SURVEY OF RECENT DEVELOPMENTS

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SUMMARY
The president reconstituted his cabinet in early December, focusing primarily on the economic team. The highly experienced Boediono was appointed as Coordinating Minister for Economic Affairs, while Sri Mulyani Indrawati was promoted from chair of the planning agency to become Minister of Finance. The former economics coordinating minister, Aburizal Bakrie, was made Coordinating Minister for Social Affairs—out of the economic limelight, but still with considerable influence. These changes overall have been well received by the markets, as indicated by a considerable strengthening of the rupiah.

The challenges facing the new cabinet remain immense, however. On a range of macroeconomic variables, performance has fallen well short of the government’s targets. Output growth declined to just 4.9% p.a. in the December quarter from 6.5% a year earlier. Investment growth has fallen to a very low level, giving rise to concern about the creation of job opportunities. In a booming global economy, exports grew by only 7.4% in the four quarters to December, despite Indonesia’s wealth of natural resources. The inflation rate doubled from September to October to almost 18% p.a., although subsequent price increases have been much slower.

The president’s anti-corruption campaign continues to generate much attention. The number of corruption cases involving government officials and state enterprise managers brought to the courts continues to increase. Some high-profile cases have resulted in convictions, but others have not. The campaign seems likely also to be extended to judicial reforms, which are clearly crucial, but one urgent issue yet to be tackled directly is the widespread suspicion that funding of major political parties derives largely from abuse of power by government officials.

Numerous floods and landslides early in 2006 resulted in deaths, injuries and considerable physical damage. The frequency of such natural disasters has risen significantly over time, suggesting that governments at all levels need to develop mechanisms to manage them and implement policies to mitigate or prevent them.

Reconstruction progress in Aceh and Nias during 2005 was disappointingly slow. The reconstruction authority predicts dramatic improvement in 2006, but there appears to be a need to clarify the relationships among its three components, and to make some adjustments to its master plan, particularly in relation to land use planning. A reallocation of available funds among major activities, better coordination of implementing organisations, and a rethinking of conflicts between the authority’s roles as implementation agency and coordinating agency may all be needed if the ambitious and urgent targets are to be met.
FINE-TUNING THE CABINET ECONOMICS TEAM

Having earlier raised the possibility of an October reshuffle of his cabinet in order to improve its performance (McLeod 2005a: 134), President Susilo Bambang Yudhoyono (SBY) at last announced a set of cabinet changes in early December (Kompas, 6/12/2005). That the reshuffle focused on the team of economics ministers was no surprise, since there had been a public perception for some time that the original team was somewhat ineffective, for various reasons. First, disbursements from the government’s budget were very slow (generating highly negative growth rates of government consumption in the first semester of 2005), such that many central government departments and regional governments could not utilise their budget allocations. Second, economic growth in 2005 had been modest and on a declining trend, and very little progress had been achieved in relation to Indonesia’s pressing need for improved and expanded infrastructure. Third, the decisions to increase domestic fuel prices considerably (in both March and October) had been unpopular, and even among those who agreed that the extremely costly fuel subsidies should be reduced there were concerns that the price increases should have been initiated sooner, and implemented in small steps rather than as two large jumps (Sen and Steer 2005: 285–8). Fourth, there was considerable unease in relation to possible conflicts of interest faced by the then Coordinating Minister for Economic Affairs, Aburizal Bakrie, because of his extensive business operations.

The key changes to the cabinet were the recall of Boediono, the highly regarded finance minister during the Megawati presidency (and planning minister in the Habibie government), to take over as economics coordinating minister from Bakrie, and the reassignment of Sri Mulyani Indrawati from her previous post as chair of the National Development Planning Agency (Bappenas) to the key post of finance minister, in place of the seemingly ineffectual Jusuf Anwar. Together with the Minister of Trade, Mari Pangestu, Boediono and Sri Mulyani are expected to take the lead in pushing for sound and prudent economic policies similar to those implemented by Soeharto era ministers led by Widjojo Nitisastro, with a strong focus on macroeconomic stability, rapid growth and poverty alleviation.

The delay in announcing the reshuffle mirrored the political difficulties faced by SBY in forming his original cabinet in October 2004 (Soesastro and Atje 2005: 6). Ever since the 2004 presidential election campaigns, it has been public knowledge that vice president Yusuf Kalla wanted to play a big part in formulating economic policy, especially in regard to government spending. This was probably the reason why Bakrie—perceived to be very close to Kalla—was appointed originally as economics coordinating minister. Kalla, now chairman of Golkar, the dominant party in the parliament (DPR), was able to mitigate his loss of economic clout by persuading SBY not to remove Bakrie from the cabinet, but rather to transfer him to become the new Coordinating Minister for Social Affairs, in place of Alwi Shihab of the PKB (Partai Kebangkitkan Bangsa, National Awakening Party). Since Social Affairs encompasses large departments such as Education and Health, Bakrie still retains a position of considerable importance, even though SBY would appear to have gained greater control over economic affairs through his appointment of Boediono.

Kalla’s position also seems to have been strengthened by other changes to the cabinet involving two Golkar members close to him, Fahmi Idris (Minister of...
Manpower until the reshuffle) and Paskah Suzetta (formerly chair of the Finance and Development Planning Commission in the DPR). Fahmi and Paskah were appointed to the portfolios of Industry and National Development Planning, respectively, in place of the under-performing Andung Nitimihardja, and of Sri Mulyani. Fahmi’s less influential Manpower portfolio was allocated to Erman Suparno from the PKB party, providing some compensation to PKB for the loss of Alwi Shihab’s position in the cabinet.

There is some expectation that the new cabinet will formulate more coherent policies than its predecessor, and avoid sending conflicting signals about the direction of the government’s economic reform agenda (Manning 2005). Initial indications are not entirely encouraging, however, especially in regard to some pronouncements of the new chair of Bappenas. Not long after his appointment to this position, Paskah raised the market-sensitive issue of rescheduling, and seeking partial forgiveness of, the government’s foreign debt, which runs counter to the policy of the economics coordinating ministry and the Ministry of Finance, and is outside the domain of the planning agency; ministers Boediono and Sri Mulyani were quick to distance the government from the proposal (Witular 2005a). A week later Paskah was in the headlines again for suggesting that the central bank (Bank Indonesia, BI) should make loans to the government to finance the budget deficit (Kompas, 28/12/2005), contrary to conventional wisdom on prudent monetary policy, and despite the fact that such lending is prohibited by article 56 of the central bank law (Law 23/1999 on Bank Indonesia).

Nevertheless, the markets seem to have taken little notice of these missteps, presumably on the assumptions that SBY will entrust these kinds of policy issues to Boediono and Sri Mulyani, and that these ministers can be relied upon to implement prudent and coherent economic policies. The fact that the currency has strengthened so greatly since the announcement of the new cabinet (from around Rp 10,000/$ on 5 December to Rp 9,245/$ on 21 February) would appear to support such a contention. Coming so soon after the drastic fuel price increases in October, this seems to lend weight to the view that Indonesia’s new democracy has successfully negotiated its first major test in relation to economic policy making—in that the SBY government has been willing to make a sensible policy choice in the face of widespread popular opposition, and that the general public has been willing, broadly speaking, to abide by the decision of its elected representatives.

