



Crawford School Dialogue

Asia's Economic Transformation:

Implications for Australia

Presented by the Arndt-Corden Department of Economics and the Crawford School

Tuesday, 12 March, 2011

Weston Theatre, J G Crawford Building 132, Lennox Crossing, ANU



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Indonesia

Presented by Ross H. McLeod, Arndt-Corden Department of Economics

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One of very few countries not to suffer a severe decline in growth as a result of the GFC

- GDP growth rate remained above 4% p.a. (mid-2009)
- Recovered to 6.9% by the end of 2010
 - Driven mainly by private investment: business confidence high
 - On supply side, growth is most rapid in services, especially wholesale/retail trade, hotels and restaurants
- Inflation around 7%, c.f. target range 4-6%
 - Reflects central bank unwillingness to allow Rp to appreciate
- Recent surges in food prices
 - Temporary removal of tariffs (rice, wheat, soybeans)
 - Increased imports of rice
- Financial markets
 - Exchange rate against \$US very stable
 - Stock market has been booming (but recent signs of nervousness)

There is a severe fiscal problem

- *Not* an unsustainable deficit
- Rather, enormous subsidies to energy consumption (fuel/electricity)
- No threat to macro stability
- But huge waste of Indonesia's hydrocarbon wealth (oil, gas, coal)
- Main benefits to middle & upper classes, who consume much more energy
 - 2011 budget subsidies to energy: *\$15 billion*
- Funds misallocated away from infrastructure, education, health...
- Government repeatedly promises to cut subsidies, then backs down

Composition of exports has altered dramatically and unexpectedly over the last two decades

- Earlier high hopes for labour-intensive exports (especially textiles, clothing and footwear) have not come to fruition
- Instead, the big growth has been in coal and palm oil
- Country shares of exports have been changing significantly
 - Traditional export markets becoming less important
 - Rapid expansion into 'new' Asian markets

Guarding against collapse of financial sector

- Banking sector collapsed in AFC at huge cost to government (perhaps \$50 billion)
- By contrast, GFC had little impact:
 - Only 1 (small) bank failed (Bank Century)
 - Cost to government 'only' about \$700 million
 - But was used as a political lever to get rid of the reformist finance minister
- Reminded policymakers of earlier decision to unify financial institution supervision in single body (FSA)
- New law drafted and discussed, but not yet enacted
- Draft is poor: would lead to wasteful/confusing duplication of supervision in BI and new FSA
- Unclear why it should be expected to achieve anything

Economic dynamism comes mainly from the private sector rather than the public sector

- Government fails to create sufficient public infrastructure
- Less noticed: it fails to manage such infrastructure well
- Both problems clearly evident in dysfunctional large cities
 - Traffic congestion
 - Frequent flooding
 - Inadequate, poor quality water supply
 - Depletion of aquifers and consequent land subsidence
 - Absence of sewerage
 - Poor environmental quality
- Key to improvement is a shift from government financial support to charging costs to users

