Reform a balancing act for Indonesians
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Indonesia is now growing at a respectable rate, after a slow recovery from the trauma of the 1997-08 economic crisis.

Yet while the current expansion rate of just over 6 per cent will gradually wear down Indonesia's poverty, growth is still below the pre-crisis pace. The needs are pressing. Mass poverty still hangs over the nation: half the population lives on less than $2 a day.

The opportunities to crank up the pace of growth to, say, 8 per cent seem to be there for the taking. Seen through an economist's eyes, there is much low-hanging reform fruit, ripe for the picking.

Ten years of underspending on infrastructure have left the country with choked roads, overburdened ports and failing electricity supplies. Factories are being asked to work on Saturdays and Sundays to deal with the power shortages.

The government budget is too limited to pay public servants a living wage, so they find innovative ways of supplementing their income. None of this helps good governance.

The budget subsidy for energy keeps fuel and electricity prices among the lowest in the world: 60¢ a litre for petrol. This costs the budget $20 billion a year, forecast to rise to $30 billion next year if world oil prices hold up.

By far the greater part of this subsidy goes to middle and upper-income groups. Both economics and equity point to a simple solution: raise the price, and compensate the needy with an income transfer. This would free the budget to fund a raft of high-return expenditures, including a doubling of expenditure on infrastructure. It would also, incidentally, put some substance in Indonesia's "green" rhetoric, diminishing pollution and making a big contribution to lessening Jakarta's chronic traffic gridlock. Why isn't such an obvious reform opportunity taken? It's not as if the problems are unrecognised or misunderstood by the government. The economic team is strong, experienced and speaks with one voice. Nor is implementation an insurmountable issue: in 2005 there was a successful application of the strategy of very large petrol price increases combined with direct income transfers for the poor. The problem is not in devising high-return reforms, but in selling them: "getting people on the cart".

The key issue is how to turn good economics into good politics. There is a long history of petrol-price sensitivity: demonstrations following the oil price increases in 1998 were one of the triggers for former president Soeharto's forced resignation. The 30 per cent petrol price rise in May this year brought angry demonstrations. Populist politicians and ignorant journalists had a field day censuring and criticising President Susilo Bambang Yudhoyono.

When petrol prices were raised in 2005, the President promised not to raise them again in his current term. So it's not surprising that this is a sensitive issue, all the more so in the still-fragile democratic environment, where the President's party has only 8 per cent of the votes in parliament and he faces an election next year. Decentralisation adds another layer of complexity to the task of getting a consensus behind sensible policies.

Last week's economic assessment of Indonesia by the Organisation for Economic Co-operation and Development provides a new perspective on these old problems. The low-key, well-reasoned report lists a range of reforms, not confined to the petroleum subsidy. In particular, the report draws attention to the labour laws that set a minimum wage and, more damaging, impose onerous dismissal restrictions, frightening off some key foreign investors.

What role can foreign observers play in this? The blunt answer is "not much". In the end Indonesia has to build its own reform consensus. Domestic journalists, parliamentarians, commentators and students need to be persuaded to support reform.

Foreigners can, however, provide moral support in the lonely task of reform. In the crisis years, the International Monetary Fund was a strident advocate of economic rectitude, imposing strict conditionality to force reforms through. But it overplayed its hand. Whatever the case for forcing the pace of reform during the crisis, this assertive approach has run out of steam. The IMF's influence in Indonesia is now quite modest.

The OECD brings a fresh, more subtle and coaxing voice to this task. Its emphasis is on international comparisons of experience rather than doctrinal lectures. Some might even see its low-key style as part of a good cop/bad cop act. Time to try the good cop role: quiet logic drawing heavily on international comparisons of approaches.

Of course, policy advocacy is only one element needed in a reform agenda. One report will not convert the ignorant, nor will it overcome all resistance. But the OECD did play such a role in the reform processes in Australia during the 1980s. The OECD reports always achieved front-page treatment in the Australian press, invariably emphasising the need for further reform. This was both a source of irritation to the government and a spur to action. Politicians and bureaucrats alike, having weathered the criticisms that came with the OECD reports, asked themselves whether the easiest way of avoiding a repeat performance might be to push ahead on the reform agenda.

The OECD report on Indonesia is timely in another sense. Indonesia has fallen off the radar in a world focused on Iraq, Afghanistan and the basket cases of Africa. Its quiet progress has gone unnoticed: in getting the economy back on an even keel, resolving the problems of Aceh and implementing an amazing transition to democracy.

It has become, in the words of one commentator, a "normal" country, with the normal frustrations we all experience. Economic policies are fallible, imperfect, sometimes fumbling, and often forced into sub-optimal compromises. But, for all that, they are on the right track. The OECD report card acknowledges the quiet progress while providing positive support for greater efforts, and takes this overlooked story to a wider international audience.

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