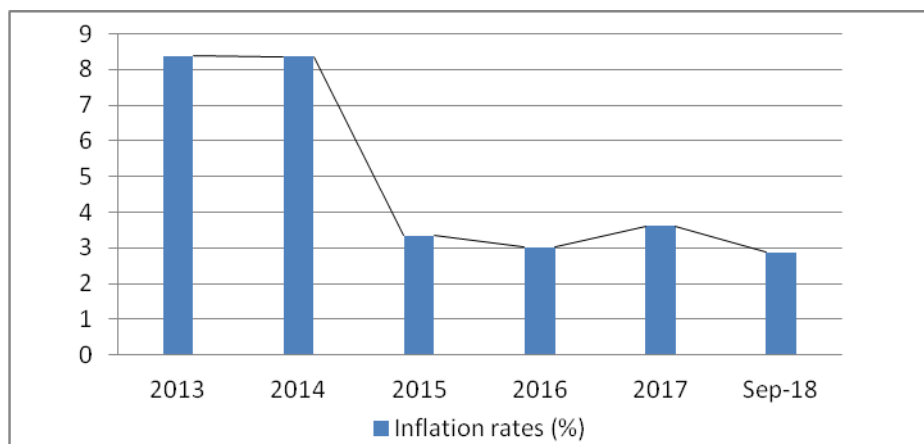
expected to grow continuously despite it is actually slowing down in the global uncertainty. Referring to BPS data, a significant decrease in the money supply was followed by a weakening of household consumption where in quarter II-2017 consumption growth was only 4.95 percent or smaller than the growth in the same period in 2016, which was 5.07 percent.

In Q2-2018, household consumption increased slowly by 5.14 percent. This condition is inseparable from the existence of major events such as the 2018 Simultaneous Local Election and 2018 Asian Games that encourage the increase of public consumption.

If analyzed further, the concept, that explains the growth of the money supply, has a positive correlation with the rate of economic growth, precisely in this case inversely proportional. It is simultaneously if examined in Figure 4, in which economic growth tends to grow thin amid a slowdown in the money supply. This condition highlights that the phenomenon of the increase and decrease in the money supply has no effect on economic growth.

Meanwhile, the rate of inflation from 2015 to September 2018 showed a positive record. In accordance with Bank Indonesia data, the average inflation rate throughout 2015 to September 2018 was able to be maintained at 3.2 percent or still within the safe limit of 3.4 percent. Even the position of the inflation rate in September 2018 was still in the range of 2.9 percent. More can be seen in Figure 2.6 below.

Figure 2.6. Inflation Rate in 2013- September 2018



Source: Bank Indonesia, 2013-2018

The rate of inflation is stable in 2018 even though in the midst of global turmoil a positive record for the government. It reflects that in general, the government is able to control the stability of commodity prices on basic necessities to maintain people's purchasing power.

In addition, this stable inflation rate also has a positive impact on economic freedom. The inflation rate that is at a safe level will increase the confidence of the business actors to try more.

D. International Trade

Gwartney and Lawson (2007) explain that in the modern world, the freedom to exchange goods and services across national borders is a key element of economic freedom. Voluntary exchanges between trading partners giving each other benefits will contribute to a more modern standard of living. In measuring trade freedom, there are at least two main indicators, namely the export-import tariff and foreign capital flows.

1. Export-import tariffs

There are some changes to the import tax rate in 2018. Referring to the Minister of Finance Regulation (Peraturan Menteri Keuangan - PMK) 110/2018, it is a change to PMK 34/ PMK.010 / 2017 on Collection of Income Tax (Pajak Penghasilan - PPh) Article 22 in connection with payment of goods and other activities in the field import or business activities in other fields, there are at least 1147 goods that are increased by import tariffs.

Quoted from the statement of Sri Mulyani as the Minister of Finance, the background of the regulation's issuance is as part of the operation to save the rupiah exchange value so that the current account deficit which has weighed on the exchange rate can be controlled (cnbcindonesia.com, 10/09). The following is the rules for changes to the import tariff policy.

