

International Forum on
Economic Development and Public Policy



Fiscal Reform To Support Strong
and Equitable Growth:
Striking The Right Balance

Rapporteur

Fiscal Reform to Support Strong and Equitable Growth: **STRIKING THE RIGHT BALANCE**

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OUTLINE

Intro: Indonesia's **potential and growth trajectory**

Current **economic condition and development** issues

Fiscal reform to support strong and equitable growth

Commiment to **Create Macroeconomic Stability**
By Continuing Budget Reform 2016



**MINISTRY OF FINANCE
REPUBLIC OF INDONESIA**

INTRO: INDONESIA'S POTENTIAL AND GROWTH TRAJECTORY



INDONESIAN ECONOMY HAS BEEN THROUGH SOME UPS AND DOWNS

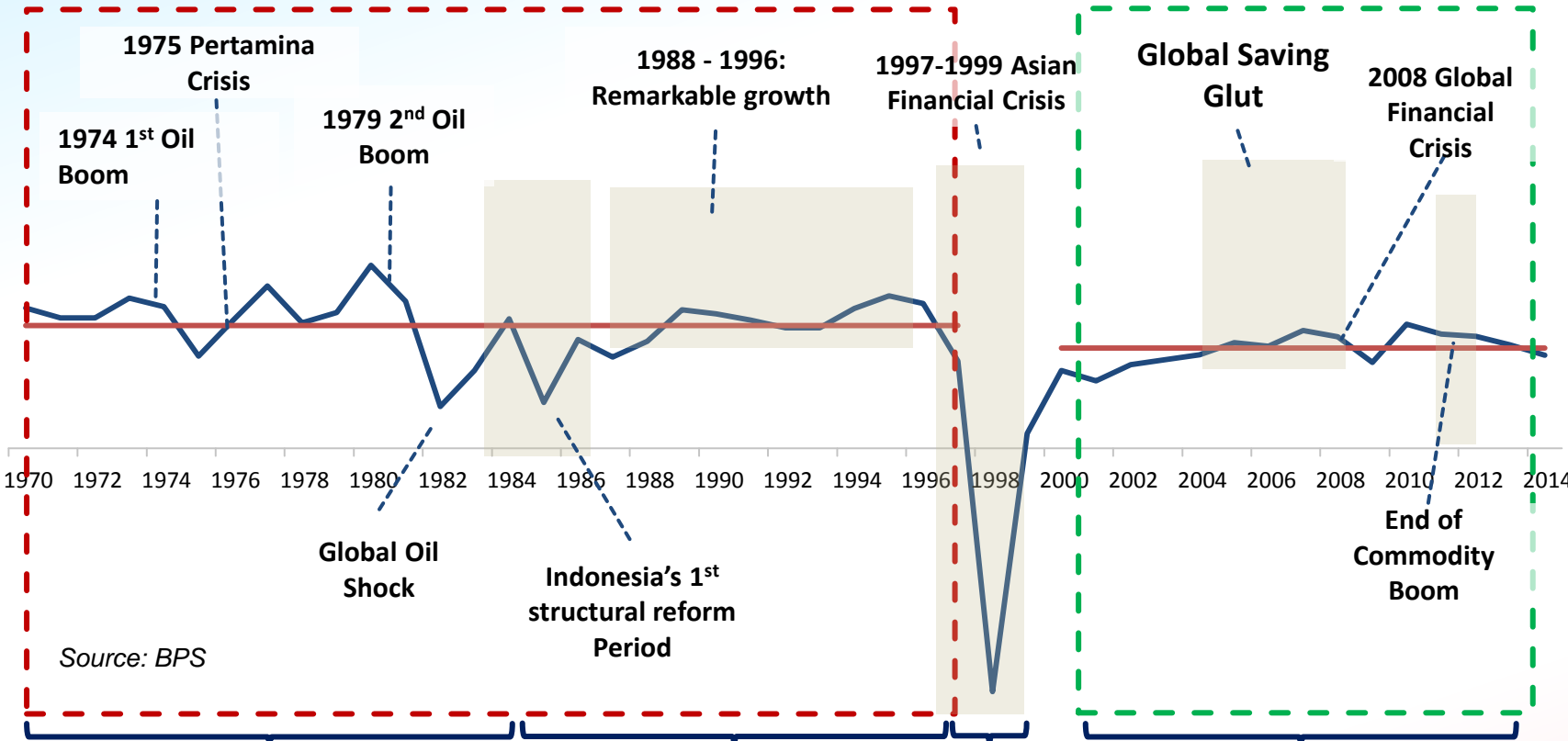
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AVERAGE '70-'97: 7.1%

AVERAGE '01-'14: 5.4%

WHAT IS NEXT?



Source: BPS

- Commodity Price Volatility
- China Moderation
- Advanced Economies Rebalancing
- Financial Market Volatility
- Geopolitics

- 3 steps of new era policy: Stabilization, Rehabilitation Reconstruction,
- Law on FDI

- Deregulation and high industrialization period: Banking, Trade, Investment, Taxation, Industries
- Industry became priority sector
- Import substitution and export promotion

**C
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- Government budget reform
- Greater local autonomy
- Reformation on regulation of the banking and financial sector

- **New Budget Perspective**
- **Strengthening Inclusive Growth**
- **Infrastructure Development**