MACROECONOMIC DEVELOPMENTS

Economic growth

The latest national income accounts data show that year-on-year gross domestic product (GDP) growth declined steadily from 6.5% p.a. in Q4 2004 to just 4.9% in Q4 2005 (table 1). It appears that the prospect of the election of SBY in September 2004 helped to generate considerable optimism on the part of the business community, manifested in a boom in investment in that year and a surge of output growth in the December quarter. But subsequent disappointment with the new government’s performance resulted in loss of this enthusiasm, and the growth spurt gradually lost momentum. The most recently recorded growth rate almost exactly matches that for the last quarter under the Megawati administration.
Previous Surveys provided some indications that economic performance would suffer as a result of political bargaining having determined the composition of the original SBY cabinet (rather than an attempt to appoint the best available candidates) (Soesastro and Atje 2005: 6), and of the delay in appointing a new cadre of top echelon officials in the bureaucracy to take responsibility for implementing the new government’s economic agenda (McLeod 2005a: 153–4). It is hardly surprising, then, that the original cabinet’s apparent lack of direction in setting out a clear agenda of economic reform, and its failure to demonstrate concrete progress and meet its major macroeconomic targets (table 2), have caused continuing uncertainty and clouded people’s expectations on the economy—all of which is crucial in making decisions on risky investments. To an increasing extent, therefore, investment seems again to be being put on hold.

### TABLE 1 Components of GDP Growth

(2000 prices; % p.a. year-on-year)

<table>
<thead>
<tr>
<th></th>
<th>Sep-04</th>
<th>Dec-04</th>
<th>Mar-05</th>
<th>Jun-05</th>
<th>Sep-05</th>
<th>Dec-05</th>
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<tr>
<td>Gross domestic product</td>
<td>4.9</td>
<td>6.5</td>
<td>6.3</td>
<td>5.6</td>
<td>5.6</td>
<td>4.9</td>
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<tr>
<td><strong>By expenditure</strong></td>
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<tr>
<td>Household consumption</td>
<td>5.1</td>
<td>3.9</td>
<td>3.4</td>
<td>3.8</td>
<td>4.4</td>
<td>4.2</td>
</tr>
<tr>
<td>Government consumption</td>
<td>-1.8</td>
<td>0.4</td>
<td>-9.6</td>
<td>-6.7</td>
<td>14.7</td>
<td>30.0</td>
</tr>
<tr>
<td>Investment</td>
<td>20.2</td>
<td>16.1</td>
<td>14.1</td>
<td>15.6</td>
<td>9.4</td>
<td>1.8</td>
</tr>
<tr>
<td>Exports</td>
<td>19.2</td>
<td>19.4</td>
<td>11.8</td>
<td>11.2</td>
<td>4.8</td>
<td>7.4</td>
</tr>
<tr>
<td>Imports</td>
<td>32.0</td>
<td>29.7</td>
<td>18.8</td>
<td>17.9</td>
<td>10.6</td>
<td>3.7</td>
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<tr>
<td><strong>By sector</strong></td>
<td></td>
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</tr>
<tr>
<td>Agriculture, livestock, forestry &amp; fisheries</td>
<td>3.8</td>
<td>-1.8</td>
<td>1.1</td>
<td>0.9</td>
<td>2.9</td>
<td>5.5</td>
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<tr>
<td>Mining &amp; quarrying</td>
<td>-6.1</td>
<td>5.3</td>
<td>4.1</td>
<td>-0.5</td>
<td>1.0</td>
<td>1.9</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>5.0</td>
<td>7.4</td>
<td>6.3</td>
<td>4.9</td>
<td>4.5</td>
<td>2.9</td>
</tr>
<tr>
<td>Excluding oil &amp; gas</td>
<td>6.0</td>
<td>8.7</td>
<td>7.5</td>
<td>6.2</td>
<td>5.7</td>
<td>4.1</td>
</tr>
<tr>
<td>Electricity, gas &amp; water supply</td>
<td>2.0</td>
<td>5.0</td>
<td>6.4</td>
<td>6.9</td>
<td>6.6</td>
<td>6.1</td>
</tr>
<tr>
<td>Construction</td>
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<td>7.4</td>
<td>8.2</td>
<td>6.9</td>
<td>6.9</td>
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<tr>
<td>Trade, hotels &amp; restaurants</td>
<td>6.7</td>
<td>9.3</td>
<td>9.9</td>
<td>10.0</td>
<td>8.6</td>
<td>6.0</td>
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<tr>
<td>Transport</td>
<td>10.7</td>
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<td>10.3</td>
<td>7.7</td>
<td>5.2</td>
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</tr>
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<td>Communications</td>
<td>23.3</td>
<td>21.8</td>
<td>21.6</td>
<td>25.7</td>
<td>27.4</td>
<td>25.4</td>
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<tr>
<td>Financial, rental &amp; business services</td>
<td>9.0</td>
<td>8.7</td>
<td>6.7</td>
<td>8.9</td>
<td>7.9</td>
<td>5.2</td>
</tr>
<tr>
<td>Other services</td>
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<td>5.5</td>
<td>4.6</td>
<td>4.4</td>
<td>5.6</td>
<td>6.0</td>
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*Source: CEIC Asia Database.*
There has been no sudden cutback of investment as occurred at the peak of economic crisis in 1998, but there has certainly been a considerable loss of momentum. Whereas investment had been growing at year-on-year rates of 14–16% p.a. for the first three quarters of the SBY administration, the rate fell to 9% in Q3 2005 and then to below 2% in the December quarter. This latest result is sobering, being well below the average investment growth rate of 3.5% recorded under the Megawati government. Moreover, the rate has fallen, for the first time under SBY, to well below the GDP growth rate.

As a consequence, the ratio of investment to GDP, which had been moving back toward the typical levels of 25–30% during the pre-crisis period, has now stagnated at around 22%, which does not bode well for the creation of new employment opportunities for the growing workforce. As 2005 drew to a close, there were many newspaper reports of companies laying off workers. For example, the high-profile food manufacturer Indofood revealed in December that it was in the process of reducing its workforce by at least 3,500 during 2005, from about 50,000 at the start of the year (JP, 15/12/2005). Whether announcements such as these reflect a broader trend is very difficult to know, however, since unemployment data are published only at half-yearly intervals, and with a rather long lag. Nevertheless, according to the most recent labour force survey data, the number of unemployed at the national level has indeed been increasing far more rapidly than the size of the workforce—by about 5.9% between August 2004 and February 2005, from 10.3 million to 10.9 million. The cabinet reshuffle in December seems to have done something to rejuvenate public optimism, but it remains to be seen whether the government can convert this renewed optimism into increased investment and job opportunities, and faster economic growth.

Household consumption, which accounts for about two-thirds of GDP, has been growing only modestly since SBY came to power, at rates around 3.4–4.4% p.a.; this also creates a drag on GDP growth. On the basis of the latest data, the large increases in fuel prices at the beginning of October do not appear yet to have had any major impact on consumption growth, which declined almost negligibly in the December quarter. By contrast, there has been an extraordinary turnaround in government consumption spending as the government attempts to correct

<table>
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<th>TABLE 2  Macroeconomic Expectations and Outcomes</th>
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<td>Budget Assumptions for 2005</td>
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<tr>
<td>Economic growth (% p.a.)</td>
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<td>Inflation (% p.a.)</td>
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<td>Exchange rate (Rp/$)</td>
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<tr>
<td>Interest rate (90-day SBI, % p.a.)(^b)</td>
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</tbody>
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\(^a\) Budget assumptions agreed between government and DPR in mid-2005 (McLeod 2005a: 139); averages, except for growth.