Table 2.1. Deregulation on the import of Commodities Goods

Goods Commodity	Type of Change
210 items of goods	22 Income Tax rates increased from 7.5% to 10%
218 items of goods	22 PPh rates increased from 2.5% to 10%
719 items of goods	22 PPh rates increased from 2.5% to 10%

Sources: Minister of Finance Regulation [\(PMK\) 110/2018](#)

Meanwhile, in terms of exports, policies that provide convenience for exporters have been stated in PMK No. 10/2016 concerning Executor in Law No. 123 of 2015 regarding Income Tax on Interest for Deposit Interest and Savings as well SBI Discounts. Broadly speaking, this regulation provides tax incentives for Export

Foreign Exchange (Devisa Hasil Ekspor - DHE) deposited domestically in the form of US dollars and rupiah. More can be seen in Table 2.2. below.

Table 2.2. The Policy of DHE Deposit Tax Rate

Duration of DHE Deposits	Withholding Tax Rates
DHE deposit in US Dollar for one month	Tax deduction from 20% to 10%
DHE deposit in US dollars for three months	Tax deduction from 7.5%
DHE deposit in US Dollars for six months	2.5% tax reduction
DHE deposit in US Dollars for one year or more	Tax free or 0%
DHE deposit in rupiah for one month	Tax deduction of 7.5%
DHE Deposits in rupiah for three months	Tax deduction of 5%
DHE deposits in rupiahs for six months or more	Tax free or 0%

Source: PMK No. 10/2016

However, despite the government's efforts to improve export performance through incentives to reduce DHE deposit taxes since 2016, this policy is still very minimal. The Chairman of the Indonesian Textile Association (Asosiasi Pertekstilan Indonesia - API) Ade Sudrajat revealed that this policy still lacks socialization in the community. The PMK had also not substantially touched the basic rights of exporters' needs, namely DHE that was intended to pay for raw materials, purchase machinery, and equipment (kontan.co.id, 13/8).

Government policy in raising tariffs on imported goods is indeed contrary to the concept of economic freedom, because the higher the tax is imposed on importers. It will reduce the chance of profit for them. However, if this regulation is carried out as an instrument in responding to the issue of economic turmoil throughout 2018 that is indeed considered quite appropriate. Amid the depreciating Rupiah against the dollar, instruments are needed to maintain monetary stability. One of them is to improve the deficit gap by encouraging export's sector.

It's just that government incentives to improve export performance through reducing DHE deposit taxes still need to be further socialized to exporters and stakeholders. This is important because currently exporters still get a few of information regarding these incentives.

2. Foreign Capital Flows

The presence of foreign investors in domestic investment is actually not new. Since 1967, the government had issued Law No.1 of 1967 on Foreign Investment.

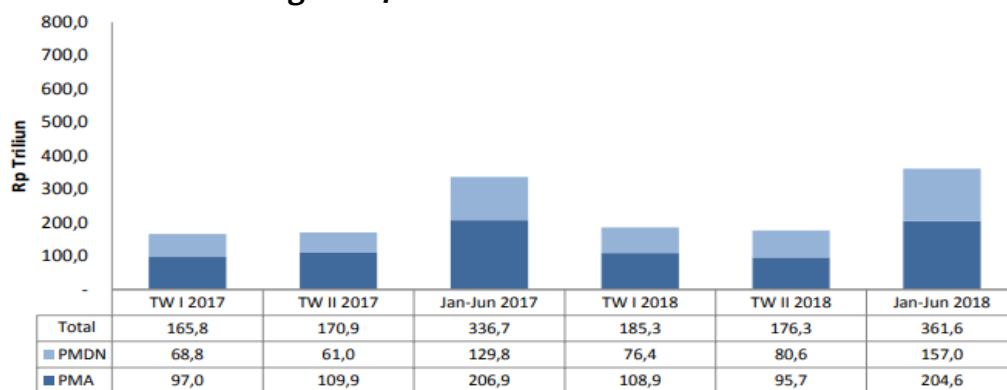
With this Law, the government's commitment involves the role of foreign private sector in the national development process.

Regulations in the investment sector also change in current economic development. In 2018, the government issued Perpres No. 24 of 2018 concerning Business Licensing Services Integrated Electronically. One of the objectives for these regulations is to accelerate and increase investment and business.

In the regulation, the most striking is the formation of one-door services, namely Online Single Submission (OSS). In the regulation, all licenses in the regions and centers are integrated into the system. In managing a Trading Business License (SIUP) and Company Registration Certificate (TDP) through OSS it can be completed within 2 days.