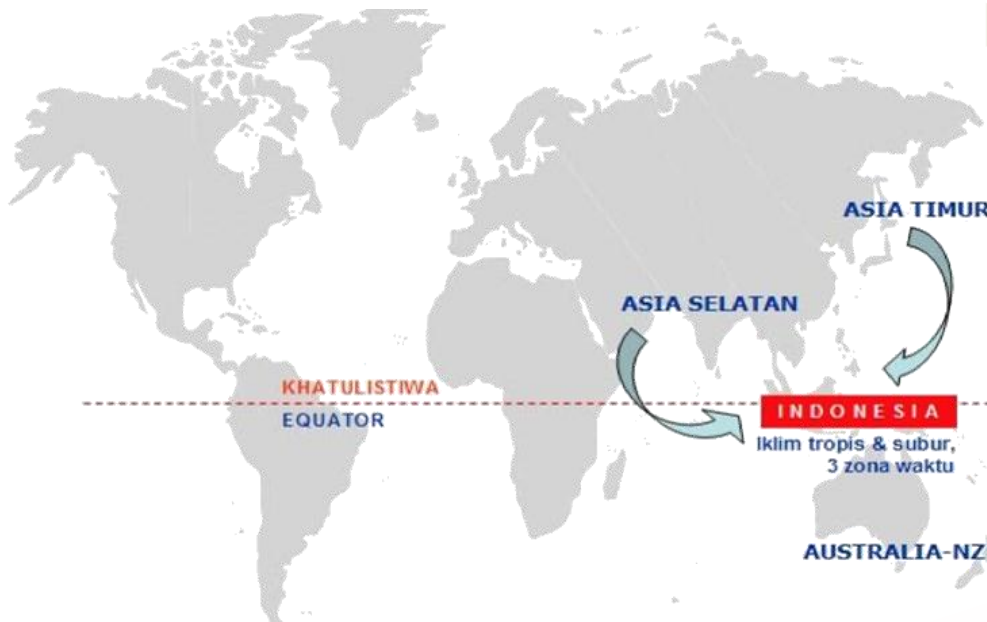
INDONESIA'S POTENTIAL TO ACCELERATE GROWTH

...Indonesia's economy has enormous promise

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The Republic of Indonesia is a key member of ASEAN and member of G20
Indonesia is spread across an archipelago of 17,504 islands



Source: Indonesia Forum (2007)

Key Statistics & Indicators

Source: BPS. (As of June 2014, figures are preliminary figures)

Largest Economy in South East Asia

Strategic Geographical Position

4th Most Populous Country in the World With a Population of ~252.2 Million

Economic Growth ~5.7% (Average for Past 5 Years)

Growing middle income population

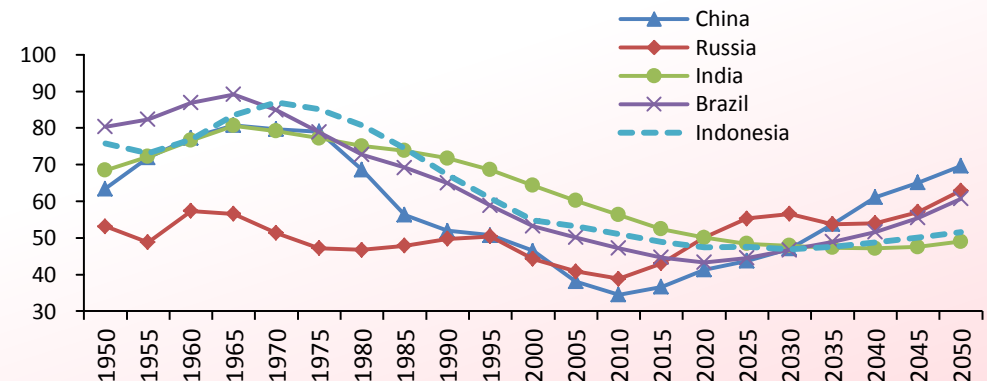
Fiscal Deficit of 1.6% (of GDP) (Average for Past 5 Years)

Abundant natural resources

Tradition, Culture, And Society

Indonesia's demography compared to its peers

Source: DESA UN (2015)



INDONESIA'S POTENTIAL TO ACCELERATE GROWTH

...world-class analyst and various institutions noted and forecasted positive improvement on Indonesian economic

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Indonesia's Rating

MOODY'S Baa3 (Stable)

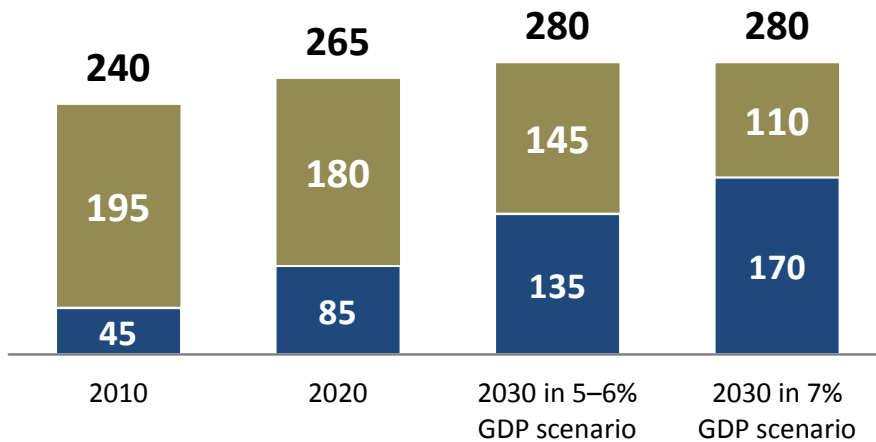
STANDARD & POOR'S BB+ (Positive)

FitchRatings BBB- (Stable)

McKinsey projects favorable population dynamics

Source: McKinsey report (September 2012)

■ Consuming class ■ Below consuming class



Note:

Consuming class refers to individuals with annual net income of more than US\$3,600 in purchasing power parity at 2005 exchange rate