\(^b\) SBI: Sertifikat Bank Indonesia (Bank Indonesia Certificate).
its earlier failure to spend as planned in the budget. The sudden acceleration of budget disbursements resulted in a huge jump in the growth rate of this item, from -9.6% and -6.7% in Q1 and Q2 2005, respectively, to 14.7% and 30.0% in the third and fourth quarters.

On the external side there has been considerable volatility in export and import growth rates, both of which were much slower in the second semester than the first (which itself recorded rates well down on the second semester of 2004). It is disappointing, in a booming global economy, that Indonesia’s exports are performing so poorly; the impact on aggregate demand is largely offset by the parallel decline in the supply of imports, however.

The breakdown of the GDP data shows growth close to the average in the last half year in most sectors (table 1). Others stand out for poor performance. The mining and quarrying sector has seen little growth during this period, which is extraordinary given the concurrent global natural resources boom. The dominant oil and gas subsector has continued to post negative growth rates over the last several years, but it is too soon to know whether the recent large reduction in subsidies to domestic fuel consumption will have a positive impact on exports. The poor performance of the natural resources sector may be attributable to factors such as cumbersome investment regulations, the long delay in enacting a new mining law, and the government’s failure to resolve the issue of who will develop the Cepu oil field.1

Manufacturing has been slowing down throughout the SBY period, and the extremely rapid growth in air transport services noted by McLeod (2005a: 134–5) has now lost its momentum as the industry consolidates; the transport sector as a whole grew by only 2.6% in the year to the December quarter. On the other hand, the communications sector continues to record astonishingly high growth rates, and the volatile agriculture, livestock, forestry and fisheries sector has rebounded strongly from earlier low or negative growth rates; within this group it is notable that the forestry subsector is now growing positively, after seeing its output fall by some 16% in the year to December 2004.

Foreign capital flows
Data from the capital account of Indonesia’s balance of payments show very high inflows of portfolio investment in Q3 2005, amounting to some $3.7 billion (table 3). This was almost fully offset, however, by the outflow of direct and other investment. It is difficult to know how to interpret these data because of the huge errors and omissions item in the balance of payments overall, but the seemingly high level of portfolio investment inflows over the year to Q3 2005 is striking. These flows are presumably a useful indicator of large-scale and foreign business sentiment, and market data (not yet evident in the comparatively out-of-date balance of payments figures) suggest continuing or increased high inflow following the cabinet reshuffle. This has contributed to the considerable strengthening of the rupiah in December 2005 and beyond. As additional data become available

1 Sen and Steer (2005: 299) reported that an agreement in principle had been reached between Pertamina (the state oil company) and ExxonMobil, but by February 2006 the dispute over who will operate the Cepu oil field seemed no closer to resolution (Nirang 2006).
it will be interesting to see whether this inflow of portfolio investment has been accompanied or followed by a decline, or turnaround, in the foreign direct investment and other investment items.

Exchange rate
The exchange rate held steady at a little over Rp 10,000/$ for most of October and November 2005. The cabinet reshuffle in early December generated positive sentiment, resulting in a modest strengthening in December, prior to a much more noticeable gain in early January and continuing modest appreciation thereafter. The rupiah ended the year valued at around Rp 9,900/$, improving to about Rp 9,500/$ by mid-January, and to Rp 9,230/$ a month later. The overall increase in the external value of the currency from early December through mid-February was thus around 9.1%. No doubt this was also partly the result of Bank Indonesia’s decision to hold the one-month SBI (Bank Indonesia Certificate) rate at 12.75% (see below)—far more attractive to investors than the rates prevailing in mid-2005.

Fiscal impact of the domestic oil price increase
According to Ikhsan (2005)—a special staff member (staf khusus) at the Coordinating Ministry for Economic Affairs at the time of the domestic oil price hike—the government was well justified in increasing fuel prices so dramatically, because about 82% of the fuel subsidies budgeted for 2005 constituted a wasteful handout to those in the top 60% of the income distribution. The net fiscal impact of the price adjustment is substantial. After subtracting funds needed for the direct cash transfer program to poor households (Bantuan Tunai Langsung, BTL) (Sen and Steer 2005: 288–91) and other compensation programs, it will free up Rp 30–35 trillion ($3–3.5 billion) for other kinds of spending in 2006.2

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2 Ikhsan noted, however, that domestic prices have not been tied to world prices, and estimated that if the average world oil price stays between $60 and $70 per barrel, the residual subsidy will jump to something of the order of Rp 50 trillion in 2006.
Referring to the 2006 annual planning document (Rencana Kerja Tahunan 2006), Ikhsan suggested several areas in which spending could well be increased, aside from the Rp 10 trillion cost of a planned 20% increase in civil servants’ salaries. These included poverty alleviation, education, health services, basic infrastructure (especially at the village level), agriculture, and defence and security. Within education, such spending might be directed to items such as library improvement, distribution of free textbooks, a scholarship program for children from poor families, rehabilitation of school buildings, and increased allowances for teachers. The village infrastructure rehabilitation program might be greatly expanded, from the current 10,000 villages to 30,000. In line with the president’s instructions, defence and security expenditures could be focused on improving the welfare of ordinary soldiers: for example, through an increase in daily food allowances, upgrading of barracks and provision of more uniforms. Funds allocated to the purchase of military equipment could be directed to domestically produced items, in order to create more employment opportunities.

It is to be hoped that the suggested expansion of the programs described in the 2006 planning document will have significant positive impacts on these parts of the economy and the military. The only cause for concern is that, with the easing of the overall budget constraint resulting from the large cuts in fuel subsidies, officials in these and other parts of the public sector may find it preferable to accommodate less deserving expenditure requests, such that the planned priority list may be compromised to a greater or lesser extent.

Inflation
The inflation outcome for October 2005 caught the government and most, if not all, observers by surprise. The CPI increased by 8.7% in that month alone, bringing the year-on-year rate to 17.9%, up from just 9.1% in September (figure 1). It had been widely expected that the rise in domestic fuel prices at the beginning of the month—by around 114% on average (Sen and Steer 2005: 285)—would have a significant impact. However, the predicted increase in the CPI, taking into account the presumed pass-through effect of these rises in the fuel cost component of prices in the production and distribution sectors, was considerably less than the figure actually reported. In seeking an explanation, many commentators turned their attention to the role of inflationary expectations: that is, the possibility that prices rose so much simply because of a widespread expectation that the fuel price increases would have this effect, thus making it a self-fulfilling prophecy. Almost overnight, discussions of inflationary expectations began to flourish in various newspapers.

At the same time, others questioned the accuracy of the official data, and the central statistics agency (BPS) came under pressure to rethink, or at least explain, its methodology for recording prices. Disaggregating the October CPI increase showed that the transport, communications and financial services component was by far the highest contributor, rising by 28.6%; within this group, transport services increased by some 41.7%. As it happens, this almost exactly matches the public bus fare increases of 25–58%—a simple average of 41.5%—approved by the Jakarta city administration on 5 October, which became effective the following day (JP, 5/10/2005). This interesting coincidence raises the possibility that BPS relied very heavily on regulated Jakarta bus fares as its indicator of the price of
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transport services, even though it claims to survey all modes of transport, including motorcycle taxis (oji), in some 45 cities.