Corruption remains a major concern

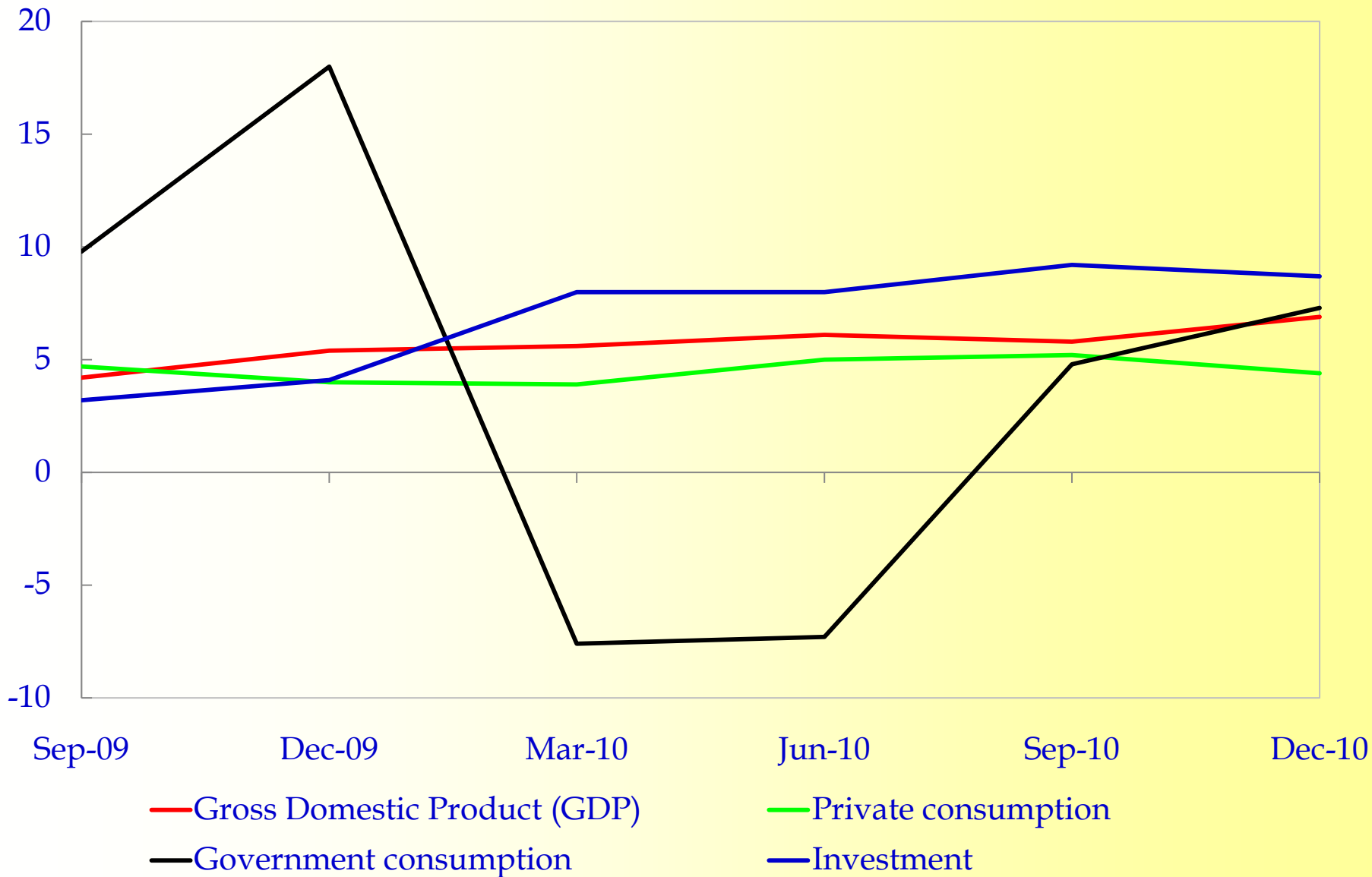
- Plenty of evidence that the anti-corruption campaign is making little headway
- Gayus Tambunan case highlighted high level corruption in
 - Tax office
 - Police
 - Judiciary
 - Prisons
 - Immigration office...
- SBY's popularity remains high, but his approval rating has fallen a great deal

Indonesia and Australia

- Not major trading partners
 - Australia not a large market for Indonesian exports
 - Australia supplies less than 5% of Indonesian imports
- Competing exporters of coal, natural gas, and certain minerals
- Not much Indonesian investment in Australia
- Australia invests in mining industry and in certain services
- Indonesian legislation has not created an environment that is truly welcoming to foreign investment
- Significant trend to protectionism in relation to foreign investment likely to constrain Australia's role