Indonesia's Business Sentiment Survey

Source: ASEAN Business Outlook Survey 2016

Factors	Indonesia's Rank
Availability of competitively price labour	1
Availability of skilled labour	5
Ease of recruiting labour from abroad	5
Prevalence of business- friendly customs procedures	3
Ease of importing goods	3
Infrastructure	5
Stable government and political system	5
Regulatory regime	5
Provision of government incentives	5
Sentiment towards the EU	3
Fiscal structure	5
Administrative cost for business	5

Indonesia is important country in terms of total ASEAN turnover

1	SINGAPORE
2	CAMBODIA
3	THAILAND
4	MALAYSIA
5	INDONESIA
6	LAOS
7	THE PHILIPPINES
8	VIETNAM
9	MYANMAR

Three reasons for why ASEAN markets, includes Indonesia, will become more important over the next two years

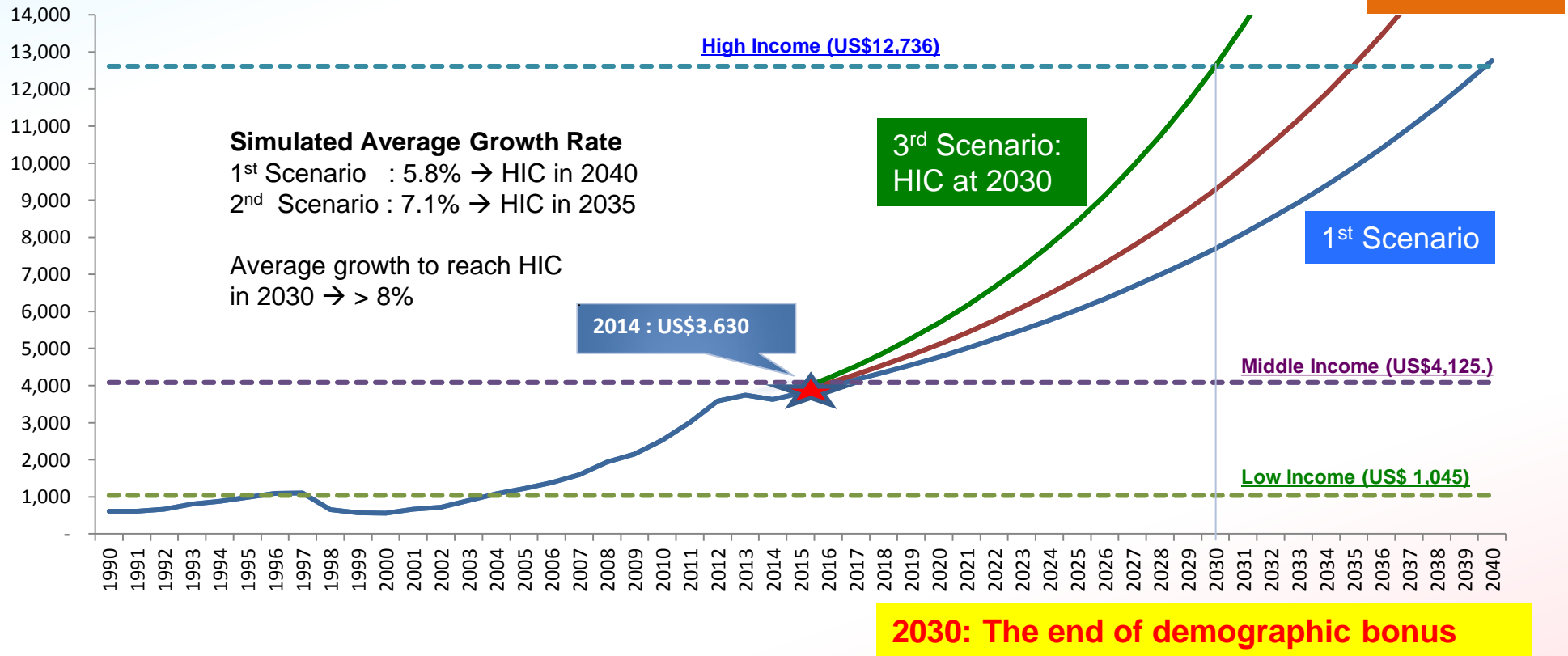
1		ENHANCED REGIONAL ECONOMIC INTEGRATION (41% of respondents)
2		IMPROVEMENTS IN INFRASTRUCTURE (41% of respondents)
3		LIMITED GROWTH OPPORTUNITIES IN OTHER REGIONS (35% of respondents)

INDONESIAN ECONOMIC GROWTH TRAJECTORIES

(with simulation)

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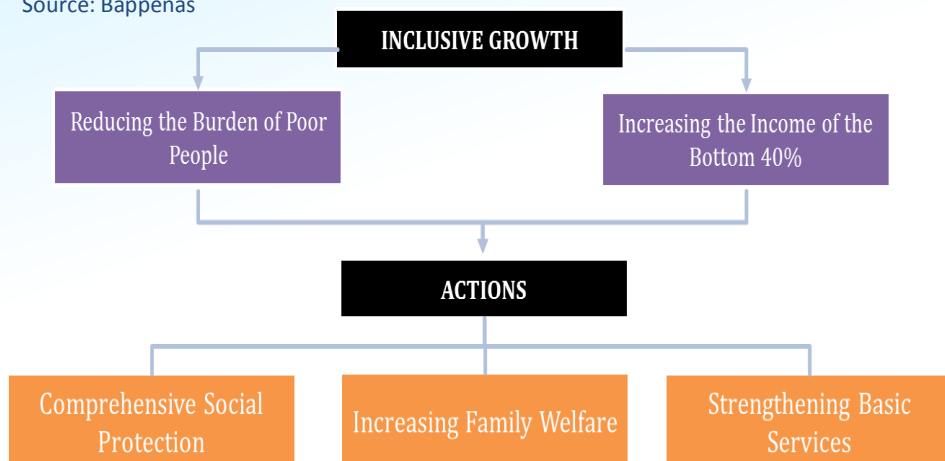
Indonesia's Income per Capita (GNI Atlas Method, 2014 USD)