Bearing in mind that fuel accounts for only a fraction of the total costs of providing transportation services, it would seem that the increases determined by the Jakarta city government sought not only to cover the fuel price increases but also to rectify the negative impact on quality of service of artificially low regulated bus fares. Profits in public transport, particularly buses and mini buses, have long been depressed as a result of the low fare structure imposed by local governments in agreement with the land transport organisation (Organda) (the presumed quid pro quo for which is continued protection of bus operators from new competitors).

With these considerations in mind it is important to note that the increase in bus fares appears to have been a one-off, opportunistic correction of the price of transport services relative to other prices: it does not imply the continuation of a high rate of inflation. Indeed, if we look at price increases over the three months to the end of January 2006, we find that all components of the CPI other than food, and processed food and beverages, have recorded annualised inflation rates not markedly different on average from those of early 2005; on this basis, the inflation rate of the CPI as a whole had already fallen to just 11.0% p.a. by this time.

Another possible explanation for the surge in inflation in October, which has been largely overlooked, is rapid growth of the money supply (figure 1). Analysis of this issue is made difficult by the fact that the fuel price increase happened to coincide roughly with the fasting month and the approach of the Lebaran celebrations, at which time consumer spending and the demand for cash on the part of

\[ \text{FIGURE 1 Inflation, Interest Rates and Money Growth}^a \\
\text{(\% p.a.)} \]

\[a \text{ Currency is cash in the hands of the non-bank public; SBI is the 1-month SBI (Bank Indonesia Certificate) rate; CPI is inflation of the consumer price index.} \]

\textit{Source: CEIC Asia Database.}
the general public increase significantly. It is not unreasonable for the central bank to increase the supply of cash to the public at such times, but BI has also suggested in the past that it favours determining its monetary policy on the basis of what is happening to ‘core inflation’ rather than ‘headline’ inflation of the CPI (Alamsyah et al. 2001: 315–16). The practical implication of this is that when ‘administered prices’ (such as those of fuels) are increased, BI will loosen its monetary policy in order that the resulting increase in demand for money does not put downward pressure on the core inflation rate (McLeod 2003: 318).

Arguably, both these factors came into play prior to, and at the time of, the fuel price increases. Currency in the hands of the public (the major component of base money) increased at annualised rates of no less than 88% and 540% in the months of September and October, bringing the respective year-on-year growth rates to 15.6% and 26.9%. Such rapid monetary expansion calls into question the degree to which the central bank may have contributed to the October inflation surge, for which the government has usually been blamed.

BI itself preferred to blame the high inflation rate in October on inflationary expectations in the aftermath of the oil price hike, ignoring the possibility that its own monetary policy at the time would have served to validate such expectations. In any case, it immediately took corrective action, raising the one-month SBI rate at first from 11.00% in October to 12.25% p.a. on 1 November, and then to 12.75% in December. Currency with the public fell back during November to its September level, and the CPI has increased very little since October. Concerns have been raised recently about the prospect of a resurgence of inflation in response to planned increases in civil servants’ salaries and electricity tariffs, but these fears seem needlessly pessimistic. Unfortunately, however, they appear to have led to a decision to postpone yet again the long called-for electricity tariff increases, which can be expected to delay further the urgently needed expansion of power generation capacity.

ANTICORRUPTION EFFORTS

With Indonesia’s democratisation, corruption has become a pre-eminent political issue, manifested in frequent exposés of corruption cases in the press, indictments of government officials and both formal and informal political leaders for corruption, and anti-corruption campaigns by government and non-government organisations (NGOs). On the government side, two of the key agencies are the Corruption Eradication Commission (KPK) and the Coordinating Team for Eliminating Crimes of Corruption (Timtas Tipikor) (McLeod 2005a: 152; Sen and Steer 2005: 300).

Indonesia Corruption Watch is perhaps best known among the anti-corruption NGOs. Its coordinator, Teten Masduki, reported that about 450 corruption cases were dealt with by the courts during 2005, a significant increase on the 200-odd cases brought before the courts during the whole of the Megawati presidency (July 2001 to October 2004). It is noteworthy that the majority of these cases involved officials of regional governments rather than the central government (Pikiran Rakyat, 20/10/2005; Kompas, 17/11/2005), reflecting the fact that President SBY has permitted 7 province governors, 36 district (kabupaten) heads, 8 district deputy heads, 9 mayors and 2 deputy mayors to be investigated for corruption (RRI-Online, 2/2/2006).
The political consequences of tackling corruption are of considerable moment, so it is perhaps no coincidence that the first phase of SBY’s anti-corruption drive has focused mainly on cases in the provinces and districts. Even so, these regional cases sometimes have involved top-level officials—most notably the former governor of Aceh, Abdullah Puteh, who has been sentenced to 10 years imprisonment (McLeod 2005a: 152). By contrast, the power of top national political leaders and government officials appears to be still too strong for the government to prosecute its anti-corruption drive effectively at this level. An interesting example is that of Golkar functionary and chairman of the Primary Cooperatives Association, Nurdin Khalid (JP, 17/12/2005). Nurdin was acquitted in June 2005 of charges of misusing a Rp 169 billion fund for cooking oil from the national logistics agency (Bulog), and is currently appealing his sentence in August to two-and-a-half years imprisonment for smuggling 59,100 tons of rice. In December he was charged again, this time with smuggling 70,000 tons of sugar, but the judges found the indictment against him to be legally flawed, raising widespread suspicion of political intervention in the case by Golkar officials.

Another example is the recent arrest of four tax officials in a North Jakarta tax office, along with a number of customs officials based at Jakarta’s port, Tanjung Priok. The arrests related to collusion between the officials and a number of business people in order to obtain VAT refund payments amounting to some Rp 19 trillion ($2 billion), based on fictitious exports (Witular 2006). Faisal Basri, a prominent economic observer, immediately highlighted this case as an opportunity for the government to clean up both the taxation and customs offices, citing widespread corruption and abuse of power in these organisations, and calling for the immediate dismissal of the directors general of Taxation and Customs and Excise (Basri 2006). Although not denying the possibility that there were leadership problems in the taxation office, the Minister of Finance was prepared to give its director general the opportunity to improve its performance (Kompas, 13/1/2006). This familiar outcome underscores one of the most serious obstacles to the anti-corruption drive: it is extremely difficult to dismiss high-level civil servants for reasons of poor leadership or general performance, or even if they are found guilty of corruption.