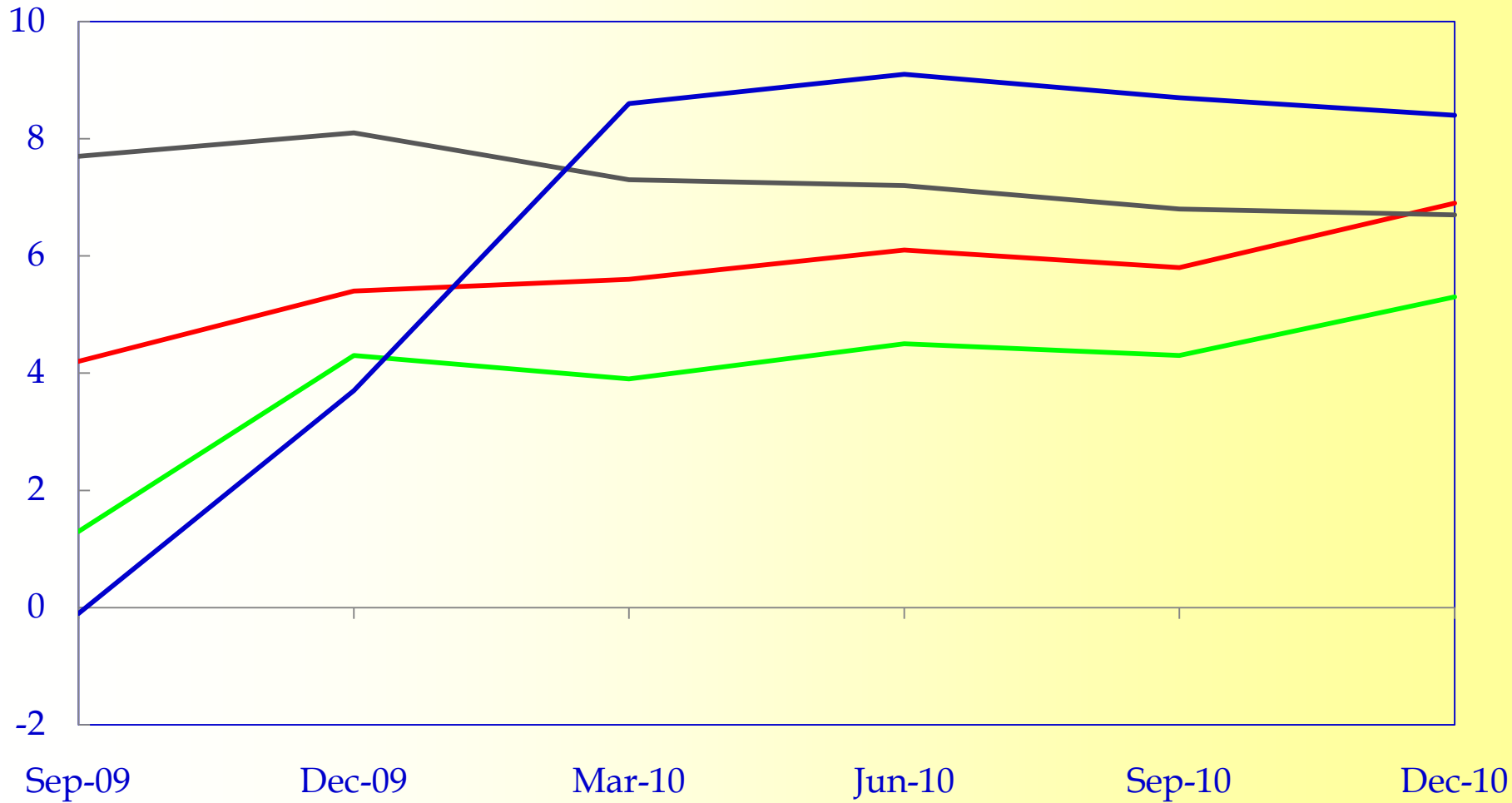
GDP Growth (Demand side)

(% p.a.)



GDP Growth (Supply Side)

(% p.a.)