Source: World Bank, staff calculation

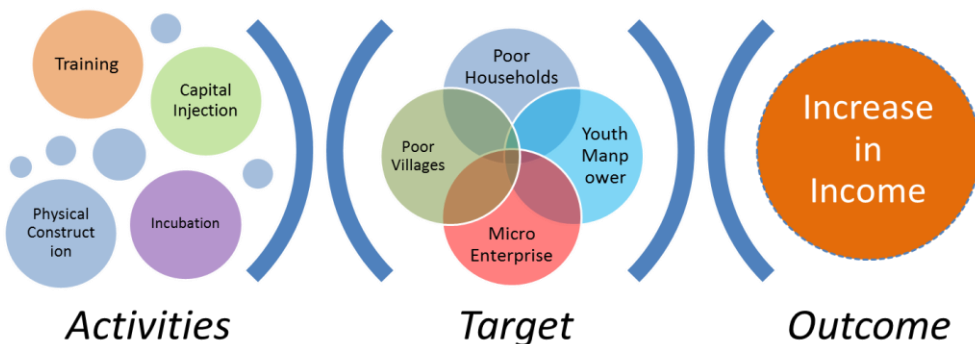
8 Poverty reduction 2015-2019

Source: Bappenas



Increasing the Welfare

Source: Bappenas



INEQUALITY REDUCTION 2015-2019

Several indicators to address inequality reduction

Basic infrastructure and poverty indicators

Source: Bappenas

Indicator	2014 (Baseline)	2019
Basic infrastructures & connectivity		
▪ Electrification ratio	81,5%	96,6%
▪ Electricity consumption per capita	843KWh	1.200KWh
▪ Urban slump area	38.431 Ha	0 ha
▪ Housing backlog	7,6 million	5 million
▪ Access to drinkable water	70 %	100%
▪ Access to sanitation	60,9 %	100%
▪ Dwelling Time	6-7 days	3-4 days
▪ Cities with access to broadband	82%	100%
▪ Shares of city public transport	23%	32%
Decrease the gap between economic group		
▪ Poverty rate (%)	10,96%*)	7,0% - 8,0%
▪ Open unemployment rate	5,94%	4,0 % - 5,0 %
Increase the coverage of basic services and access to productive economic disadvantaged communities		
▪ Coverage at 40% of the poor		
○ Health insurance	86%	100%
○ Nutritious Food	60%	100%
○ Financial service	4,12% *)	25%
○ Possession of birth certificates (2013)	64,6%	77,4%
○ Clean water	55,7%	100%
○ Adequate sanitation	20,24%	100%
○ Electricity	52,3%	100%



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CURRENT ECONOMIC CONDITION AND DEVELOPMENT ISSUES



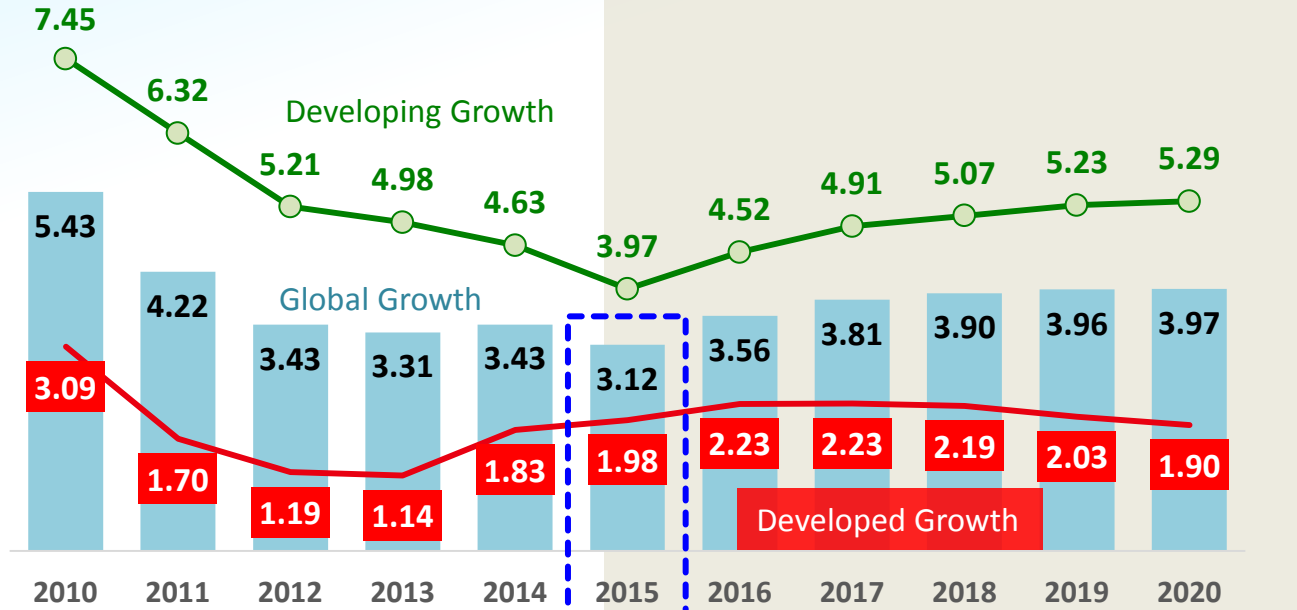
(1) GLOBAL ECONOMY FACE SOME CHALLENGES

...various institutions have lowered their global economic outlook from time to time

