



SURVEY OF RECENT DEVELOPMENTS

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SUMMARY

The survey period was dominated by the presidential election and its immediate aftermath. After receiving a clear mandate from the 20 September second-round election, on 20 October Susilo Bambang Yudhoyono (hereafter referred to as SBY) was installed as Indonesia's sixth president, and the first to be elected directly. He announced his cabinet that evening.

The president inherits an economy which, in terms of per capita income, has recovered to pre-crisis levels, and is growing at about 4.3% per annum. Developments during the survey period continued to confirm the assessments of previous surveys that macroeconomic stability has been restored, albeit precariously. Inflation is under control, though it is stubbornly above that of Indonesia's major trading partners. Interest rates have bottomed out and will probably start to rise, reflecting both international trends and the current very low real domestic rates.

A major achievement of the Megawati administration was its prudent fiscal policy. The fiscal deficit has fallen to below 2% of GDP, and would be less than 1% under the proposed 2005 budget. However, the fuel subsidy has risen alarmingly, from a budgeted Rp 14.5 trillion to an officially estimated Rp 63 trillion in 2004 (and probably higher still), approximately equivalent to the central government's entire development budget. The subsidy is of such a magnitude as to imperil the incoming administration's development-oriented expenditure program.

The economy weathered the third major terrorist attack in two years, on 9 September in front of the Australian embassy, with surprising ease. The longer-term ramifications may be more serious, however, especially if there are repeat attacks.

With its strong mandate and the macro-economy stabilised, the SBY team has an historic opportunity to return Indonesia to strong economic growth. To do so will require the restoration of business confidence and the pursuit of a predictable, growth-oriented commercial climate. Investment, both foreign and domestic, is anaemic. Labour-intensive manufactured exports and the mining industry, to name just two problem areas, continue to languish. Serious infrastructure bottlenecks are beginning to emerge. Labour regulations constitute a major disincentive to employ workers in the modern sector. Export-import procedures are cumbersome and costly, and lag well behind regional best practice. Property rights are insecure. Corruption is just as widespread as in the Soeharto era, but much more unpredictable. Coordination between different tiers of government is weak. The reform agenda is well known and clearly articulated; the nation now waits for the new administration to make serious progress on many fronts.