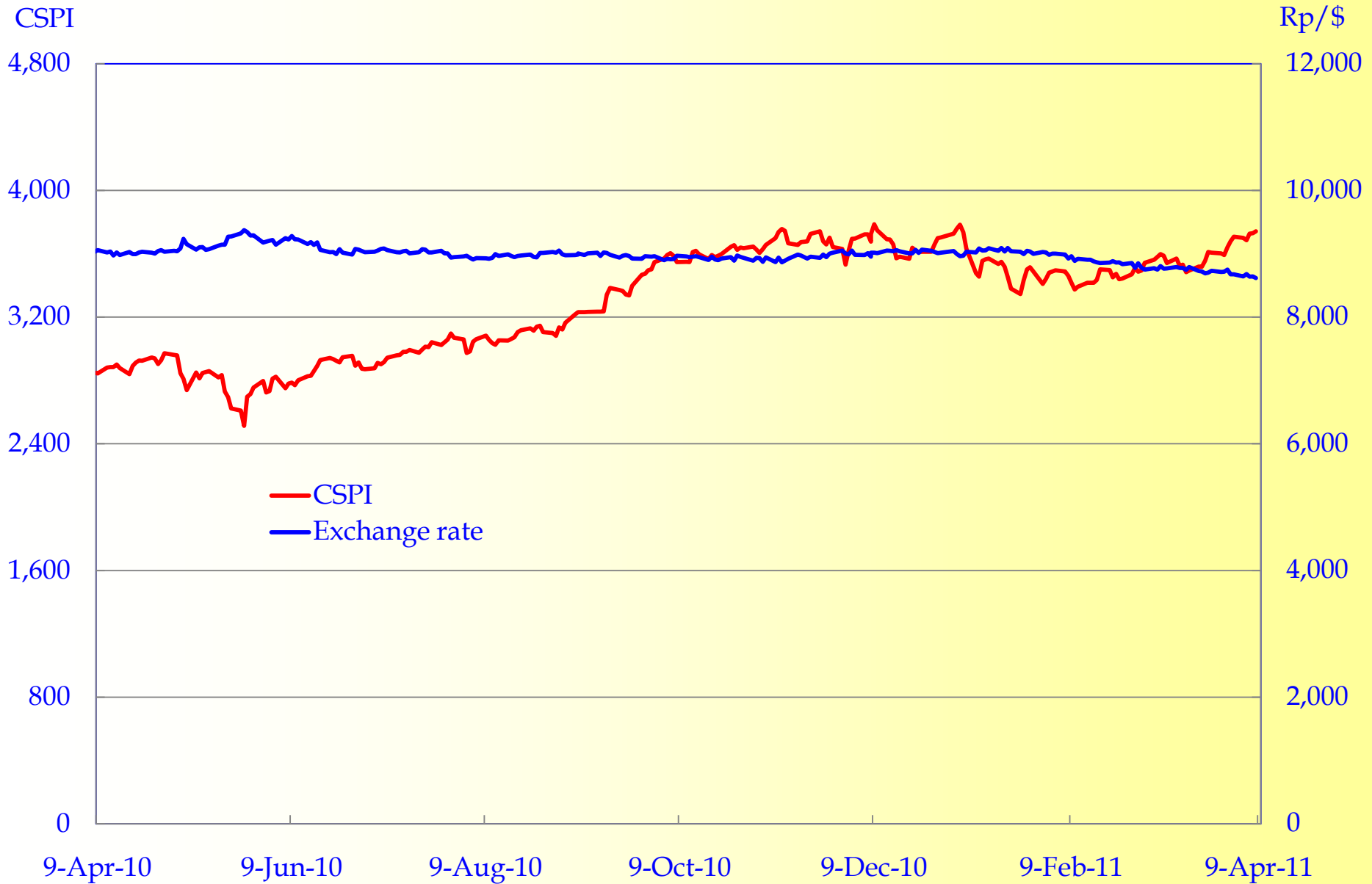
— Gross Domestic Product (GDP)