Although the effort to eradicate corruption hitherto has mainly targeted individuals lacking strong links to top government officials and political leaders, the increasing number of successful prosecutions in the regions provides some cause for optimism that these efforts may be replicated at the national level. Indeed, there is now a growing number of corruption cases before the courts that can be described as national in character. For example, the Minister of Religious Affairs in the Megawati government, Said Agil Hussein Al Munawar, was recently sentenced to five years imprisonment for siphoning off millions of dollars from payments to the government by Muslims undertaking the hajj pilgrimage (Agence France Presse, 7/2/2006). Several former or current directors of state enterprises are also facing prosecution for corruption. On the other hand, anti-corruption efforts appeared to suffer a setback with the acquittal of the president and two other directors of the state-owned Bank Mandiri on corruption charges (JP, 21/2/2005). The basis on which the charges had been overturned had yet to be explained at the time of writing.
Political parties and corruption

One urgent issue that has yet to be dealt with openly in newly democratic Indonesia is how political parties finance their activities. It is widely suspected that their major funding derives from abuse of power by corrupt government officials. This is similar to what happened during the Soeharto era, when many government regulations and policies were the focus of rent-seeking activities to provide funding for the regime (Kuncoro and Resosudarmo 2004)—or ‘private taxation’, in McLeod’s terminology (McLeod 2005b: 369–71).

The possibility of government funds flowing to parties’ coffers is exemplified by the corruption case involving Theo Toemion, former head of the Investment Coordinating Board (BKPM). Toemion was arrested recently for alleged misuse of funds that had been allocated to ‘Indonesia Investment Year’ projects in 2003 and 2004. Of Rp 48 billion set aside for these projects, only Rp 7.4 billion was actually used; the rest was allegedly transferred to the personal accounts of Toemion and others (Antara News, 28/12/2005). There is widespread suspicion that much of this money was channelled to his party (and that of former president Megawati, PDI-P), although Toemion has denied this (Herlina 2005).

It is also widely believed that the DPR is another major conduit through which parties are gaining access to funding. Thus the 2005 Global Corruption Barometer survey conducted by the international anti-corruption NGO, Transparency International, showed that the general public in Indonesia put political parties and the DPR at the top of the list of institutions suspected of involvement in corrupt activities (along with, or closely followed by, the police, the customs service, the judicial system and the tax office) (Transparency International 2005: annex 1). Reportedly there are middlemen (calo) who can influence the decisions of members on appointments to important public offices, the allocation of expenditures in the government’s budget, the speed at which draft legislation is processed and so on, in return for bribes (JP, 30/9/2005). Funds received are thought to be used both to finance political activity and to supplement members’ incomes.

Judicial reform

Combating corruption is considerably more complicated when the legal system that is supposed to enforce the law is itself plagued by corruption, as the survey just mentioned suggests. A recent bribery scandal involving the Chief Justice of the Supreme Court, Bagir Manan, and a wealthy businessman, Probasutedjo (half-brother of former president Soeharto), hints that corruption may reach to the highest position in the judicial system. Probasutedjo claimed to have attempted indirectly to bribe the Chief Justice in order to have his earlier conviction on corruption charges overturned, although it has not been proven that the alleged bribe offer was either made or accepted (Rukmahantara 2005).

Against this background there are some signs that SBY intends to undertake significant judicial reforms. August 2005 saw the establishment of a Judicial Commission to monitor the performance of courts and judges, although it has quite limited powers (Sen and Steer 2005: 300). Another reform, foreshadowed by the president during a visit to the Supreme Court office in December, is to increase the salaries of judges at all levels, but the extent of these increases has yet to be
announced. These signs provide only limited grounds for optimism, however. As the head of the Judicial Commission, Busyro Muqoddas, has commented, after decades of neglect the ‘court mafia’ culture has become deeply entrenched, and what is really needed is a rapid improvement in the quality of human resources among the judiciary (Kompas, 21/12/2005).

Decentralisation as an anti-corruption instrument
Sen and Steer (2005: 300) reported some preliminary data suggesting that anti-corruption campaigns might be having some impact on corruption at the local (particularly district) level. Along with these campaigns, it is hoped that the process of decentralisation (that is, devolution of many central government responsibilities to lower levels of government) will itself contribute to a reduction in corruption in the regions. With decentralisation, local governments become responsible for certain tasks specific to their respective jurisdictions, and the expectation is that more direct accountability should create an incentive for improvement of their performance—one aspect of which is reduced prevalence of corrupt behaviour (Persson and Tabellini 2004). Local governments that appreciate the importance of attracting businesses and investment to their regions will also understand that business people and investors will be reluctant to commit themselves to regions in which corrupt officials are likely to impose heavy costs on their operations. In the end, competition among Indonesia’s several hundred local governments to attract businesses and investors may well prove a more effective means of discouraging corrupt behaviour than slow-moving anti-corruption campaigns relying on detection and punishment of offenders.

An unintended impact
While there are obvious and strong reasons for wanting to rid the public sector of corrupt practices, many government rules and regulations can be turned into political weapons or instruments of bureaucratic extortion by using them to support allegations of misconduct against target officials, even in the absence of corrupt behaviour. For this reason there is an unintended and unwanted impact of the current anti-corruption drive, in that government officials and state enterprise managers—in particular, those who doubt the strength of support they can expect from political leaders or high-ranking officials—have become very cautious, and this has resulted in long delays in making important decisions. In turn, this bureaucratic inertia—for example, in relation to infrastructure development and natural resource exploitation—weighs heavily on economic growth.

DELAYS WITH KEY NEW LEGISLATION
New tax laws

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3 Judges’ salaries currently range from just Rp 2.2 million to Rp 24.4 million ($240–2,650) per month (Kompas, 21/12/2005).
proposed for these tax laws, and noted concerns that power had been shifted further to the tax collector, an institution ‘perceived to be corrupt and predatory’. Officials in other areas of the bureaucracy have little difficulty in finding reasons for withholding the issue of permits of all kinds as a means of extorting bribe payments (Kuncoro 2004: 337), and the concern here is that the draft tax laws put excessive and unchecked power in the hands of tax officials. The Indonesian Chamber of Commerce and Industry (Kadin) has since claimed that the submitted draft was not the one it had agreed on with the ministry at the drafting stage, but was full of last-minute changes that reflected the influence of vested interests within the tax directorate (Witular 2005b).

These concerns continue to delay enactment of the new laws. Examples include the following. Art. 30 of the draft Law on General Rules on Taxation Procedures authorises the tax office to order banks to freeze the accounts of anyone suspected of committing a crime, without any apparent check on the validity of such suspicions. Art. 35 requires banks, tax consultants, and anyone related to a taxpaying individual or organisation under examination for alleged tax evasion, to provide evidence and personal information about that taxpayer. And, in the case of a dispute between a taxpayer and the tax office over the amount of tax liability, resolution of the dispute is entirely at the discretion of tax officials (art. 36); this creates an environment bound to encourage face-to-face negotiations and unofficial deals.

With the inclusion of these kinds of stipulations in the draft laws, it is hardly surprising that cooperation from the business world has turned to opposition. The general public, including the foreign business community, has expressed concern over several provisions in the proposed new laws. Five former ministers of finance have testified before the DPR that if these bills are passed in their present form—especially the revision of the Law on General Taxation Arrangements and Procedures—this will force potential taxpayers into hiding, scare away potential investors, and encourage existing investors to consider leaving Indonesia (Koran Tempo, 29/11/2005). Mounting opposition is delaying deliberation of the new laws, forcing the intended overhaul of the tax regime to be postponed until 2007, but there is some hope that, with a new finance minister, the government may decide to accommodate the demand for a more taxpayer-friendly tax regime (Witular 2005b). The risk here, however, is that Indonesia will simply continue to collect a far lower revenue yield than is theoretically available from its various tax bases.