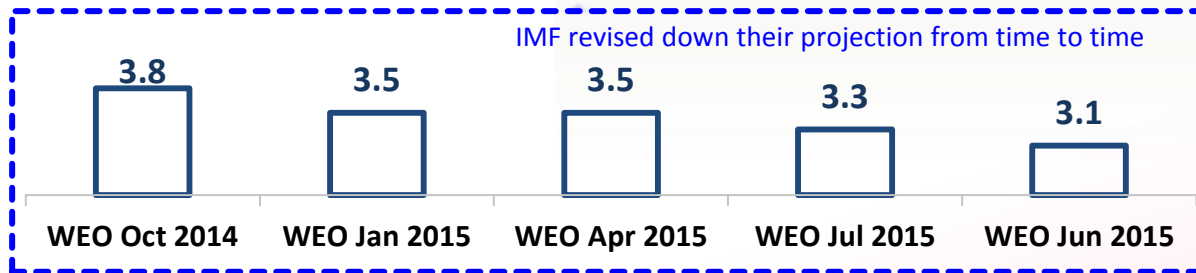


World Growth Projection

Source: WEO IMF



IMF revised down their projection from time to time



World economic recovery is expected to be slow, with several challenges:

- The developed countries have not yet reach full employment
- Low commodity prices have an impact on countries that depend on commodity export markets
- Appreciation of the US Dollar impact on the balance of the debtor in dollar
- China's economy continued to slow
- Stagnant growth in Europe and Japan

Most of analyst revised their forecast on Indonesian economic growth lower, from Aug to Nov 2015. Regarding global economic pressure recently. But still, 2016 economic growth is projected higher than 2015

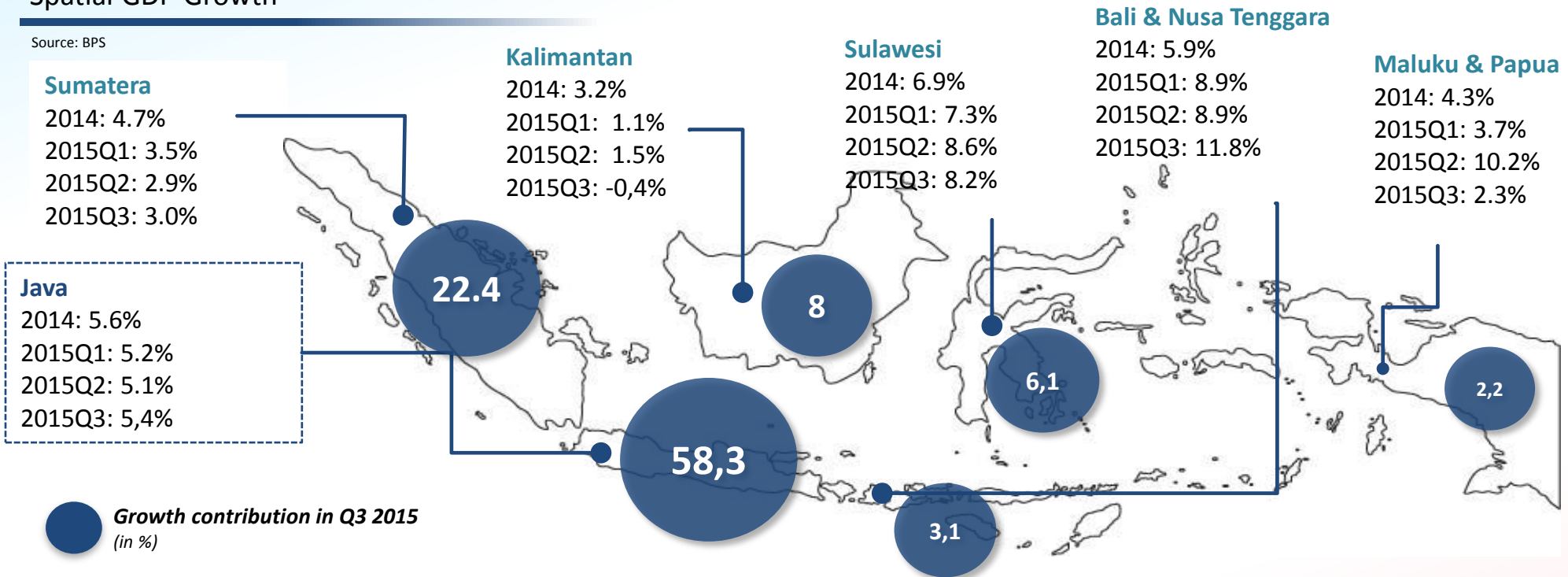
(2) JAVA IS STILL THE MAIN ENGINE OF INDONESIA'S ECONOMIC GROWTH

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...household consumption and Java island as the main driver of Indonesia GDP growth

Spatial GDP Growth

Source: BPS



- Indonesia **continues to drive growth in resource-based industrialization** to shift from commodity-based economy
- In 3rd Quarter 2015, Indonesia booked **4.7% GDP growth YoY**, same with 1st Quarter 2015. **But majority of the growth was still driven from Java island**, at 5.4% YoY and contributed 63% of Indonesia's GDP growth
- **Growth in Java is even higher than resource-rich regions** such as Sumatra and Kalimantan, given its high industrialization and larger consumption base. In the near term, inequality of growth between regions should be addressed.