— Manufacturing

— Construction

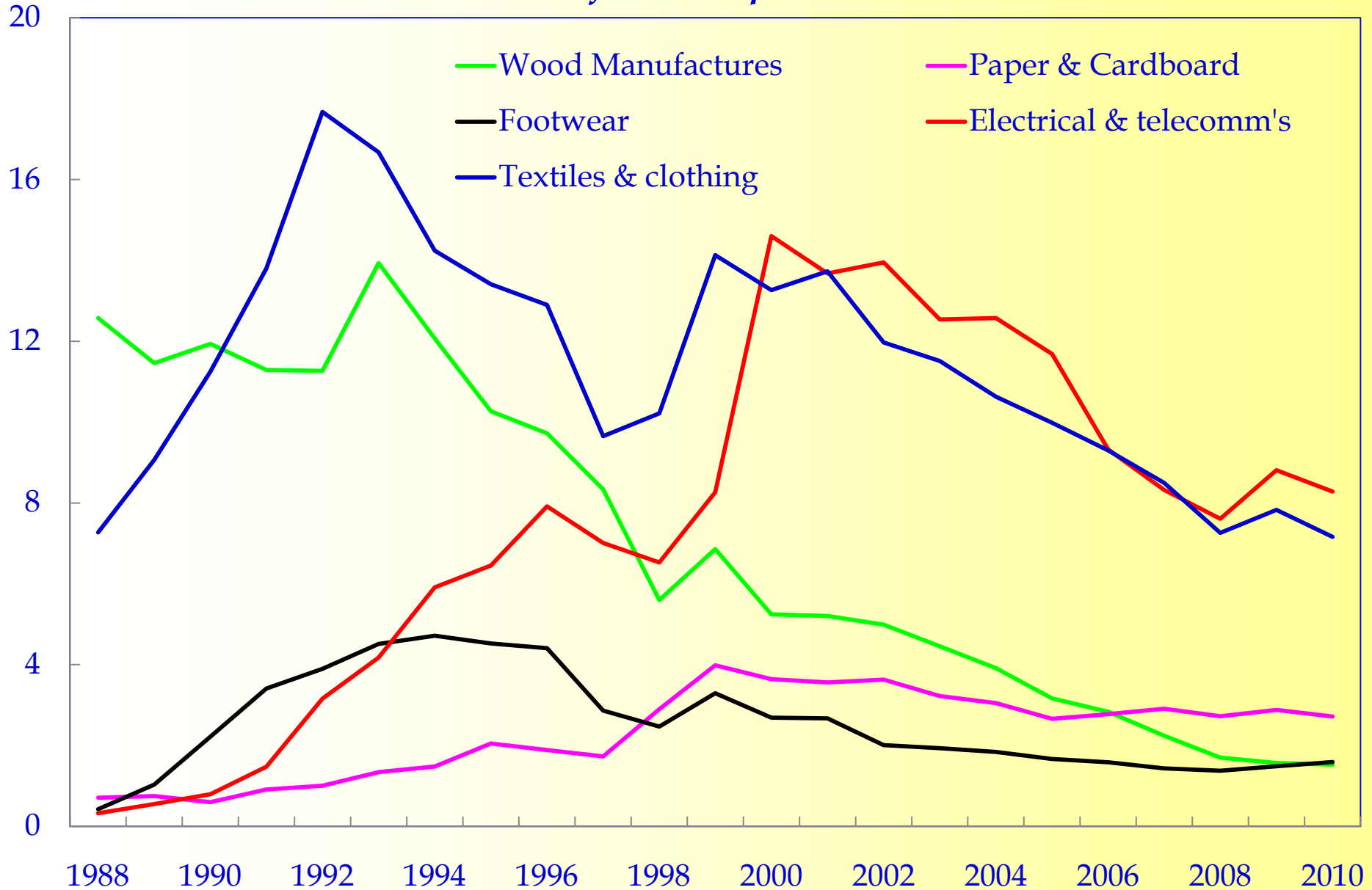
— Trade, hotels & restaurants

Composite Stock Price