New customs and excise laws
Draft amendments to Laws 10/1995 and 11/1995 on Customs and Excise were also submitted in August 2005, and are now being considered by the DPR. Unlike the proposed new tax laws, these have attracted little public attention, perhaps because they do not affect individual citizens directly. However, their impact on the welfare of the general public could be significant, considering their potential effect on the costs of conducting international trade, where the importance of keeping logistical costs low has increased greatly over the past 10 years (Basri 2005: 45). Efficiency in the customs service is a prerequisite for maximising the benefits from a country’s participation in global trade transactions.

According to James (2005), the draft amendments address the following issues: prevention and deterrence of smuggling and customs fraud; consistency of Indonesian import duties with rates in the World Trade Organization (WTO) agreement
on import duties; customs supervision of certain items that may be used for illegal activities and terrorism; and improving customs services for legitimate traders. A positive development is the possibility of appeal if there are disputes and disagreements between customs and importers or exporters over the classification of goods, their valuation (and, hence, the amount of duty owed), and the responsibility for errors and omissions. Until now, disputes of this kind have been used by corrupt customs officials as a means of extorting bribes from importers and exporters.

The proposed new amendment purports to handle such disputes in a fair and transparent manner, but James also argues that it contains several grey areas that may reflect an intention on the part of the customs service to maintain, and even extend, its bureaucratic power. For example, art. 1 includes a provision for customs supervision of ‘certain goods’ (for example, illegal drugs and materials that may be used to produce them, or items that may be used in terrorist attacks). Owing to the vagueness of the definition of ‘certain goods’, this article in effect allows customs to interfere with internal (domestic) trade if it is deemed necessary. Given the poor reputation of the customs service in Indonesia, it is doubtful that this measure will enhance national security, but it will almost certainly increase bureaucratic harassment of legitimate business activity, adding to the difficulties of doing business in Indonesia.

Other issues pertaining to the draft law concern fines and penalties. Entities that deliberately fail to pay duties for which they are liable face fines ranging from 50% to 1,000% of the underpaid amount (arts. 16 and 17). The upper limit of this range is well in excess of the international standard of triple damage (i.e. a 300% penalty), however, and the broadness of the range allows great scope for negotiation between corrupt customs officials and importers, giving the impression that the customs service wishes to retain its power of extortion (LPEM–UI 2005). There have been some efforts already to eliminate, or minimise, direct interactions between customs officials and importers that create opportunities for solicitation for, and offers of, bribes (JICA 2005). The electronic data interchange (EDI) system introduced in 1997 was intended to minimise face-to-face contact between importers and officials. Despite the adoption of the EDI system, however, businesses point out that every import shipment still requires contact with officials (whether by a company employee or the company’s shipping agent) to submit hard copy documents. The customs service responds that hard copy documents are still needed because electronic data may not suffice as evidence in case of disputes, since there is no law on digital signatures, electronic documentation and so on (LPEM–UI 2005). Thus in the end the customs clearance process in Indonesia is still lengthy in comparison with that in other countries (JICA 2005: 251). As is the case with the tax laws, this example suggests that improved performance in the administration of the customs service may have to await more fundamental reform of the civil service (McLeod 2005b); modifying the content of the customs and excise laws is unlikely to make much difference.

**NATURAL DISASTERS**

The months of December and January were characterised by frequent heavy rainfalls, some of which resulted in serious flooding and landslides. Approximately 100 people died on 2 January in a huge flood in Jember, East Java, and heavy rains
caused a landslide the next day in Banjarnegara, Central Java, in which, again, more than 100 people died (Kompas, 7/1/2006). Reports of numerous floods and landslides in various places continued through this period—particularly in more heavily populated Java—resulting in damage to thousands of houses and vast areas of agricultural land, and displacing thousands of individuals (table 4). Paddy fields were destroyed in many areas, significantly reducing the rice harvest and thus contributing to the increase in rice prices (Suara Pembaharuan, 18/1/2006, Kompas, 30/1/2006). The crucially important highway along the northern coast of Java was cut in several places, disrupting the flow of commodities and people (Kompas, 30/1/2006).

Figure 2 shows that the frequency of floods and landslides has increased dramatically since the 1950s. Scientists argue that the main explanation for this is extensive, rapid deforestation, which has severely reduced the capacity of the landscape to absorb rain water: that is, it can be attributed mainly to failure to manage this aspect of the ecosystem properly. According to Otto Soemarwoto, former director of the

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4 floods occurred in 19 provinces and destroyed approximately 85,000 ha of paddy fields, resulting in the loss of approximately 224,000 tonnes of unhusked dry rice (gabah kering) at harvest time (Antara News, 1/2/2006).
Centre for Research on Natural Resources and the Environment at Bandung’s Padjadjaran University, the capacity of Java’s ecosystem to lessen and slow down the runoff from rainfall has declined by around 60% (Kompas, 7/1/2006).

So far there has been little or no serious attempt to prevent, or mitigate the damage caused by, flooding and landslides, and when these occur there are no clear procedures for conducting rescue and relief activities. The two main agencies currently responsible, Bakornas PBP (the National Coordination Agency for Disaster Mitigation and Refugee Management) and the Department of Social Services, are relatively weak and do not have sufficient capacity to handle natural disasters, particularly when they occur on a large scale throughout the country.

Considering that floods and landslides—not to mention other natural disasters such as earthquakes and tsunamis—frequently cause severe damage, injury and loss of life in Indonesia, the development of mechanisms and systems for the prevention, detection and management of natural disasters should be given high priority by governments at national, provincial and local levels. A principal emphasis should be on conservation and better management of the environment, especially through the properly enforced regulation of land use. Institutions such as Bakornas PBP need to be strengthened in order that they can more effectively detect incipient disasters, implement early warning systems relying on modern monitoring technologies, and significantly expand their capacity to manage the impact of such disasters (Resosudarmo 2005). Education programs in schools

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\[\text{FIGURE 2} \quad \text{Frequency of Floods and Landslides Involving Significant Loss of Life}\]

\begin{figure}
\centering
\includegraphics[width=\textwidth]{frequency_of_disasters.png}
\caption{Frequency of Floods and Landslides Involving Significant Loss of Life$^a$}
\end{figure}

$^a$ The data refer to episodes in which at least 10 people were killed, or at least 100 people were affected, and show totals for the periods in question.

should be widened to include the study of the nature and causes of natural disasters, and of how best individuals can protect themselves from them.

**RECONSTRUCTION PROGRESS IN ACEH AND NIAS**

Previous Surveys have reported on the earthquake and tsunami that devastated Aceh province and parts of North Sumatra on 26 December 2004, and another earthquake on 28 March 2005 that caused wholesale destruction on the island of Nias, also in North Sumatra. The government’s lead agency for handling the recovery effort is the Aceh–Nias Rehabilitation and Reconstruction Agency (BRR, Badan Rehabilitasi dan Rekonstruksi NAD [Nanggroe Aceh Darussalam] – Nias). Various other government agencies, as well as around 120 international NGOs, 430 local NGOs, dozens of donor country agencies and several United Nations agencies are also participating in the reconstruction effort.

The relative priorities accorded to recovery efforts in several broad fields are shown in figure 3. The emergency phase, involving urgent treatment of the injured, provision of temporary accommodation facilities, clearing of debris and so on, has long passed, and the strong emphasis for 2006 will be on housing construction. Looking further ahead, the restoration of physical and social infrastructure will become the top priority, and will extend over the next two to three years. The rather nebulous ‘livelihoods and business’ field has a similar time profile of activity, but is seen as requiring less intensive effort.

