SURVEY OF RECENT DEVELOPMENTS

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SUMMARY
Despite a turbulent global economy and expectations that declining exports would cause an economic slowdown, the Indonesian economy grew at 6.5% in 2011. The growth rate was supported by high consumer confidence – the result of lower inflation of just 3.8% in 2011. Nevertheless, there were indications that the global financial crisis had had an impact on Indonesia in the last quarter of 2011, notably on the growth of exports and imports.

In October 2011, President Yudhoyono reshuffled his cabinet, citing a need to improve its performance in the administration’s remaining three years. The reshuffle showed that the president is still subject to political party pressures. Moreover, the governing coalition of parties remains weak. Agreements made within coalition meetings are often broken in the parliament, and coalition parties are frequently distracted by media polemics. The case of former Democrat Party treasurer Nazaruddin, arrested in Colombia following a two-month manhunt, has revealed the magnitude of the money politics surrounding the Democrat Party, whose ratings are declining rapidly.

Indonesia enters 2012 bolstered by the restoration of its investment-grade credit rating. This will expose Indonesia to increased capital flows, since many funds are permitted to invest only in investment-grade countries. The effects on foreign direct investment (FDI) are not automatic, however. These investors evaluate the wider business climate and economic governance in making their investment decisions.

The fuel subsidy remains a challenge for Indonesia in 2011/12. Parliament rejected a proposal to limit fuel consumption from April 2012 over doubts about the government’s readiness to handle the policy’s technical complexity. Now the government is again considering a fuel price increase, and will have to seek parliamentary approval soon.

Indonesia faces a long-term problem of regional inequality. After four decades of economic development there is little variation in the shares of GDP across regions, but GDP per capita in some regions is slipping behind that of Java. Regional development policy needs to generate more economic activities in the outer islands, and to learn from the mistakes of past initiatives to promote economic development and growth centres in the regions. It is important to align policies with the current decentralisation arrangements.

The government is revising Law 33/2004 on Intergovernmental Finance with the aim of improving some dimensions of decentralisation in Indonesia. Revenue certainty is to be enhanced in part through changes to the general allocation grant (DAU) formula and the disbursement mechanism for intergovernmental transfers. The planned revision has not, however, addressed sufficiently the problem of inefficiency in regional spending. In fact, some of the proposed solutions may well create further spending inefficiency.

The main barrier to increased FDI is infrastructure development, whose progress has been slowed by land procurement problems. Unfortunately, Law 2/2012 on Land Procurement for Public Purposes seems unlikely to deliver a clear solution to the key problem of determining fair prices for land compensation. What is needed is the creation of more independent price-setting committees, with sufficient capacity to disentangle the problems of land acquisition.

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