Index (CSPI) and Exchange Rate



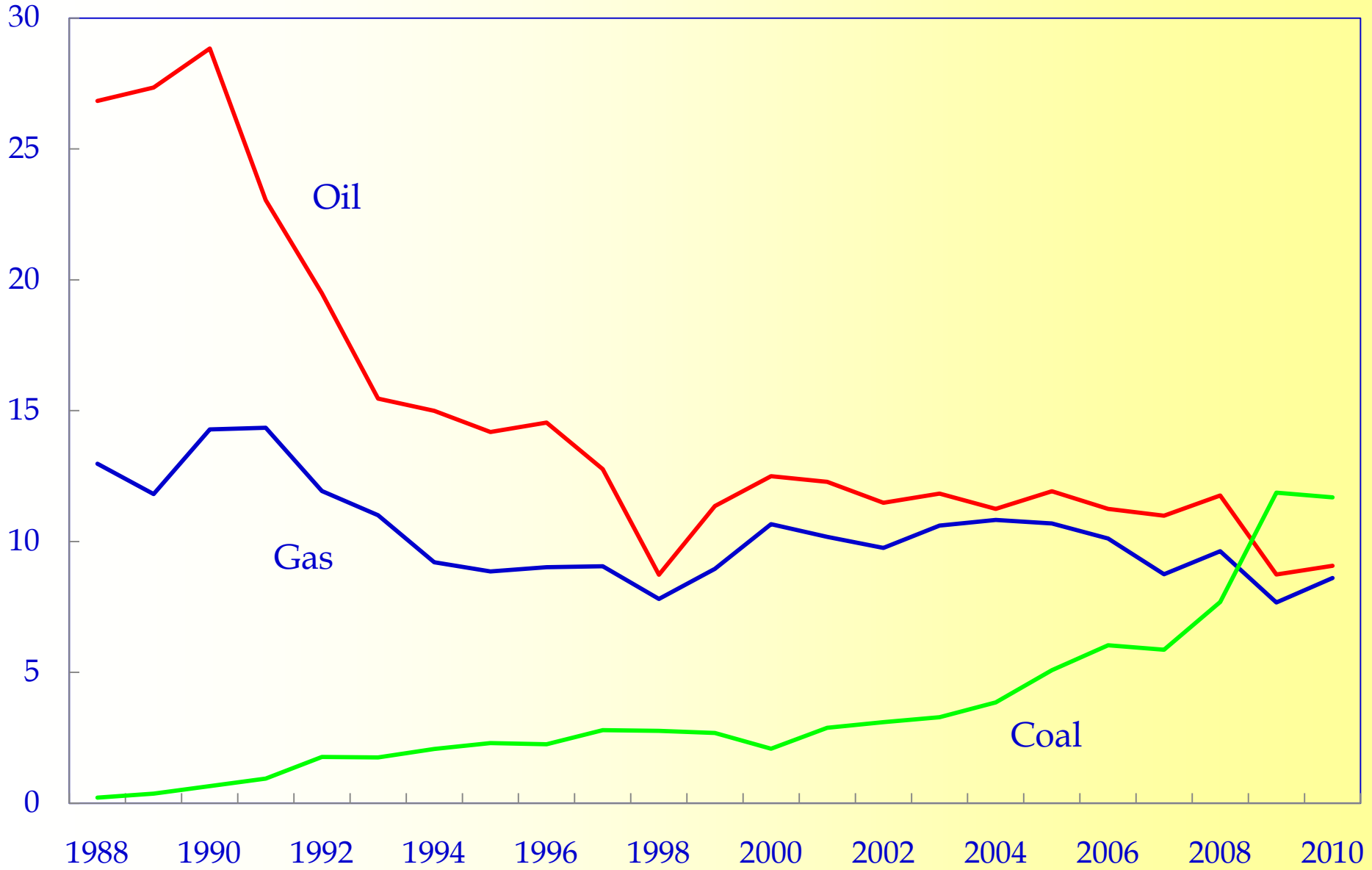
Trends in Key Manufactured Exports

(% of total exports)