Then the ease of investment is also explained in Article 35, that in special economic zones and free trade areas, micro and small businesses are not required to have Environmental Management Efforts and Environmental Monitoring Efforts (UKL-UPL). The following is a report on the realization of investment in Domestic Investment (PMDN) and Foreign Investment (PMA).

Figure 2.7. Level of Investment in Indonesia



Source: BKPM, 2018

Throughout Q1 and Q2 of 2018, investment performance only grew slightly around 7.39 percent compared to the same period in 2017, or reached Rp 361.6 trillion. Based on proportion, foreign investors contributed 56 percent of the total investment overall and the remainder was contributed by domestic investors.

However, based on trends the growth of foreign investment or PMA had decreased actually in the Q2-2018 in which the value of PMA had declined about 12.9 percent (yoy). These conditions occur due to the domestic economy which is still under pressure from global conditions, resulting in the outflow of capital

investment. The research results of the CNBC Indonesia Team said that the net sell-off of foreign investors touched Rp 53.03 trillion as of September 2018 or the highest since 2004 (cnbcindonesia.com, 8/9).

Based on the explanation above, it can be explained that in terms of regulation, the government has shown a commitment to incline national investment by involving various actors on both national and foreign private. It is expected that the relatively larger contribution of foreign investors can also be a driving force for business sectors and industries that have not been fully implemented by the national private sector. Beside to this, foreign capital is expected to directly or indirectly be able to further stimulate the climate of domestic business.

The next discussion will evaluate the regulations, including credit market, labor market, and regulation on business activities. Regulation becomes an important thing to be analyzed because it involves policies carried out by the government in giving space to individuals for doing every economic activity.

E. Credit Market and Labor Market Regulations

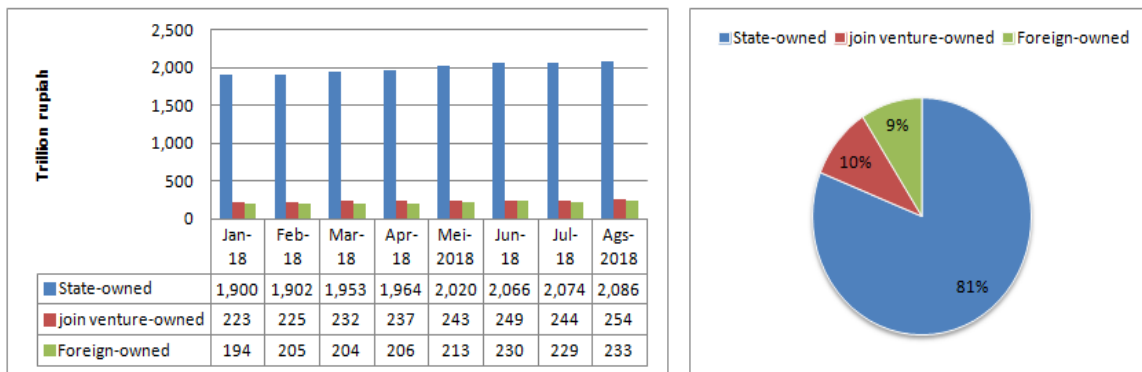
1. Credit Market

Banking has an important role as an intermediary institution. This intermediation role shows that banks are intermediary institutions in collecting Third Party Funds (DPK), then distributing funds to people in need. In the process, credit distribution becomes one of the banking products.

In August 2018, the number of credit distributions to DPK reached Rp 2,573 trillion. Of this amount, 81 percent are loans channeled by state banks (BNI, BRI, Bank Mandiri and BTN), while as many as 10 percent and 9 percent, each of that is a credit allocation from Mixed Banks and Foreign Banks. Mixed Bank is a Bank whose share owned by national private and foreign parties whereas Foreign Banks are a Bank whose share purely controlled by foreign parties.

The dominance of credit absorption by red plate banks (State Bank) is one of them because the state banks have very high assets. If referring to the data of the Financial Services Authority (OJK) as of August 2018, 78 percent of state banks have accumulated assets of Rp 3.068 trillion or 78 percent of total assets, whilst the rests are assets owned by mixed banks and foreign banks. The following figure 2.8 shows the level of credit and assets of banks in Indonesia.

