Just Getting By: The Outlook for Indonesia’s Economy

By Stephen Norris

Southeast Asia’s largest economy continues to register steady economic growth, but at levels lower than seen in recent years. With national elections in 2014, policymakers are unlikely to quickly take the tough fiscal and regulatory decisions needed to put the country back on track to achieve its long-term growth potential. Political analyst Stephen Norris provides an outlook for the coming year.

INDONESIA’S ECONOMY in 2014 can expect to perform much as it has in 2013, with acceptable if unspectacular growth colored by policymaking that ranges from the adroit handling of monetary policy by Bank Indonesia, the country’s central bank, to the nationalist-, protectionist- and populist-prone unpredictability of several key ministries. The report card on management of priority challenges — such as current-account and currency issues — and macroeconomic performance will inevitably be mixed.

Growth in gross domestic product of 5.3 percent to 5.7 percent looks to be a reasonable expectation, but fluctuations between more or less optimistic projections will take place at a time when little business will be done by most ministries as they prepare for the personnel transitions that will take place after the 2014 elections. Most policies that do emerge will be largely geared towards implementation year. Chatib has in the past advocated capitation — the fuel subsidy and establishing mechanisms to insulate the state budget from spikes in oil prices, as interim steps to reduce the vast fiscal burden. With fuel subsidy reductions politically out of reach, the effectiveness of the ministry’s separate initiatives to balance the current account will be blunted.

FOCUS ON FUEL SUBSIDIES AND INFRASTRUCTURE

In November 2013, Chatib and his team acknowledged that there will be no repeat of this year’s reduction in state fuel price subsidies in 2014, an unsurprising decision given the need for political parties in the ruling coalition to avoid moves that alienate swathes of the electorate in an election year. Chatib has in the past advocated capping the fuel subsidy and establishing mechanisms to insulate the state budget from spikes in oil prices, as interim steps to reduce the vast fiscal burden. With fuel subsidy reductions politically out of reach, the effectiveness of the ministry’s separate initiatives to balance the current account will be blunted.

Vice President Boediono, a former central bank governor, has been active in the second half of 2013, driving home the need to divert state spending — including on fuel subsidies — to
much-needed infrastructure development. He is in a minority here, however, and Co-ordinating Minister for Economic Affairs Hatta Rajasa, who is a professional politician and not a technocrat, maintains that the bulk of investment in the government’s infrastructure master plan will come from the private sector. Whatever the source of financing of the scheme, infrastructure development is such a huge task that even if the government’s Economic Master Plan (MP3EI) suddenly finds elusive momentum, only minimal change would be felt in 2014. The World Bank in 2012 ranked Indonesia 59th out of 155 economies surveyed in its Logistics Performance Indicator, and in November this year reaffirmed the connection between required upgrades and growth.

Prospects for expedited development in 2014 are not great. There are signs of discord among cabinet ministers, with Boediono acknowledging that beyond projects that are already well advanced — new rail links between Jakarta and Surabaya, and expansion of the capital’s over-burdened Tanjung Priok port — limited progress will be made on the broader transport- and power-generation-focused program. Many projects are bogged down in land disputes with resistant communities. They cannot be resuscitated in significant numbers without the powers set out in the Land Acquisition Law, which was passed in 2012 but will fully come into effect only in 2015. That lag time is still baffling for many, including Boediono.

Other ventures — such as rail systems in the Kalimantan provinces of Borneo — will run into hurdles obtaining requisite permits from the forestry ministry, which has yet to get fully behind projects pushed by other branches of government such as the energy and mineral resources ministry. Co-ordination between regulators has been irregular, and projects snagged in the cracks will continue to be held up. Given the intertwined relationship of politics and big business, heavy reliance on private-sector funds will inevitably entail examples of suspected collusion and encroachment of vested interests into tendering processes. Rumors abound in Jakarta of supposed tensions between senior cabinet ministers pulling in different directions over private sector nominees for major infrastructure projects. Insulating these projects from predatory instincts will be no small task, especially in an election year when all political parties face intense fundraising pressures that force them to call on their corporate allies.

Such factors mean the lack of transport and electricity infrastructure will endure, putting a drag on economic performance and imposing significant costs on businesses. Those needing to move output (especially perishables) or fund back-up power generators will feel the squeeze most, particularly outside Java.

SECTOR SNAPSHOTS
Sectors with healthy outlooks include real estate, financial and other services, and retail, while manufacturing and agriculture will all record stable growth. Oil and gas, mining, commodities (especially palm oil and rubber), renewables and telecoms will be among those sectors that will struggle or perform below capacity. Foreign direct investment will neither boom nor bust.

