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Why Indonesia struggles to reform fuel subsidies

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President Prabowo Subianto at the launch of the B50 biodiesel programme, Indonesia.
Photograph by Cahyo, Press, Media and Information Bureau of the Presidential Secretariat

Key findings

- Indonesia continues to provide large-scale subsidies for fossil fuels which cause significant economic, fiscal and environmental harm.
- Analysing the political economy of subsidy reform shows that subsidies persist because:
  - They fit the ideology of President Prabowo Subianto.
  - Reform would create large political costs for the president and his coalition.
  - Vested interests linked to the biofuel industry are likely to oppose any reform.
- If change occurs, it is likely to happen through one (or more) of the following pathways:
  - A fiscal crisis forces (partial) reform.
  - Inner circle members find a way of reframing reform.
  - New technology allows the government to target subsidised fuel.
  - Actors invested in non-fossil technologies become more politically powerful.

1. Introduction

Energy subsidies in Indonesia are large. One estimate suggests that they amounted to Rp 713.5 trillion in 2024 ($45 billion), with 90% of this going to fossil fuel subsidies. Meanwhile, Indonesia is a net importer of fuel. Most fossil fuel subsidies arise because the government of Indonesia chooses to sell three key fuels – petrol, diesel and liquid petroleum gas (LPG) – at fixed prices well below the international market price (Box 1). These subsidies are a significant fiscal burden for Indonesia, particularly when the price of crude oil is high (as has happened in 2026 as a result of the war in the Middle East) and when the exchange rate depreciates.

Box 1: How Indonesia subsidises liquid fossil fuels

Indonesia subsidises three key liquid fossil fuels:

1. **Pertalite:** This is a low-octane petrol, used in motorbikes and smaller cars. The price is fixed at Rp 10,000 per litre. Higher octane fuels like Pertamax and Pertamax Turbo retail nearer to market prices.
2. **Biodiesel:** Most diesel in Indonesia is a blend of fossil diesel and fatty acid methyl esters (FAME) obtained by refining crude palm oil (CPO). The blend is known as biodiesel. The current mandate is for B50 – i.e. 50% of the blend is FAME. Since early 2026, the government has set a fixed price of Rp 6,800 for biodiesel for retail consumers, far below the cost of production. In addition, there is an off-budget subsidy for biodiesel refining, funded through a levy on CPO exports. This enables biodiesel refiners to sell FAME to the state-owned oil company, Pertamina, at the same price at which it buys fossil diesel.
3. **LPG:** The government heavily subsidises LPG in green 3 kg canisters (known as *elpiji melon*). Ubiquitous throughout most of Indonesia (with the exception of remote communities), these canisters are the primary source of cooking energy for 84% of households. The prices of 5 kg and 12 kg canisters are also regulated, but adjustments are made to ensure they roughly reflect market prices. The vast bulk of LPG is imported.

Notes: Kerosene is also still subsidised, but, as a result of the Zero-Kero programme of 2007, the volumes are now very small. The government also suppresses the price of coal for PLN, the electricity utility, and subsidises electricity for consumers and gas for certain industries. However, this study focuses on subsidies for liquid fossil fuels, which account for the bulk of energy subsidies.

Many development partners have supported efforts to reform fossil fuel subsidies. The World Bank has provided technical assistance to the government to introduce mechanisms to compensate poor households for the price shock of reforms. Other donors supported the Tim Nasional Percepatan Penanggulangan Kemiskinan (TNP2K, or National Team for the Acceleration of Poverty Reduction) from 2010 until 2024. This was responsible for an extensive programme covering the design, improvement and integration of social-protection systems, as well as studies and pilots exploring mechanisms for shifting from commodity-based to household subsidies.

The government of Indonesia has attempted to reform fossil fuel subsidies many times in the past. When the fiscal costs of subsidies have become too great, it has sought to reduce them, primarily by increasing domestic prices (to reduce the gap with international prices). Often, such reforms have been accompanied by a variety of compensatory policies for the poor, notably temporary cash transfers. Outcomes from these episodes of reform have varied, ranging from political backlash and reversal to partial and temporary success. However, because prices continue to be fixed, subsidies always re-emerge. This presents a puzzle: why does Indonesia continue to provide large fossil fuel subsidies despite significant fiscal, economic and environmental costs? To understand this, The Policy Practice, in collaboration with Indonesian energy policy experts, conducted a study to explore the political economy of subsidy reform in Indonesia.