Figure 2.8. Statistics for Level of Credit and Banking Asset in Indonesia



Source: OJK, 2018

Throughout 2018, credit growth carried out by banks can be said to experience sluggishness. In fact, in July 2018 only state banks grew thin at 0.38 percent, while mixed banks and foreign banks experienced minus growth with values of 2.11 percent and 0.5 percent respectively. In a survey conducted by Bank Indonesia (2018), the slowdown in credit occurred due to a decrease in credit in all fields (investment credit, working capital and consumption) (kompas.com, 16/10).

Banking performance is indeed faced with an uneasy situation in the midst of global turmoil throughout 2018. The level of credit that is expected to grow steadily for encouraging economic activity is actually low absorption. However, actually credit must continue to increase its absorption, not only by state-owned banks, but also by foreign banks and mixed banks. Thus, the community has many choices to enjoy credit facilities for inducing their activities.

2. Labor Market

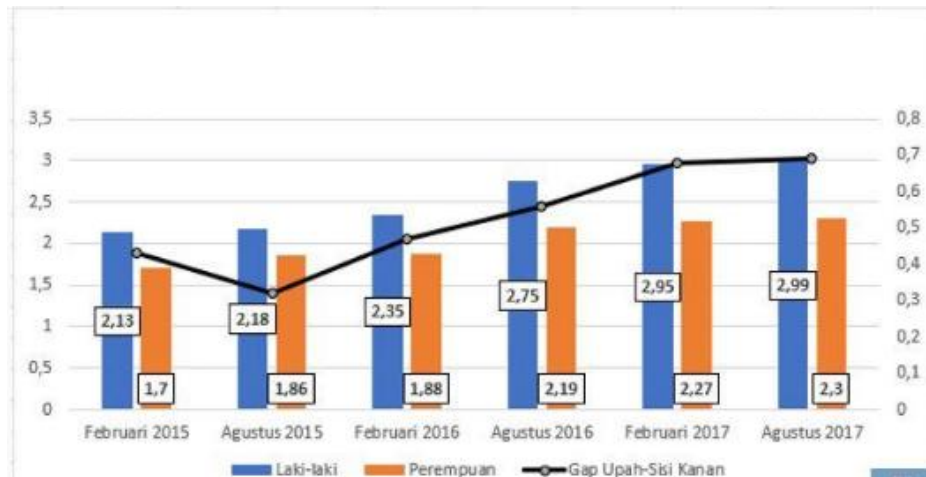
Based on the results of the World Economic Forum survey, Indonesia in the 2017-2018 period experienced a rise in global competitiveness, achieving the position 36 out of 137 countries. Conversely, previous Indonesia's competitiveness towards the global was only ranked 41st among 138 countries.

Referring to the results of the survey, the increase in Indonesia's competitiveness is inseparable from the wider market reach that is not only oriented domestically, but has reached the global market. However, efficiency in the labor market still scores quite lower in 96th ranks out of 137 countries. The survey also revealed the issue of wage justice and the lack of representation of women in the workforce, which is a problem in the labor market in Indonesia.

The results of CNBC Indonesia's research found that the income gap between men and women increasingly widened by a difference of Rp 690 thousand/ month

in August 2018. Even if looking at it in August 2015, there is a slight gap between Rp 370 thousand/ month. Then the income gap continues to widen consistently two years later (cnbcindonesia.com, 9/3). More is shown in Figure 2.9 below.

**Figure 2.9. Comparison of Male and Female Labor
(in millions of rupiah)**



Source: cnbcindonesia.com

It seems that there is indeed a difference in the income gap between female and male workers. If we calculated the income of male labor, every year grows by an average of 7.2 percent, while the income of female labor on average grows 6.4 percent each year. Furthermore, the current income gap is most likely to occur because the portion of female workers who work in the productive sector is still very small compared to men.

Based on the BPS data in August 2017, from nine economic sectors, there were three-economic sectors having the highest income, consisting of mining sector, electricity, gas and water sector, and financial service sector. However, the number of women working in these 3 sectors was only 2.7 percent of the total. Thus, this is one of the strong factors in the occurrence of income gaps between women and men, especially in the formal economic sector which has a good data record.