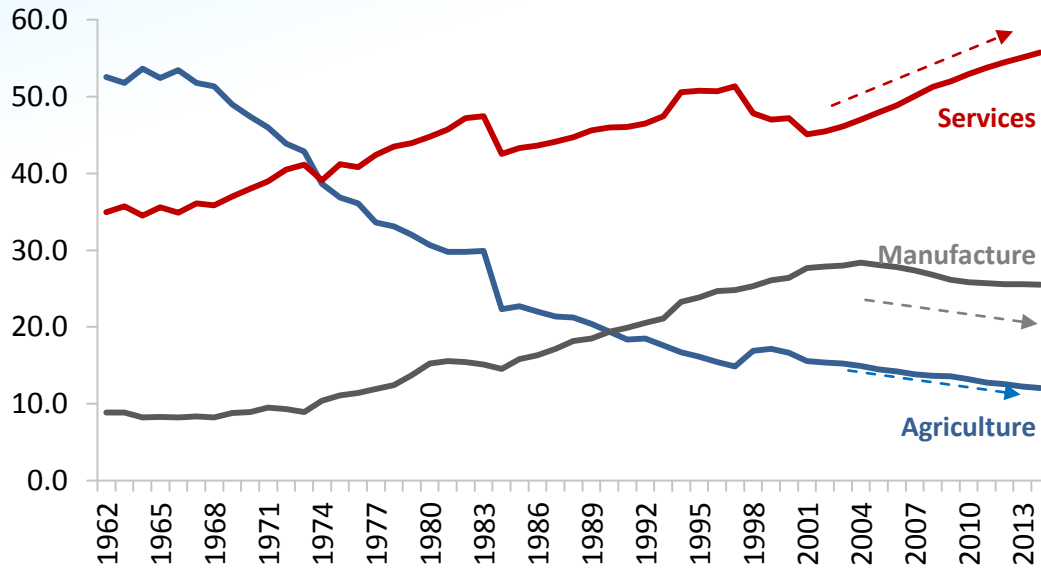


(2) STRUCTURAL TRANSFORMATION

...there has been a significant structural shift in the last few decades

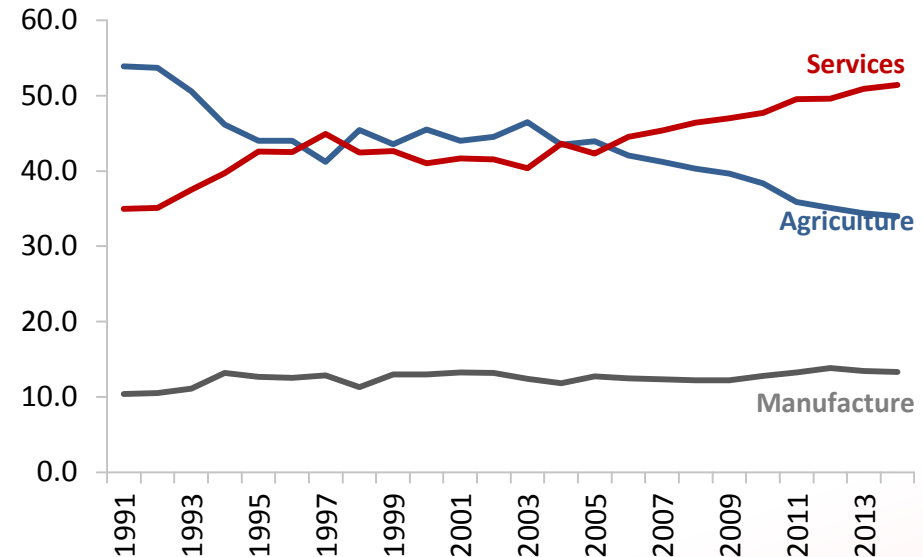
Value Added (% of GDP)

Source: BPS



% of Total Employment

Source: BPS



- **The productivity in agriculture sector is declining**, marked with a stagnant jobs creation followed by further decline at agriculture sector's value added as percentage of GDP
- Besides, declining share of manufacturing sector is often associated with a **sign of premature exit (de-industrialization)**
- Contribution of jobs creation in manufacturing sector has been stagnant



(2) CHALLENGES OF INCLUSIVE GROWTH: INCOME INEQUALITY

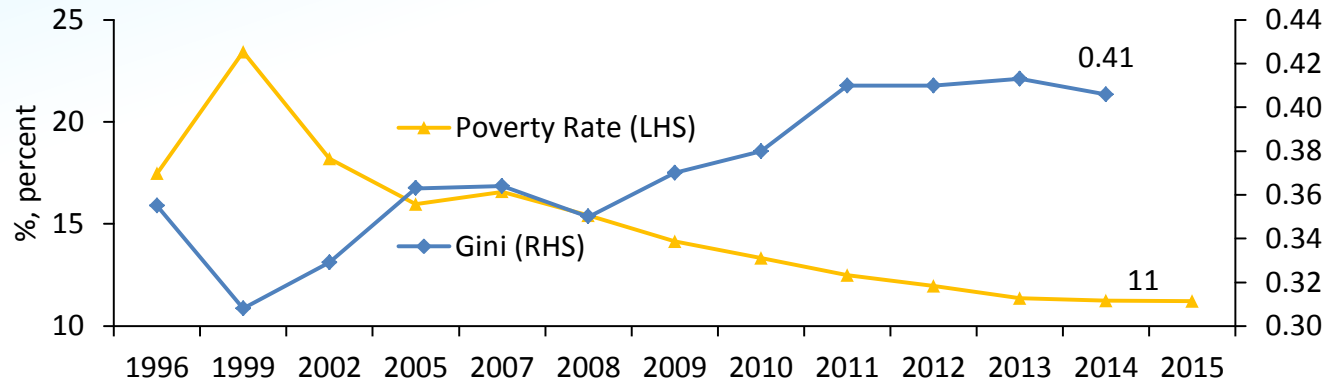
...poverty has decreased from year to year but GINI ratio moved in different way

