

## SURVEY OF RECENT DEVELOPMENTS

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### SUMMARY

The growth of Indonesia's GDP accelerated in the second quarter of 2006, thanks to the buoyant performance of the communications, construction, transport and agriculture sectors. From the demand perspective, growth was supported by increased government spending and net exports. Macroeconomic stability has continued to improve, and Jakarta's stock exchange has been out-performing others in the region, reflecting positive market sentiment in response to stable government, the improved growth rate, and the steady decline in inflation and interest rates

With these positive macroeconomic signs and high commodity prices in international markets, a sense of optimism has started to emerge in some sectors, but there are also concerns that economic reform has stalled. The challenge for the government is to balance its political need for short-run 'wins' with the imperative for long-run macroeconomic stability. Among the ideas for generating a quick win, the ambitious proposal for development of a large-scale bio fuel industry has gained much attention, but it is very unlikely to be a short-term panacea for the problems of high unemployment, poverty and dependence on increasingly costly fossil fuels.

The government has had to deal, once again, with the highly controversial issue of rice imports. The rice import ban imposed by the government last year was the main cause of surging rice prices in 2006. These in turn – not the 2005 fuel price rises, as has often been claimed – were the primary trigger for the significant increase in poverty reported in September. Removing the rice import ban is therefore likely to help reduce poverty.

The announcement of a number of policy packages intended to boost lagging investment, particularly in infrastructure, may well reflect genuine intentions on the part of the government, but what really matters is implementation. There seems to have been a loss of momentum in this regard for various reasons, including a lack of capacity in the bureaucracy, and the fact that many officials have a clear incentive to oppose reform. This strongly suggests the need for a major civil service overhaul, extending far beyond the present focus on anti-corruption efforts. The need for such an initiative is also apparent in the failure of the bureaucracy to prevent or deal adequately with the mud flow disaster in Sidoarjo in May. Reform is also necessary in relation to the legislatures, where delays in enacting or amending key laws often reflect a pay-off to members from being able to frustrate governments' legislative intentions.