Based on this phenomenon, there is still stiffness in the labor market in Indonesia. The income gap between male and female labor can clearly reduce women's competitiveness in the labor market. Regulations in the labor market that are friendly to women are needed. In addition, increasing the Human Development Index (HDI) for women is also very much needed. Referring to the 2017 BPS data, women's HDI levels are still lagging behind those of men, where the male HDI

level reaches 74.85 or the high category and women at 68.08 or the moderate category.

In the next section, this paper will highlight the level of financial inclusion in Indonesia, which we add as an important indicator in analyzing economic freedom. This subject also complements TII's annual study of economic freedom in Indonesia.

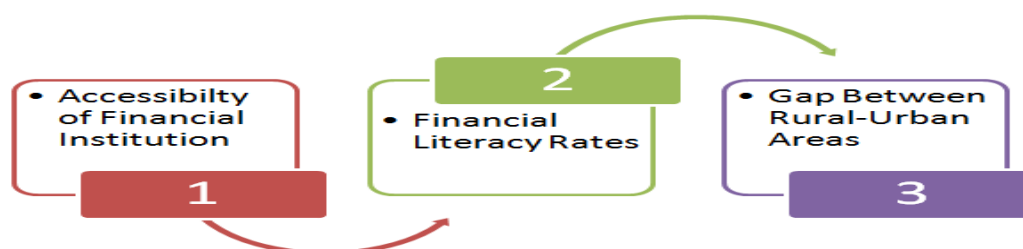
Financial Inclusion

As regulated in the *Perpres* No. 82 of 2016 on the National Strategy for Financial Inclusion (SNKI), the financial inclusion is very important to be carried out to expand the access at all levels of society to financial institution services. From this regulation, it can be explained that obtaining fair and equitable financial services is the right of every individual.

In accordance with SNKI documents, the target of Indonesia's financial inclusion rate in 2019 is 75 percent. However, if looking at to the *Global Findex* survey conducted by the World Bank, so far the level of financial inclusion in Indonesia has only reached 48.9 percent. This figure can explain that only around 95.4 million adults (> 15 years) already have accounts in formal financial institutions (Commercial Banks, rural banks (Bank Perkreditan Rakyat - BPR), Koperasi, Microfinance Institutions).

Furthermore, when there are currently 148 million adults, it requires an additional minimum of 52.6 million adults' residents to use financial services for achieving financial inclusion targets in 2019. In order to meet the financial inclusion targets in 2019, there are several aspects that need to be noted. Referring to the results of the *Global Findex* survey, TII provides several important notes to achieve inclusive financial services, including through the following steps: improving the accessibility of financial institutions; strengthening financial literacy; reducing the gap between rural-urban areas, and providing convenience in terms of financial services. The following is some important things in order to realize inclusive financial services that TII underlined in this report.

Figure 2.10. Important Points on the Issue of Financial Inclusion in Indonesia



1. Access for Financial Institutions

Accessibility to financial institutions is a fundamental problem faced by society in general. Referring to the *Global Findex* survey, as many as 33 percent of the population in developing countries, including Indonesia, have not used formal financial services because of problems in the distance. This condition is a factor for people who are reluctant to use formal financial services.

The Indonesian government has actually issued the program of a *branchless banking* to minimize the problem of public inaccessibility to financial institutions. In 2015, the Financial Services Authority (OJK) had initiated the "Laku Pandai" program. The concept of the program allows the banks to have the right hand or agents in each region that have not been accessed by financial institutions.

The presence of the Laku Pandai's Program is relatively positive, but TII analyzes that the program is not friendly to disabled people. Persons with disabilities are not only faced with the problem of distance, but the extent to which the agents and outlets of Laku Pandai are friendly to people with disabilities.

Based on the 2014 the survey of Study Center and Disability Service (PSLD) at Brawijaya University, the inefficiency of infrastructure and the still difficult requirements are factors that make people with disabilities reluctant to use banking services.

In addition, if we look at the Laku Pandai document, there are no conditions specifically related to agent skills when dealing with potential customers with limitations. Besides this, there are no criteria for Laku Pandai's agent outlets that are accessible for people with disabilities. This shows that there is no financial inclusion in providing financial services to all levels of society.