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GINI Ratio vs Poverty

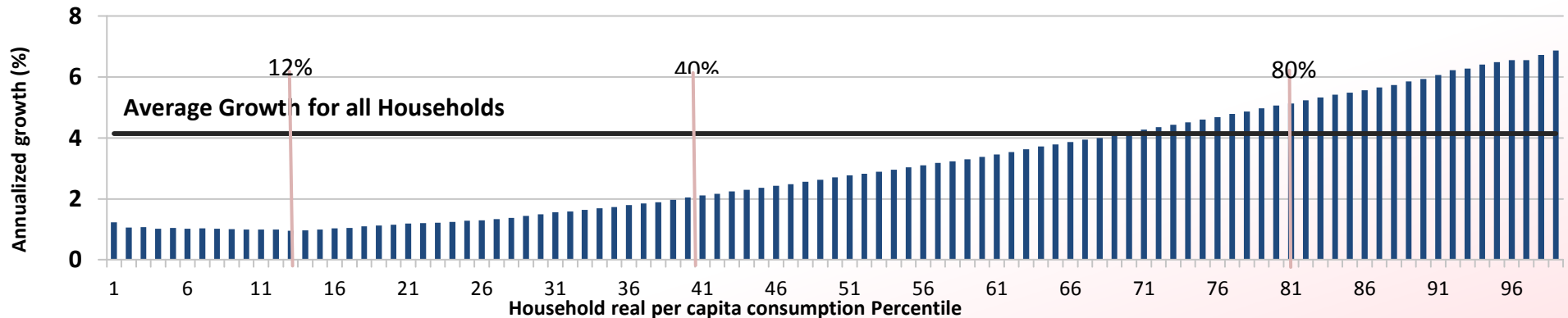
Source: BPS



Economic pie has been enjoyed by all income groups yet **the richest gets larger benefits than lower income groups**

Growth Incidence Curve

Source: BPS

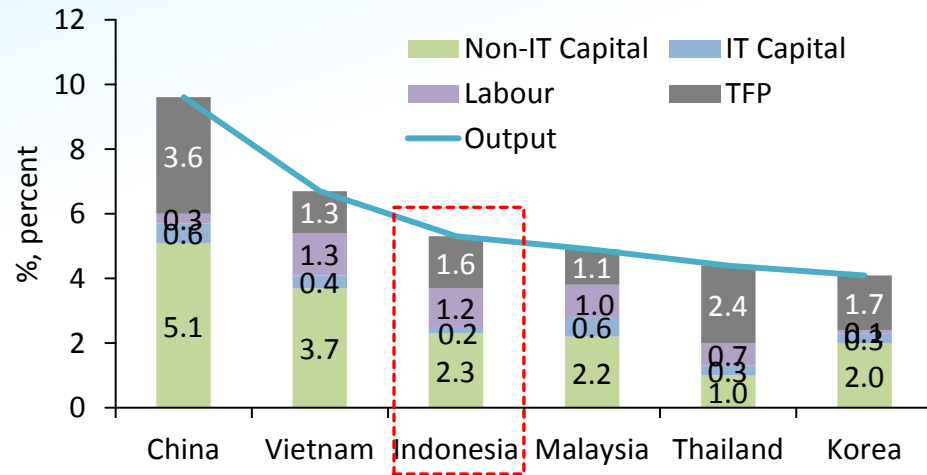


(3) SUPPLY CONSTRAINTS: LOW TFP CAUSES LOW PRODUCTIVITY

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Source of Economic Growth (average 1990-2013)

Source: Asian Productivity Organization (APO) database.



Source: Asian Productivity Organization (APO) database.

Low spending of R&D, low quality of Human Capital, and low capacity of innovation:

- low contribution of technology in economic growth
- difficult to sustain high growth
- Low level of Patent Application reflects low level of innovation incentives.

Number of applications filed under the Patent Cooperation Treaty (PCT) per million population (2011–12 average)

Source: Global Competitiveness Index 2015-16, World Economic Forum

Country	Patent Application / World Rank
S.Korea	220.7 / 7
China	13.4 / 32
Malaysia	11.6 / 33
Thailand	1.3 / 66
Philippines	0.3 / 85
Indonesia	0.1 / 102

Indonesian manufacturing sector is relatively still under developed:

- large dependencies on traditional industries.
- Manufacturing exports has not yet reached mature stage.

(4) SUPPLY CONSTRAINTS: LOW ECONOMIC EFFICIENCY AND INFRASTRUCTURE GAP

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...economic growth could be taken through: increasing Investment Ratio, decreasing ICOR, or combination of both

Economic growth could be taken through:

a) Increase Investment Ratio of GDP

Investment is greatly influenced by people's Saving Rate (S) → Financial Deepening

- ✓ Infrastructure spending → fiscal space, revenue optimization, efficiencies in expenditure policy
- ✓ Policies to attract foreign investment

b) Decrease ICOR

Economic efficiency is reflected through lower investment needs per unit output.

- ✓ Productivity improvement, Technological Support and Innovation.

c) Combination of Both

ICOR 2001-2014 average booked at 4.2, means that Indonesia needs investment to grow 4.2% to create 1% economic growth.

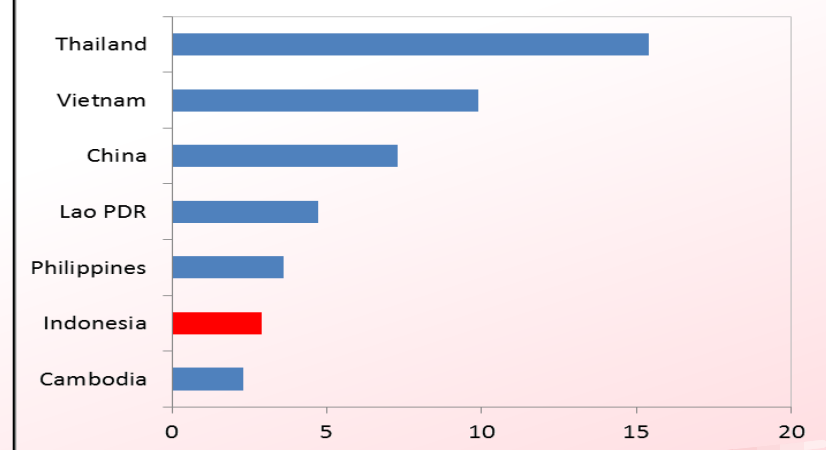
- To boost its economy, Indonesia needs to create investor-friendly markets → infrastructure development is necessary.
- Inadequate infrastructure reflected in relatively high logistic cost
- Inadequate Infrastructure is due to low infrastructure spending
- Lack of infrastructure → inefficiency and low productivity

