

**Corporate Briefing**  
by  
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Mr. Castle, a veteran business consultant in Jakarta and member of the USINDO Board of Advisors, began his briefing by observing that Indonesia “actually is in a pretty good place” insofar as business conditions are concerned. Specifically with regard to the U.S., he continued that there are “so many important interactions between the United States and Indonesia.” Nonetheless, “things can go wrong when there are differing priorities and perceptions” and business relations and politics in Indonesia cannot be separated as in most countries.

His assessment of the Indonesian economy in January 2006 was at the “outer edge of the rosy spectacle” because there was high inflation, widespread hardship was expected from fuel price increases and subsidy cuts, consumer confidence plummeted, reforms were going slowly, and the government’s infrastructure investment campaign failed to produce results. Today, there is high confidence in the economic trends:

- GDP growth in 2006 turned out to be a respectable 5.5% and is forecast to increase in 2007 to 6.2% (above the ASEAN norm).
- Inflation was 6.6% in 2006 and is expected to decline to 5.8% this year.
- Real interest rates are declining from 9.0% to a projected 7.5%.
- Foreign exchange reserves are increasing.
- The trade balance is up 37% from \$28 billion in 2005 to \$38 billion at the end of 2006.
- The Rupiah is stable against the U.S. dollar, mainly because the dollar is weakening.
- The Jakarta Stock Exchange (JSE) is up sharply for the year.
- Cash crop demand and prices increased and are expected to remain high.

On the somewhat unfavorable side, government spending is expected to increase 10.5% in 2007, as compared to 13.6% last year, because of increased vigilance and financial controls on disbursements resulting from the anti-corruption campaign. The minimum wage is expected to increase 10% in 2007 but labor market rigidities continue and no relief is in sight. Consumer confidence, having recovered in the second half of 2006, dropped in December because of the government’s “botched handling” of the rice supply and to prohibit needed imports to reduce prices for poorer consumers. There is also an extended drought in some areas that will depress rice supply and increase the need for imports.

Castle's conclusion is that government policies should be attuned to what is best for the consumer, as these are what will benefit business as well. This rubric applies to the rice situation as well as other forms of protectionism which are outmoded and counter-productive in economic terms. Despite these disabilities only an "unknown circumstance" such as a massive avian flu outbreak could knock Indonesian growth off track. Even an economic slowdown in the U.S. would not affect Indonesia significantly because the Indonesian economy increasingly depends on intra-Asian trade and investment.

On the political side, Castle observed that President Susilo Bambang Yudhoyono is still way ahead in the polls and there is no viable alternative candidate, even Vice President Kalla according to the Jakarta elite "gossip mill," although one could emerge. Local elections in 2006-07, and especially the Jakarta elections later this year, are beginning to have a profound effect on the character of politics.

Castle spoke at some length on the impact of regional autonomy which in his view portends an "historic" redistribution of wealth from the center (Jakarta and the central government) to the provinces. As one indicator, 75% of bank deposits and credit were centered in Jakarta, meaning 10% of the population controlled 75% of the wealth. Jakarta is now responsible for only 45% of deposits and credit, thus signifying a shift of resources to the regions for investment and trade.

Overall, Indonesians under *devolusi* stand to keep more of the wealth they generate and the political consequences of this shift will be seen more and more by the Jakarta elite. In this regard, great enthusiasm has been shown in local elections for changes in the political party system and old-line personalities. The regions "are playing catch-up" on development which will propel national growth in the future.

Castle concluded his formal talk with comments on legislative reform which in his view merited a failing grade, although damaging actions have been avoided. The government has turned in a middling performance on regulatory reform and efforts to stimulate infrastructure investment are still not bearing fruit. The "core" reformers in the government's economic team are pursuing a conservative strategy and have targeted certain sectors for improvement, such as the Tax Authority. Higher quality officials are moving into responsible positions in key economic agencies, whether in advisory or formal roles, but civil service and other regulations still impede change.

Judicial reform, Castle observed, is hard to do and is still suffering from the Soeharto period which "hollowed out" state institutions to serve the government's ends and personal interests.

### ***Discussion***

During the question-and-answer period, Castle predicted that there will be "more intense jockeying" among political factions in and outside Golkar. The 2009 elections, as in 2004, are likely to be in two stages: parliamentary (DPR) elections early in the year and a separate presidential election later. As political intrigue heats up, it is therefore important that the SBY administration take real action this year on reforms affecting the business sector and civil service. Castle speculated that the DPR might produce tax law changes and a new investment law this year, but not labor law improvements.

On the relationship between economic growth and employment, Castle said that there is no direct correlation between the growth level and job creation. While 5.5% GDP growth creates “enough stimulus” to increase per capital income slowly, hard-core unemployment remains at about 10%. The key to employment generation seems to be in regional growth, while “globalization” impacts are small in affecting the broad Indonesian economy outside Jakarta. That said, there is still potential for social tension over employment concerns and it will be important for local governments to improve their delivery of services and leadership in economic development.

The regulatory structure to mobilize investment in infrastructure development is inadequate. Until there are improvements, we will not see much U.S. interest or real investment in this sector. The “new Asian powers,” however, will play a greater role as they are “more comfortable” with “relationship investing” rather than with “contractual investing.” This “Asian style” of investing will take the lead in areas that U.S. investors won’t, as it has differing expectations and faces lower hurdles. U.S. investment will continue to focus on mining, oil and gas, and financial services with the caveat that regulatory and legal issues are retarding new participation in the first two sectors.

Military reform is moving faster than civil service transformation. Strong armed forces (TNI) leadership is promoting reform and the Police are doing better under National Police commander General Sutanto. There are improved popular perceptions of Police performance.

On other matters:

- The Sidoarjo mud flow is an “environmental tragedy” and may be declared a natural disaster.
- Ethnic Chinese domination of the economy, estimated at 75-80% during Soeharto’s time, is no longer the case as ownership, management and investment are much more diffuse.
- Nationalistic tensions “basically are an elite phenomena” caused by political jockeying and obsolete monopolistic practices, including those of the state-owned enterprises (SOEs). Such political pressures make it difficult for the SBY administration to carry out structural reforms.