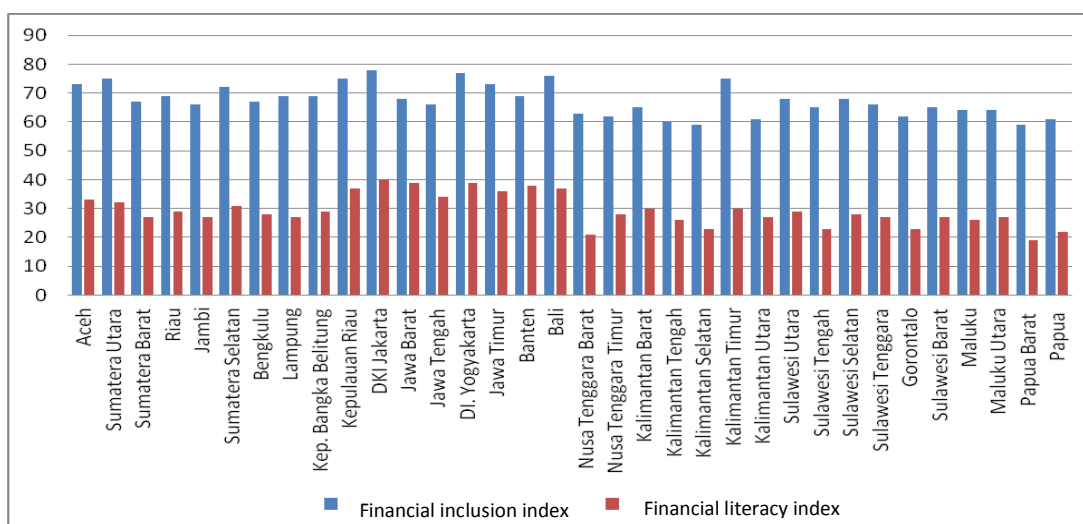
One of the rights to justice and legal protection for persons with disabilities includes access to financial services even if it refers to Law No. 8 of 2016 concerning People with Disabilities. Therefore, the government and related parties need to realize equitable and inclusive financial services for all people, including those with disabilities.

2. Low financial literacy

The level of financial literacy in the Indonesian population is still relatively low. As the results of the 2016 Bank Indonesia publication report, the level of public financial literacy in Indonesia was 29.66 percent. This figure depicts there are only around 77 million Indonesian people who have well literate financial assets from

the total population which reaches 260 million. Read more Figure 2.11 shows the level of financial literacy and financial inclusion of each province in Indonesia.

Figure 2.11. The Level of Financial Inclusion and Financial Literacy Per Province in 2016



Source: Bank Indonesia, 2018

The level of financial literacy is an important part of supporting financial inclusion. The results of the correlation test conducted by TII show there is a positive and significant relationship between the level of financial literacy in a province with a level of financial inclusion, with a correlation value reaching 80 percent. This condition implies that an increase in the level of financial literacy will have an effect of approximately 80 on the financial inclusion index.

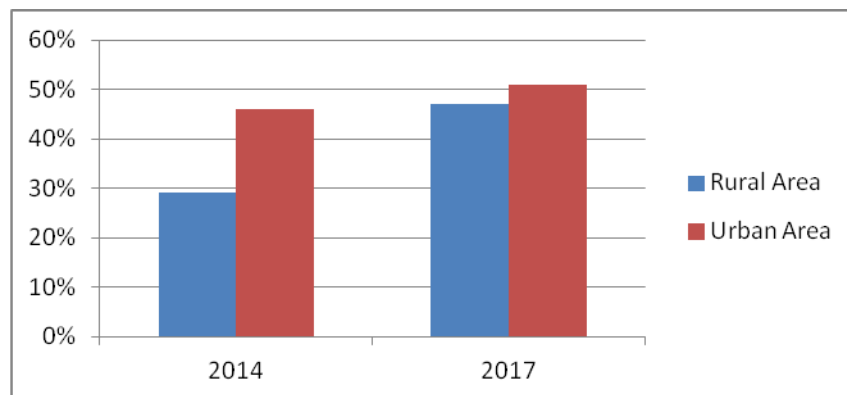
However, efforts to improve financial literacy are very essential in which there are many efforts that can be made by the government and related parties. *First*, the government needs to mitigate areas with levels of financial inclusion and literacy that are relatively low. *Second*, socialization and education programs at the school's early stages on the financial management are indispensable factors.