2. Findings: the underlying reasons why subsidies persist

The research team reviewed the literature on fossil fuel subsidy reform, analysed the statements of key stakeholders in media articles on the topic and conducted a network analysis showing the linkages between key actors. This was supplemented by a series of qualitative, in-depth interviews with a wide range of stakeholders, including respondents from the Ministry of Energy and Mineral Resources, the National Economic Council, oil traders and transporters, think tanks, development partners, private sector associations, unions, politicians and other well-informed actors. Most interviews were conducted in person in Jakarta in May 2026, while others were conducted online. The team concluded that there are four key reasons why subsidies persist:

1. **The ideology of the president:** The president maintains an ideology that reflects his background in the military under former President Suharto. He believes in strong state (and military) involvement in the economy and has a paternalistic view of the population, seeing the role of the government as directly providing food for schoolchildren and subsidies, including energy subsidies, to the population. This results in inefficient, top-down, state-driven solutions that are not always well matched to the challenges of modern Indonesia.
2. **Fixed ideas:** Almost all respondents pointed to the fact that the president had extremely fixed ideas. Several described meetings with the president lasting several hours but consisting entirely of the president speaking without asking any questions. He does not appear to be open to evidence about the fiscal cost, developmental opportunity cost or environmental harm associated with subsidies. Rather, respondents suggested that the president believed that he had all the answers already and had surrounded himself with a group of people who avoided telling him uncomfortable facts.
3. **Political cost:** The president's principal concern about fossil fuel subsidy reform is the likelihood that it would result in large protests and unrest. Several people said that the president had been scarred by the experience of Suharto's fall and believed that price increases imposed on Suharto by the International Monetary Fund had triggered his downfall. Given the febrile environment of 2025 and 2026, which has seen major protests by students about corruption and inefficiency, he is not inclined to do anything that might accelerate his decline in the polls.
4. **Vested interests:** The president has a close relationship with key businesspeople in the biofuel industry, which he strongly supports. These actors are likely to benefit from the existence of the subsidy regime, both because lower prices encourage consumption of the commodity they produce and because maintaining fixed domestic retail prices may allow importers and distributors of fuels to disguise the margins paid by Pertamina, the national oil company. Biofuel actors are known to be important contributors to the financing of the president's election campaigns. Removing or significantly reducing subsidies would harm their interests and therefore those of the president too.

3. Possible pathways of change

The Policy Practice defines a 'pathway of change' as 'a causal explanation of how the desired outcome (in this case, fossil fuel subsidy reform) might come about as a result of shifts in the context and associated incentives affecting actor behaviour.' In effect, the approach examines how change might realistically happen given our knowledge of the mindsets, incentives and capabilities of key stakeholders.

The traditional approach to promoting fossil fuel subsidy reform in Indonesia has been to conduct studies showing the fiscal, economic and environmental costs of subsidies and to run pilots showing how reform might be implemented. Numerous such studies and pilots have been undertaken in recent years, with minimal impact on actual policy for the reasons outlined above.

The value of the pathways of change approach is that it takes into account what we have learned about the underlying political economy of the situation to construct more credible narratives about how change might happen, based on the actual incentives of the key actors.

Four possible pathways of change were identified:

1. **Fiscal crisis:** An adage in Indonesia is that 'bad times make good policies', i.e. adversity can compel decision-makers to make hard choices that they would otherwise avoid. In this pathway, tight fiscal conditions make subsidies harder to afford, which then leads the Ministry of Finance to press for reform.

   Assessment: We believe that this pathway is plausible and fits with Indonesia's historical reforms, although typically Indonesia has undertaken defensive reforms to stem losses during periods of high prices and left more structural reforms to periods of falling prices. The current administration tends to prioritise conformity with the president's economic creed and therefore approaches the issue as an exercise in stemming leakage of state resources. This has resulted in incremental adjustments, preparations for restrictions on the volume of subsidised fuel that can be purchased and consideration of narrower targeting, but the administration has not examined removal of subsidies themselves. This pathway is therefore likely to yield only partial reform with limited durability.

2. **Inner circle reframing:** If the president accepts that change is needed, then it might be possible for reform to be framed in language that he already accepts – i.e. protecting the poor, stopping leakages, disciplining waste, improving energy sovereignty and preserving fiscal space for his flagship social programmes. The key to this pathway is not analysis; it is whether someone in the president's inner circle whom he trusts is able to convey the reform to him in language that fits his ideology and political priorities.

   Assessment: This is a possible but difficult pathway, since it assumes that the president's position on subsidised fuel is not politically fixed. If he sees subsidies as essential to protecting purchasing power, maintaining popularity or holding his coalition together, then improving the framing may not be enough. Also, the president's trusted circle includes actors who may benefit from the existence of the subsidy system, so any reform message may be filtered or blocked before it reaches him.

