Big business spells out economic agenda for new Indonesian president

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In the lead up to his inauguration as Indonesian president tomorrow, Susilo Bambang Yudhoyono has remained tight-lipped about the make-up of his cabinet, and, as throughout the election campaign, any policy details. However, representatives of big business, inside Indonesia and overseas, have made clear that they expect his administration to impose tough new economic measures.

A closed-door meeting on October 13 attended by outgoing US Ambassador Ralph Boyce, Japanese Ambassador Yutaka Iimura and World Bank representative Andrew Steer spelled out the agenda to Yudhoyono. Those present were acting on behalf of the Consultative Group on Indonesia (CGI)—a group of donor countries and institutions that have pledged $2.84 billion in aid to Indonesia for 2004. Prior to the meeting, Boyce told the media that the discussion would focus on "ideas on winning investment" in preparation for a full CGI meeting.

No details were released after the meeting but business spokesmen have listed a series of demands including an end to corruption, legal reform to protect foreign investors, and the abolition of investment regulations. Since the end of the presidential election campaign, however, two clear priorities have emerged: the reduction or abolition of government fuel subsidies and amended labour laws to allow employers to sack workers more readily.

Yudhoyono is already signaling that his government will proceed along these lines. He has promised to fight corruption, stimulate the economy and review tax and labour laws that discourage foreign investment. Irzan Tandjung, one of Yudhoyono's principal economic advisers and chairman of his Democratic Party, has indicated that the new president will also review the fuel subsidy.

Any cutback to the fuel subsidy or changes to the labour laws will impact directly on the living standards of tens of millions of people—particularly the most impoverished social layers—and will have potentially explosive political consequences.

Subsidies on fuel and other basic necessities were among the concessions granted by the Suharto dictatorship to avert mass discontent and shore up its rule. In the wake of the 1997-98 Asian economic crisis, the IMF and World Bank insisted on the abolition of fuel subsidies as part of an extensive restructuring package. Suharto's decision to raise fuel prices in line with IMF demands heightened the protests that led to his resignation in 1998. After his fall, successive presidents have baulked at cutting fuel subsidies.

In 2000, President Abdurrahman Wahid attempted to increase fuel prices by 10 percent but was forced to back down after large-scale demonstrations in Jakarta. In 2003, President Megawati Sukarnoputri announced limited plans to cut back on subsidies on fuel and other essentials but dropped the proposals after a series of protests. This year, in a bid to boost her popularity prior to the election, Megawati pledged that the price of fuel and electricity would not rise.

The government plans to spend $US6.5 billion this year in subsidising the price of petroleum products—equivalent to more than twice its budget deficit. The subsidy has kept the price of fuel well below world prices with petrol currently costing just 20 US cents a litre in Jakarta.

The subsidy not only keeps the cost of motor fuel low. Tens of millions of poor Indonesians depend on gas or kerosene for their cooking stoves. Spending on cooking fuel is a large part of family expenditure and any price rise would have a dramatic effect on the cost of living. Big business, however, regards the subsidies as an intolerable drain on the government budget, particularly when the country's oil and gas could be sold on the world market at far higher prices.

With world oil prices of oil at more than $US50 a barrel and rising, the strain of the fuel subsidy on the national budget will only increase and undermine the reduction of the public debt that took place under Megawati. Writing on the *Bloomberg.com* website, analyst Andy Mukherjee, echoing the sentiments of other commentators, bluntly stated that "soon after his inauguration" Yudhoyono will "have to risk a popular backlash and raise fuel prices."

Mukherjee noted approvingly: "There's a strong indication that Yudhoyono may indeed make a reduction in the fuel subsidy his priority." He quoted Arfan Karniody, a

Jakarta investment firm manager, as saying: “Reducing oil subsidies will be in the right direction. It’s not a populist policy. If oil prices go up, people may object because everything will go up, electricity, even water” but it is a “necessary policy”.

Jakarta has also been reluctant to change the existing limited labour laws. There are already officially 40 million unemployed and underemployed throughout the country. In a bid to slow retrenchments, Megawati issued a presidential decree placing restrictions on the sacking of workers. But business leaders are demanding that such measures be scrapped.

At a major business conference this month, Singapore’s foreign minister George Yeo told a delegation from the Indonesian Chamber of Commerce and Industry that unfavourable labour laws, along with legal uncertainties and complex investment regulations, had to be changed to attract new investment. In 2003, Singapore companies invested $US692.4 million in Indonesia, making it the fifth largest source of investment funds.

What is galling to investors is the labour “inflexibility” caused by the relative high cost of sacking workers. According to the World Bank, companies pay an average of 157 weeks’ wages to sack an Indonesian worker—the highest cost anywhere in East Asia, apart from Laos. Yudhoyono adviser Irzan Tandjung told *Bloomberg.com* on October 1 that the changes to labour laws would be a priority for the new government.

Driving these policies is the country’s underlying economic crisis and growing competition for foreign investment, particularly from China. In the first seven months of 2004, foreign direct investment in Indonesia fell by a third to $US3.3 billion compared with the same period last year. The lack of investment in the oil industry has led to reduced production, transforming Indonesia this year into a net oil importer for the first time and compounding the country’s economic problems.

But any economic restructuring will have a savage impact on the living standards of the poor. About half the population lives on $US2 a day or less. Unemployment is likely to rise. Economists estimate that a growth rate of 6 percent is necessary to keep pace with the annual growth in the labour force. But the current growth rate is estimated at around 4.8 per cent.

In the course of the election campaign, Yudhoyono appealed to popular resentment and anger over the failure of Megawati’s administration to lift living standards. The former general presented himself as “a man of the people” and made vague populist pledges to improve the lot of the ordinary workers. In office, he will be compelled to implement measures that further undermine the social conditions of the masses.

The Time Asia website pointed to the political implications. After praising Megawati for slashing national debt, selling off state enterprises and reducing interest rates, it noted that “the toughest reforms—those that might threaten the interests of powerful bureaucrats and business leaders—have been left to Yudhoyono... Moreover, [Yudhoyono] appears to be on a collision course with his mainstay constituents, Indonesia’s working class.”

In comments to *Bloomberg.com*, Takeshi Kohno, a former Japanese diplomat in Indonesia, was just as blunt, declaring: “The labour issue and fuel subsidy problem—essentially a class issue—will be a test for Yudhoyono as he has to balance between populist policies and market-orientated policies... [he] will need to override temptations to fall in populist policies as they will irritate the market and investors.”

While Yudhoyono will announce his cabinet tomorrow, there are already strong indications that he has heeded the demands of international capital and chosen ministers known for their tough economic measures. According to the Singapore-based *Straits Times*, Yudhoyono’s economic adviser Irzan Tandjung or Megawati’s finance minister Boediono are likely to be appointed to the top economic post.

The implementation of economic austerity measures will rapidly dash the hopes of many of those who voted for Yudhoyono and will inevitably lead to social unrest. When that happens, Yudhoyono’s real political character as a leading figure in the Suharto military dictatorship that ruthlessly crushed any opposition to its rule will rapidly come to the fore.