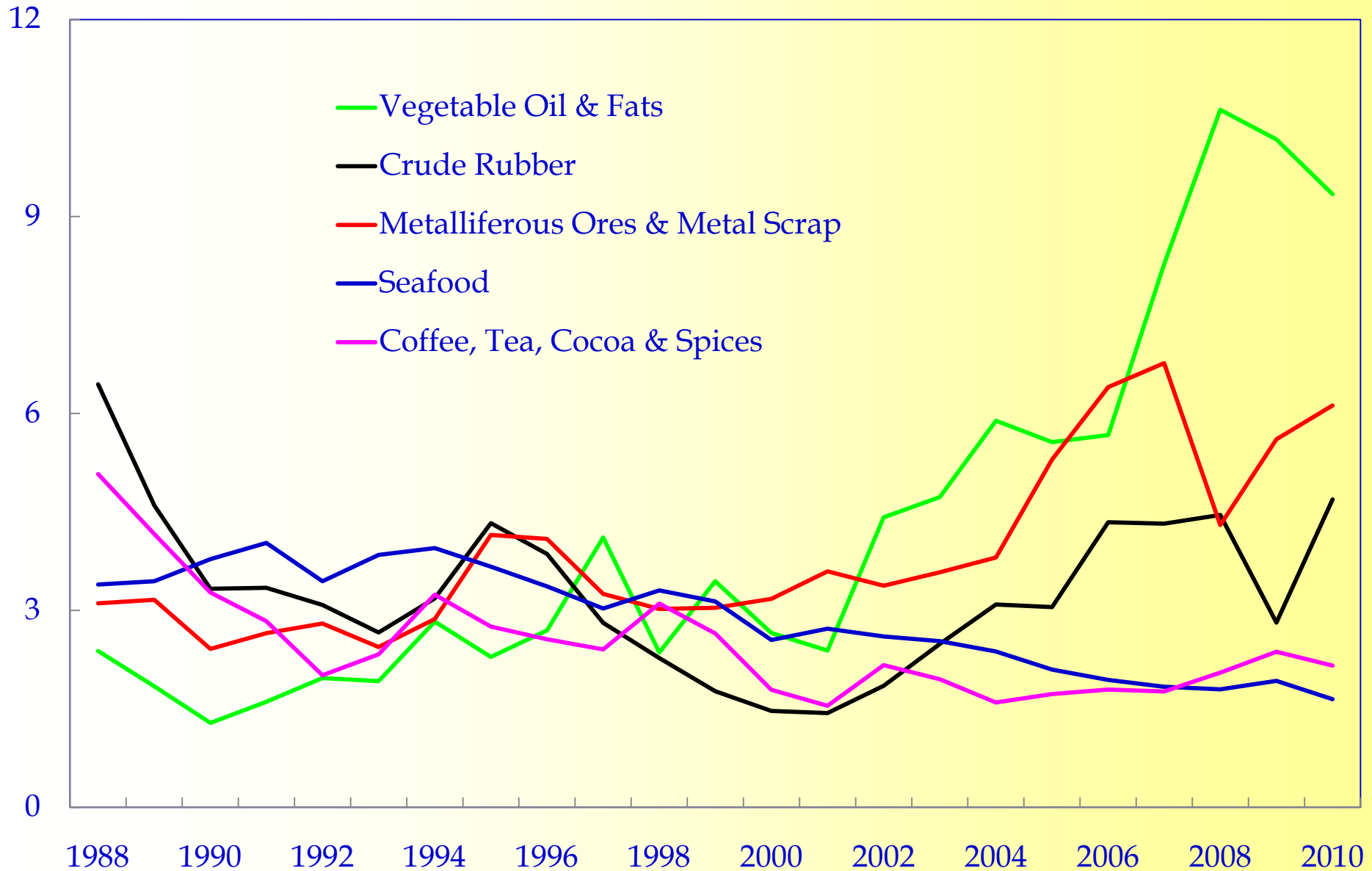


Trends in Energy Exports

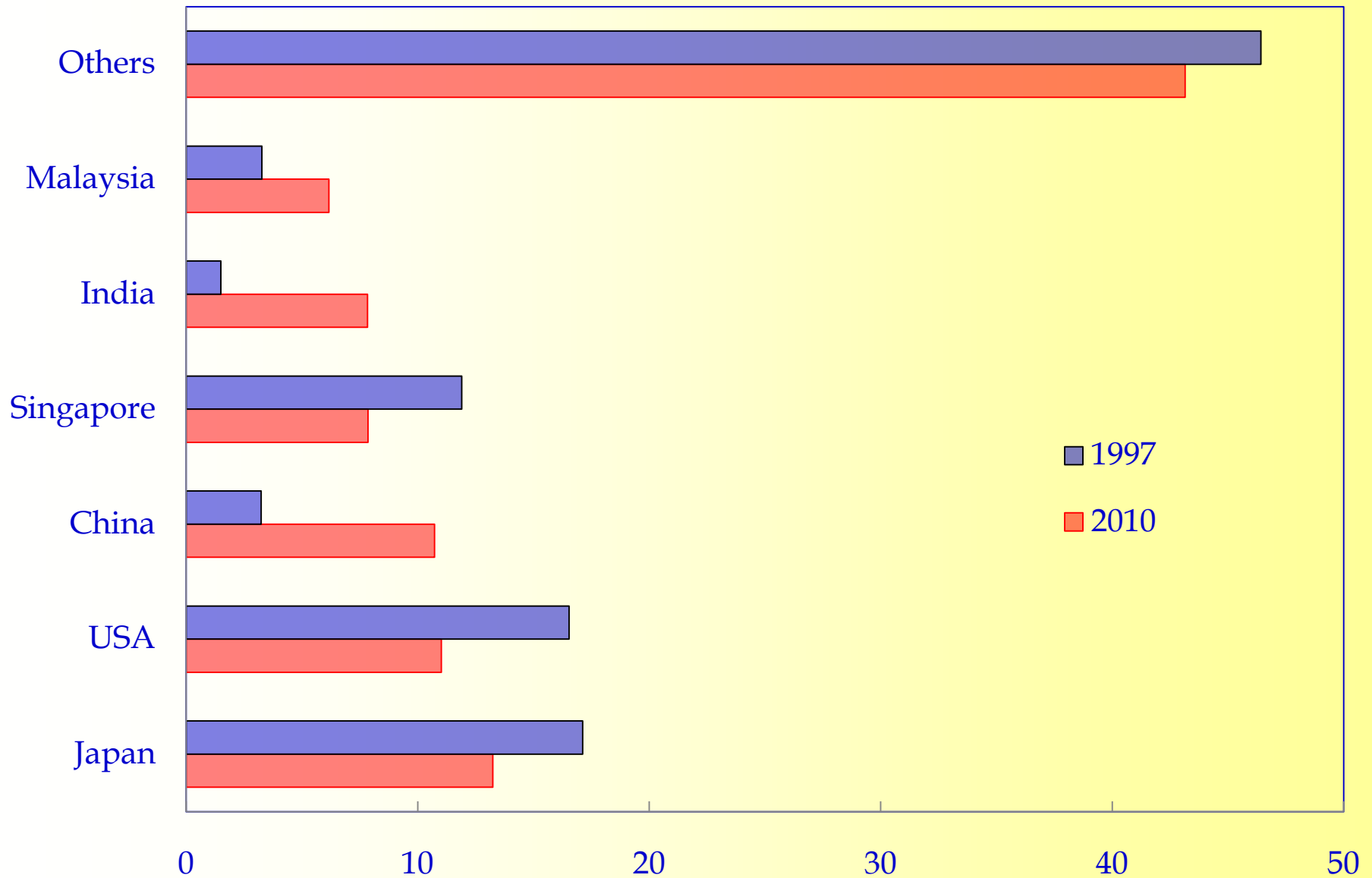
(% of total exports)



Trends in Other Natural Resource Exports (% of total exports)



Country Shares of Indonesian Non-Oil and Gas Exports (%)



Country Shares of Non-Oil & Gas Imports (%)