Table 5 summarises the main damage and losses resulting from these natural disasters, and progress so far with restoration. Of particular concern is that, by the end of 2005, only about 16,000 of perhaps 110,000 new houses needed had been built, along with 335 of 2,000 new school buildings, and 38 health centres and hospitals compared with about 120 destroyed. BRR and its international partners acknowledge that progress in 2005 was rather slow, but have promised that the pace will be much faster in 2006 (BRR and International Partners 2005).

**Challenges**

This somewhat optimistic outlook should be seen against the background of a number of difficult challenges that confront the BRR in the process of rehabilitating and reconstructing Aceh and Nias, however.

*Relationships among components of the BRR*

A first challenge concerns the relationships among the three bodies that comprise the BRR: the Executing Agency, headed by the highly respected former Minister of Mines and Energy, Kuntoro Mangkusubroto, the Advisory Board, chaired by the Coordinating Minister for Political and Security Affairs, and the Oversight Board, chaired by Abdullah Ali, a former rector of Syah Kuala University in Aceh. Members of the Oversight Board have been reporting problems in the field on the basis of advice from local people and NGOs—such as houses being built too close to the coastline, without proper water supply and sanitation systems, and with key specifications at odds with the expectations of their intended occupants. There has been little response on the part of the Executing Agency to these reports, however,\(^5\) so it

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\(^5\) Based on interviews in January 2006 with several members of the Oversight Board.
would seem worthwhile to strengthen the role of the Oversight Board (and indeed
the Advisory Board). Careful consideration would need to be given to the mecha-
nisms through which the Oversight Board might induce the Executing Agency to
confront problems it identifies.

*Status of the master plan*

A second challenge concerns the status of the master plan developed by Bap-
penas (and formalised as Presidential Regulation No. 30/2005) (GOI 2005). Kuntoro has decided to follow the master plan only when he deems it prac-
tical to do so, and to modify it when necessary. His definition of ‘practical’ is
not clear, however: there is no agreement on this among the Executing Agency,
Advisory Board and Oversight Board. This creates obstacles to healthy dialogue
between the three bodies, and there is a perception that the Executing Agency
can do whatever it wants, even though the Advisory and Oversight Boards may
have different opinions on the activities in question. Even within the Executing
Agency itself there is no clear guidance on this for staff, resulting in a lack of
consistency in its operations. Some directors follow the stipulations of the mas-
ter plan—even when doing so is problematic—on the grounds that abandoning
the plan would be tantamount to ignoring the law, since it is embodied in a
presidential decree.

The dilemma facing BRR officials reflects the adoption of an overly prescrip-
tive master plan in the beginning. In retrospect, it may have been more sensi-
tle to recognise that the scale of the devastation, and the consequent uncertainty
about all the things that needed to be done, called for a more flexible approach,
## TABLE 5 Damage and Progress in Aceh and Nias after One Year

<table>
<thead>
<tr>
<th>Damage</th>
<th>Progress</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>People</strong></td>
<td></td>
</tr>
<tr>
<td>167,000 dead or missing from tsunami</td>
<td>In Aceh, over 300,000 have been able to return to homes</td>
</tr>
<tr>
<td>500,000 displaced from homes in Aceh</td>
<td>About 75,000 given shelter by relatives and neighbours</td>
</tr>
<tr>
<td>900 dead from the March earthquake and 13,500 families displaced from homes in Nias</td>
<td></td>
</tr>
<tr>
<td><strong>Housing</strong></td>
<td></td>
</tr>
<tr>
<td>80,000–110,000 new houses needed</td>
<td>16,200 new houses completed</td>
</tr>
<tr>
<td>About 50,000 are housed in barracks</td>
<td>13,200 under way</td>
</tr>
<tr>
<td>About 65,000 remain in tents</td>
<td>5,000 new houses being built per month</td>
</tr>
<tr>
<td><strong>Infrastructure</strong></td>
<td></td>
</tr>
<tr>
<td>3,000 km of roads impassable</td>
<td>235 km of roads restored</td>
</tr>
<tr>
<td>14 of 19 seaports badly damaged</td>
<td>West coast road project started</td>
</tr>
<tr>
<td>8 of 10 airports damaged</td>
<td>Major road projects under way</td>
</tr>
<tr>
<td>120 arterial bridges destroyed, plus 1,500 minor bridges</td>
<td>35 arterial bridges rebuilt</td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td></td>
</tr>
<tr>
<td>More than 2,000 school buildings damaged</td>
<td>335 new schools built or under construction</td>
</tr>
<tr>
<td>Approximately 2,500 teachers died</td>
<td>Over 1,100 new or temporary teachers trained</td>
</tr>
<tr>
<td>Over 1.7 million textbooks distributed</td>
<td></td>
</tr>
<tr>
<td><strong>Health</strong></td>
<td></td>
</tr>
<tr>
<td>More than 8 hospitals damaged or destroyed</td>
<td>38 hospitals, clinics and health centres rehabilitated or rebuilt</td>
</tr>
<tr>
<td>114 health centres and sub-centres damaged or destroyed</td>
<td>51 more under reconstruction</td>
</tr>
<tr>
<td><strong>Economy</strong></td>
<td></td>
</tr>
<tr>
<td>$1.2 billion damage to productive sector</td>
<td>Construction boom is stimulating economy</td>
</tr>
<tr>
<td>Projected economic decline of 5% in Aceh; 20% in Nias</td>
<td></td>
</tr>
<tr>
<td><strong>Fisheries</strong></td>
<td></td>
</tr>
<tr>
<td>4,717 coastal fishing boats lost</td>
<td>3,122 boats replaced or being built</td>
</tr>
<tr>
<td>20,000 ha fish ponds destroyed or out of action</td>
<td>5,000 ha fish ponds repaired, back in use</td>
</tr>
<tr>
<td><strong>Agriculture</strong></td>
<td></td>
</tr>
<tr>
<td>60,000 farmers displaced</td>
<td>40,000 farmers assisted to return</td>
</tr>
<tr>
<td>Over 60,000 ha agricultural land damaged</td>
<td>13,000 ha farmland restored</td>
</tr>
<tr>
<td><strong>Enterprise</strong></td>
<td></td>
</tr>
<tr>
<td>100,000 small business persons have lost their livelihoods</td>
<td>7,000 workers given skills training</td>
</tr>
<tr>
<td>Over 120,000 have benefited from cash-for-work schemes</td>
<td></td>
</tr>
</tbody>
</table>

*Source: BRR and International Partners (2005).*
with considerable discretion given to the BRR to respond to circumstances on the ground as these were revealed. Thus there is now a growing impetus to re-evaluate the master plan, with a view to removing parts that create problems, sharpening and simplifying others that are unclear, and strengthening those that are of considerable importance—particularly those relating to land use planning. It is hoped that the revised version of the plan would then provide firm guidance that would be followed consistently by all components of the BRR, and by other institutions contributing to the reconstruction effort. Business people hoping to be involved in reconstruction activities would also have clear guidance on the ‘rules of the game’.