The lingering influence — or retention — of the policies from the outgoing administration will be a key determinant affecting all sectors above. Strong demand for new housing from the country’s young, growing middle class — a driver of rapid urbanization and broadly robust domestic consumption — will ensure a good year for real estate in 2014. That said, the sector can’t keep pace with the housing market and, fearing...
Sectors with healthy outlooks include real estate, financial and other services, and retail, while manufacturing and agriculture will all record stable growth. Oil and gas, mining, commodities, renewables and telecoms will be among those sectors that will struggle or perform below capacity. A price bubble inflated by over-zealous developers taking on high levels of debt, the central bank will maintain its tight grip on mortgage lending to tame demand. The result will be slower real estate sector growth than could otherwise be expected, with subsequent dampening in imports of construction materials, another current account-linked consideration. This should mean a more stable footing for an industry with a bright future. These policies are unlikely to be changed by the election cycle.

The coming year looks to be an inopportune time for investments in Indonesian resources, for foreign players at least (see next story). A September 2013 regulation issued by the energy and mineral resources ministry confirms the worst fears of foreign mining companies, making explicit that divestment obligations unceremoniously thrust forth in 2012 — requiring foreign mining companies to cede majority control in their interests by the 10th year of production — will not only be upheld, but will involve price-determination mechanisms that effectively ensure the foreign party must sell at least 51 percent of their Indonesian entity to a domestic investor at knock-down prices. The regulation even states that the obligation will apply to foreign mining companies operating under the old contract of work (CoW) regime, arrangements that do not include a divestment obligation. If the government pursues this notion, international arbitration will likely follow.

A ban on exports of raw minerals due to take effect in January has also riled the industry, and despite an unavoidably deleterious impact on the current account (via lost export receipts and taxes), the policy has yet to be rescinded. Meanwhile, energy officials talk of rising investment in oil and gas, but acknowledge that an inadequate proportion is devoted to new exploration. No wonder, given heavy capital outlays required and a rash of regulatory uncertainties, industry corruption scandals and resource nationalism, all of which deter major foreign oil companies with the resources to undertake such financially high-risk activities. At best, a new government could begin unwinding some of these policies, but the economic impacts would not begin filtering through until late 2014 at the very earliest.

Much will be made of the vast untapped potential of renewable energy, but not in 2014. Feed-in-tariffs, fiscal incentives and profitability issues, as well as familiar difficulties with land acquisition and overlapping administrative jurisdictions will continue to stifle progress on the realization of ambitious renewable energy targets. There are serious efforts under way to address these challenges, but acceleration in the next year seems out of reach.

A last area to watch will be the fate of moves mooted in November to increase foreign access to a number of sectors currently proscribed or restricted on the government’s negative investment list (DNII). Port and airport management are among the touted new openings. A final announcement is expected by the end of the year, though there are also signs here of cabinet rifts, with Boediono pushing for relaxation, but others in Yudhoyono’s circle urging against policies that could be seen as too “pro-foreign.” Whether Boediono gets his way with the DNI revisions will be an early indicator of where the balance of power lies between more nationalist and more liberal voices in the cabinet at the outset of the election year.

A REFORMIST INTERLOPER?

So, expect mixed policymaking at least until the July elections, but a note of optimism beyond that: Jakarta Governor Joko Widodo, better known as Jokowi, is the current runaway favorite to complete a meteoric political rise to take the presidency on the opposition Indonesian Democratic Party of Struggle (PDI-P) ticket, assuming that party chief Megawati Sukarnoputri, a former president, allows him to stand in her stead (she seems amenable). Jokowi may be a rookie in some ways, with little experience of back-room deal-making and navigating the traps of elite-level politics, but he has a substantial pedigree in effective city-level governance (in the Central Java city of Solo and, for the last year or so, Jakarta). His specialty seems to be banging heads and getting things moving. That would be a huge virtue. While Jokowi would not be able to make heavy inroads into corruption or eradicate the country’s myriad economic bottlenecks, he could — through key appointments of trusted and credible figures to important positions — bring a more favorable business climate. And, in much the same way as President Benigno Aquino III has in the Philippines, he could use his own personal integrity and accessibility to help reverse current negative foreign investor perceptions.

The Indonesian economy can rely on a reasonably solid base and a minimum level of growth that is the envy of many of its neighbors. But building from there will hinge on the arrival in 2014 of new thinking in the presidential palace and strong personalities handling pivotal portfolios. Even in the best-case scenario, a reformist president would be unable to significantly amend the immediate outlook, and would be constrained by the realities of coalition politics and resistance to reformist measures at both national and local administrative levels. Progress on policy issues will take time, leadership and hard work.

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