Third, the government needs to be intensive in providing education to the actors of Micro, Small and Medium Enterprises (MSMEs) related to the importance of financial management in business. The MSMEs' sector is a potential sector in encouraging financial inclusion, because the number is more than 90 percent dominating the industrial market in Indonesia. Thus, when the MSMEs' sector has good financial literacy, it will have the potential for decent status in utilizing financial services.

3. Rural-Urban Financial Services Gaps

A portrait of the gap between urban and rural areas in Indonesia in terms of access to financial institution services still occurs. Based on data from OJK in 2017, rural areas that had bank accounts reached 47 percent, while in urban areas, bank account ownership figures had reached 51 percent in 2017. More can be seen in Figure 2.12 below.

Figure 2.12. Bank Account Ownership in Rural and Urban Areas



Source: OJK, 2017

Even if compared to 2014, the ownership of bank accounts in rural areas in 2017 showed considerable progress or grew by around 15 percent, but the gap is still happening. The tendency of the high rates about poverty in rural areas compared to urban areas and however, it becomes one of the factors causing low utilization of financial institutions. Referring to the BPS data in 2018, the average poverty rate in rural areas reached 13.47 percent, whereas 7.26 percent was in urban areas.

This condition is also strengthened by the findings of the World Bank in 2011, which stated that around three-quarters of the poor in the world (around 2.5 billion people) were not touched by the services of formal financial institutions. Reflecting on this phenomenon, in order to improve the financial inclusion index, various efforts are needed to minimize the gap in inequality between rural and urban areas.

Furthermore, a number of conclusions will be presented from the study of Indonesia's economic freedom in 2018. Then, this section also provides several policy recommendations as an effort to increase economic freedom in Indonesia in 2019.

Conclusions and Recommendations

Based on the reviews, TII provides the following conclusions and recommendations:

- 1) The household consumption sector is the main contributor to GDP. Average household consumption accounts for 60 percent of total GDP. However, if observed, there is a positive relationship between fluctuations that occur in the growth rate of government spending and household consumption, which when there is an increase in government spending also has an impact on increasing household consumption. This indicates that it is very possible that economic activity in Indonesia still depends heavily on government spending
- 2) From the aspect of Intellectual Property Rights (HaKI), the government regulation has shown its commitment to respect and protect the copyright law owned by individuals. However, the policy outreach process is still very lacking. Although the data shows an increase in registered numbers of copyright and patent rights, local registrants are still relatively low.
- 3) In the midst of the pressure on the Rupiah exchange rate for 2018, the government is quite able to maintain the stability of the inflation rate below the 3.5 percent. This achievement is very positive considering that this trend has been able to be maintained steadily since 2015. It is expected that in 2019 the rate of inflation will be able to be maintained in a safe zone (<3.5%), so that it can provide convenience and certainty for doing businesses to determine their business plans.
- 4) The international trade sector is one of the important sectors that has undergone a major overhaul in 2018 to encourage the competitiveness of the domestic export market. The government provides several tax incentives to exporters in the form of interest discount on foreign exchange savings from an export proceeds. In addition, the government's efforts stem from imports of goods in order to maintain a domestic foreign exchange that are also carried out by raising taxes on 1147 types of goods. It is expected that in 2019 the increase in competitiveness of local business actors in the international market will not only rest on tax incentives, but also needs to be emphasized on improving product quality as well as strengthening capital facilitation.
- 5) The labor market in Indonesia is still faced with problems, one of which is the widening inequality between the increase in salary obtained by male and female workers. In the upcoming 2019, regulations are needed to push the involvement of women working in productive sectors that have high-added value. In other words, it is necessary to increase the HDI rate of women who are currently lagging

behind men. This is important as an effort to increase women's competitiveness in economic activities.

- 6) Indonesia's financial inclusion level is still far from the government's target of 75 percent in 2019. There is a lot of work that must be done by the government to realize financial inclusion. *First*, providing easy financial services is that all of societies could access it. *Second*, making the tremendous efforts improve public financial literacy. *Third*, bringing financial services in rural areas is that the serious way narrow the gap between rural and urban areas.

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