Coordination among major activities and implementing organisations

A third challenge relates to the BRR’s ability to coordinate various activities conducted by other agencies. In general, the BRR has been able to take the lead in managing the reconstruction of Aceh and Nias, but in certain respects it has not seemed able to secure adequate coordination. This is apparent in significant imbalances within the many components of the reconstruction and rehabilitation effort between available funds and minimum requirements. Figure 4 shows the difference between total current commitments of funding by government and donors in each sector, and the minimum funding requirement to rehabilitate the sector. It can be seen that funding far in excess of actual needs has been allocated to areas such as health, culture and religion, governance and administration, enterprise rehabilitation, education, and water and sanitation, while energy supply, the environment, flood control and irrigation works, and transport are significantly under-funded. So far, the BRR has not been able to persuade donors to reallocate funding from excessively funded to under-funded sectors. Another example of the BRR’s limited ability to coordinate the recovery

FIGURE 4  *Gaps between Funding and Minimum Requirements, by Broad Activity* ($ million)

effort is that several of the NGOs involved have not been able to deliver the outcomes they have promised, particularly in relation to house construction and provision of income earning opportunities.

**Conflicting roles of the BRR**

A fourth challenge relates to the BRR’s acquisition of additional powers for implementing housing construction in response to the earlier poor performance of the housing program. The agency has now been provided with additional funding of Rp 4 trillion to build up to 40,000 houses itself in 2006, bringing its total budget for the calendar year to around Rp 9.6 trillion (table 6)—an increase of around 140% on its budget for 2005—but there are serious concerns as to the desirability of this policy shift. It is not obvious that, as a new agency lacking experience in managing large-scale construction projects, it will be able to implement this huge new task more successfully than the other organisations involved. Moreover, this major additional task must further constrain its capacity to coordinate and monitor other reconstruction programs. If it turns out that the BRR does not perform well in the housing construction area, this is likely to lessen further its moral authority to monitor and control the programs of other institutions. Perhaps of greatest concern is whether, having such a large budget, the BRR can remain a clean institution. There is bound to be considerable pressure on its officials to engage in corrupt behaviour and, if they succumb to this pressure, its ability to continue to lead the reconstruction effort will quickly diminish.

**TABLE 6 Budget of the Aceh–Nias Rehabilitation and Reconstruction Agency (BRR) for 2006 (Rp billion)**

<table>
<thead>
<tr>
<th>Expenditure Item</th>
<th>Employees</th>
<th>Materials</th>
<th>Capital</th>
<th>Social</th>
<th>Total</th>
<th>(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Planning &amp; programming</td>
<td>1</td>
<td>175</td>
<td></td>
<td></td>
<td>176</td>
<td>1.8</td>
</tr>
<tr>
<td>Institutions</td>
<td>19</td>
<td>603</td>
<td>440</td>
<td></td>
<td>1,063</td>
<td>11.1</td>
</tr>
<tr>
<td>Housing, infrastructure &amp; communications</td>
<td>49</td>
<td>175</td>
<td>3,845</td>
<td>1,544</td>
<td>5,613</td>
<td>58.4</td>
</tr>
<tr>
<td>Economy &amp; business empowerment</td>
<td>35</td>
<td>127</td>
<td>255</td>
<td>648</td>
<td>1,065</td>
<td>11.1</td>
</tr>
<tr>
<td>Religion, society &amp; culture</td>
<td>15</td>
<td>115</td>
<td>170</td>
<td>58</td>
<td>358</td>
<td>3.7</td>
</tr>
<tr>
<td>Education &amp; health</td>
<td>37</td>
<td>180</td>
<td>867</td>
<td>31</td>
<td>1,115</td>
<td>11.6</td>
</tr>
<tr>
<td>Secretariat &amp; finance</td>
<td>113</td>
<td>86</td>
<td>24</td>
<td>6</td>
<td>228</td>
<td>2.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>269</td>
<td>1,461</td>
<td>5,602</td>
<td>2,286</td>
<td>9,618</td>
<td>100.0</td>
</tr>
</tbody>
</table>

*Source: Based on BRR Executing Agency presentation at Syah Kuala University, Banda Aceh, 12/1/2006.*
Target for new housing in 2006
Perhaps the major current challenge, however, will be meeting the BRR’s target of building around 92,000 houses in Aceh and Nias during 2006. Although restoration of the housing stock is justifiably seen as the main priority, the feasibility of this target is questionable. Although most of the new homes will be small, the number of new homes constructed annually nationwide is typically only around 60,000. In the absence of any decline in house construction elsewhere, the BRR target implies an increase of roughly 150% in the output of the housing construction industry, which is very ambitious. Construction industry wages and the prices of construction materials have already increased to significantly higher levels than elsewhere in Indonesia (BRR and International Partners 2005: 102), even with the relatively modest rate of construction achieved in 2005 in Aceh and Nias. Adhering closely to such an ambitious target runs the risk of encouraging low construction standards, such that the opportunity to ‘build a better Aceh and Nias’ (World Bank 2005) would be missed. Moreover, the heavy additional demand for timber will tend to hasten deforestation in Aceh and the rest of Indonesia.

It seems highly likely that the housing target will not be achieved, in which case the BRR could lose credibility. For all these reasons there is a quite widespread view that the agency should put more emphasis on the quality of reconstruction—keeping house construction as its main priority, but without committing itself to such an ambitious numerical target—meanwhile ensuring that all those yet to receive new housing are accommodated in temporary shelters, and providing more comfortable living conditions for them. There should also be a strong emphasis on ensuring more rapid restoration of people’s ability to earn their livelihoods, through provision of suitable fishing boats, support for farming activities (such as provision of seeds), repair of infrastructure and so on.

Notwithstanding these concerns, BRR officials are confident of meeting the housing target, for the following reasons. First, after a delay of some months in its establishment, the agency has generally been able to impose its leadership on the reconstruction effort, and hence to focus major participants’ efforts on housing. Second, the BRR has been allowed—at least up until the time of writing—to modify the master plan stipulations when it deems this appropriate, based on advice from, and representations by, local communities. This pragmatic approach has allowed a number of conflicts between these communities’ perceived interests and master plan constraints on housing activities to be overcome. Third, most problems of land identification have been solved through the Reconstruction of Aceh Land Administration System (RALAS) project, in which people in a village first map out their community, showing approximate boundaries, damage to property, and who lived where. The whole community then collectively determines who owns, or should inherit, which plot. The National Land Agency (BPN) then certifies the community’s decision, draws up detailed maps, and initiates the process of issuing legal title to these plots.

Fourth, the central government and the Free Aceh Movement (GAM) agreed to end their 30 years of conflict on 15 August 2005 (Sen and Steer 2005: 303), as a result of which Aceh is now far safer than before, allowing reconstruction activities to be conducted in a peaceful environment. Sixth, the BRR’s new authority to
implement housing reconstruction projects through direct contracting is viewed as offsetting the slow operating pace of other government agencies responsible for building houses, such as the Ministry of Public Works. Sixth, funds for reconstruction activities have started to flow smoothly.

**Prognosis**

The challenges discussed above are by no means the only ones facing the BRR. Others include the need to build strong relationships with local governments and improve their capabilities, and to include ex-members of GAM in reconstruction activities so as to encourage their re-entry to society. It remains to be seen, therefore, whether the reconstruction of Aceh and Nias will become a success story for the BRR.

21 February 2006

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