3. **Administrative restrictions and managed access:** A technique used in the past is to simply remove subsidised products from filling stations, compelling consumers to purchase higher-priced products. Now, however, technology enables better control over the availability of subsidised fuels: rather than raising prices for everyone, the government can tighten access selectively via the MyPertamina app, which has been rolled out nationally. This features vehicle eligibility verification, smartphone scanning and online QR code readers at filling stations. This allows for volume limits and tighter monitoring of Pertalite and B50 distribution, for example restricting access by car owners (who are relatively better off) while preserving access for the far more numerous motorbike owners. For LPG, it could mean better household registration, tighter controls over agents, restrictions on ineligible users and more digital monitoring.

   Assessment: This is the strongest near-term pathway. It fits Indonesia's preference for targeting, digitalisation, quota control and the anti-leakage framing. It also avoids the political symbolism of a large fuel price increase. However, it is not full reform. Administrative targeting can reduce leakage, but it does not remove the price distortion. If subsidised and non-subsidised prices remain far apart, evasion remains attractive and enforcement becomes a permanent cost, not a one-time adjustment. This pathway could instil the idea that access to fuel should be targeted, which would be an important step, but it will not deliver major fiscal savings unless combined with a price adjustment. Thus far, the government has set Pertalite and B50 quotas at levels that are generous and do not significantly curb consumption.

4. **Elite realignment around new energy opportunities:** This pathway explores a medium-term shift in elite economic interests. Currently, some powerful actors appear to benefit from the existing system. However, there are also potential winners from fossil fuel subsidy reform, such as electric vehicle (EV) producers and induction stove suppliers. As the production of EVs and induction stoves, and electrification more generally, becomes more profitable, the actors involved may become more politically influential. Their interests are served by higher fossil fuel prices, and so they may use their influence to press for subsidy reform.

Assessment: This is the weakest near-term pathway because EV manufacturers and induction stove suppliers are not yet a powerful reform coalition. There is also no guarantee that these new actors will push for fossil fuel subsidy reform. EV manufacturers may prefer EV incentives, charging infrastructure, tax breaks or procurement support. Induction stove manufacturers and importers are not strong enough to drive LPG reform. However, this is a potentially important long-term pathway since durable reform usually needs winners. The most likely version of it is green rent creation alongside continued fossil subsidy politics. Nevertheless, over the longer term, fossil fuel subsidy reform will be easier if influential actors can see profit, status and political advantage outside the existing subsidy system.

4. Implications for proponents of change

Given the scale of fossil fuel subsidies and the large distortions that they cause in Indonesia, it is common for analysts new to Indonesia to call for subsidy reform as a 'quick win' with major benefits. This attitude fails to recognise that reforming fossil fuel subsidies is fundamentally a political problem. Subsidies are seen as part of the social contract in Indonesia; citizens regard low prices as a right (and a responsibility of government). President Prabowo embraces this view emphatically. Subsidy reform entails price increases, which are unpopular and have led to protests in the past, while there may also be vested interests who oppose reform since subsidies provide a mechanism to obscure their capture of rents from the fuel supply value chain.

Moreover, the political feasibility of fuel subsidy reform is linked to public trust in government. Widespread reports of corruption involving public officials may undermine the credibility of the government's fiscal justification for raising fuel prices. When citizens perceive that public resources continue to be mismanaged through corruption, they are less likely to accept higher fuel prices, even if subsidy reform is economically justified. Consequently, corruption increases the political cost of fuel price reform by weakening state legitimacy and public confidence in the effective use of fiscal savings.

Those keen to support fossil fuel subsidy reform in Indonesia might do better to focus on ways of supporting feasible pathways of change. This might entail:

- Providing analysis and support to the Ministry of Finance on the scale of subsidies and the risks they pose to the country's fiscal position. The president appointed a new, respected technocrat as finance minister on 14 September 2026. Tackling the *looming fiscal crisis* will be high on his agenda.
- Identifying and engaging key members of the president's *inner circle* who might be able to frame the reform in a way that is consistent with his ideological position.
- Working with the Ministry of Energy and Mineral Resources and Pertamina to explore *alternative mechanisms* through which access to subsidised fuel might be targeted to those who need it the most.
- Building the strength and influence of actors investing in and distributing *non-fossil fuel technologies* as a long-term approach to creating a constituency who would benefit from the removal of subsidies.

Further readings

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