Rank of Infrastructure Gap

Source: Global Competitiveness Index 2015-2016, World Economic Forum

Country	Overall Infrastructure	Quality of Roads	Quality of Ports	Quality of Electricity Supply
Singapore	4	3	2	3
Japan	7	8	22	21
Malaysia	16	15	16	36
Korea	20	17	27	38
Saudi Arabia	31	32	39	23
China	51	42	50	53
Thailand	71	51	52	56
India	74	61	60	98
Iran	76	63	78	58
Indonesia	81	80	82	86

Infrastructure investment (% GDP)



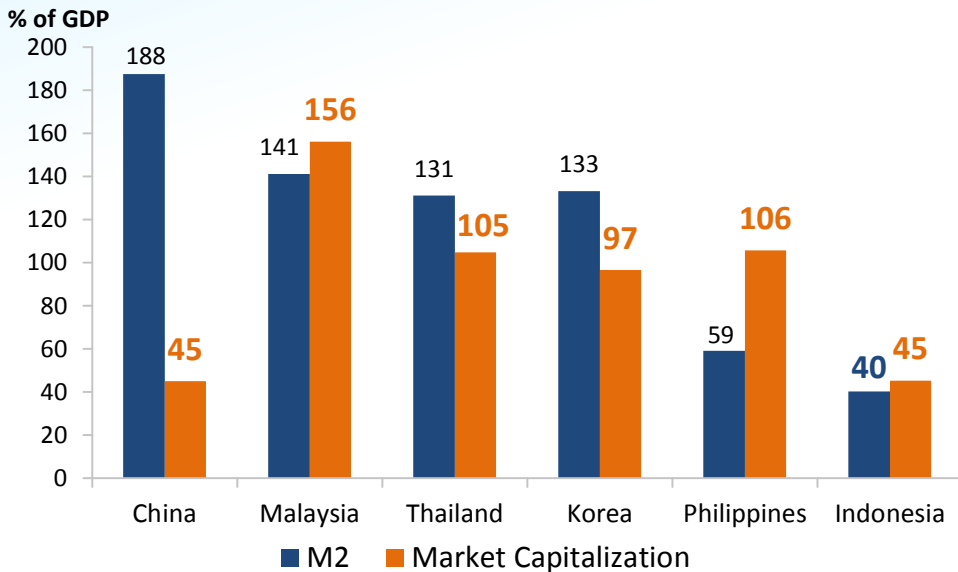
Source: World Bank



(5) SUPPLY CONSTRAINTS: RELATIVELY SHALLOW FINANCIAL SECTOR AND HIGH COST OF FUND

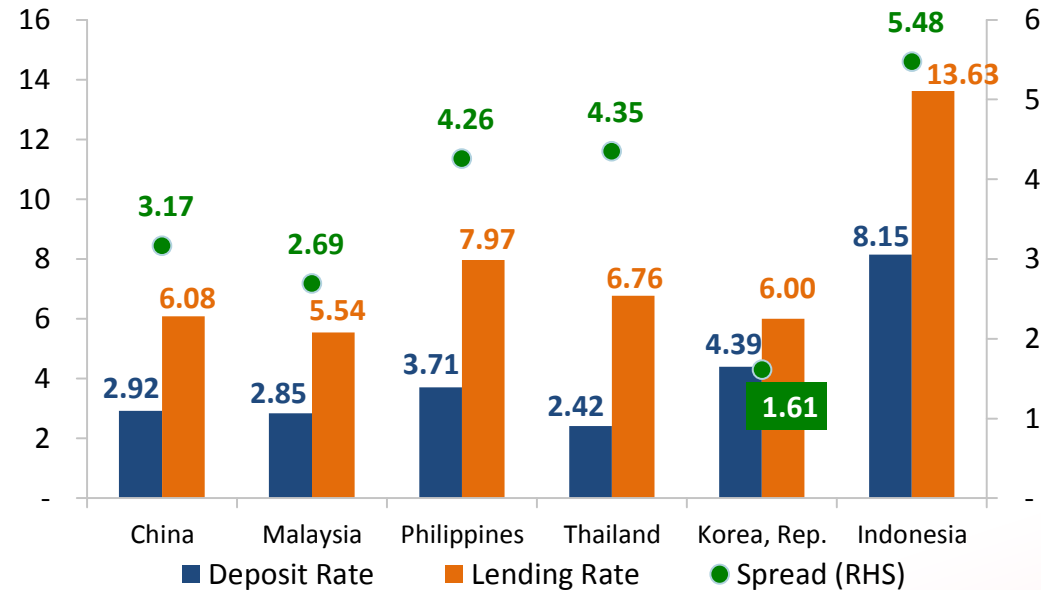
Market Capitalization

Source: World Development Report, September 2014



Deposit Rate vs Lending Rate

Source: WDI



- Both banking sector and capital market have not well developed yet compared to peers
- Access to banking service is relatively small (20%)
- Relatively high spread
- Relatively high lending rate

→ Financial deepening is needed

→ Financial inclusion is needed

→ Indicates relatively inefficient banking sector

→ Constraint economic capacity enhancement





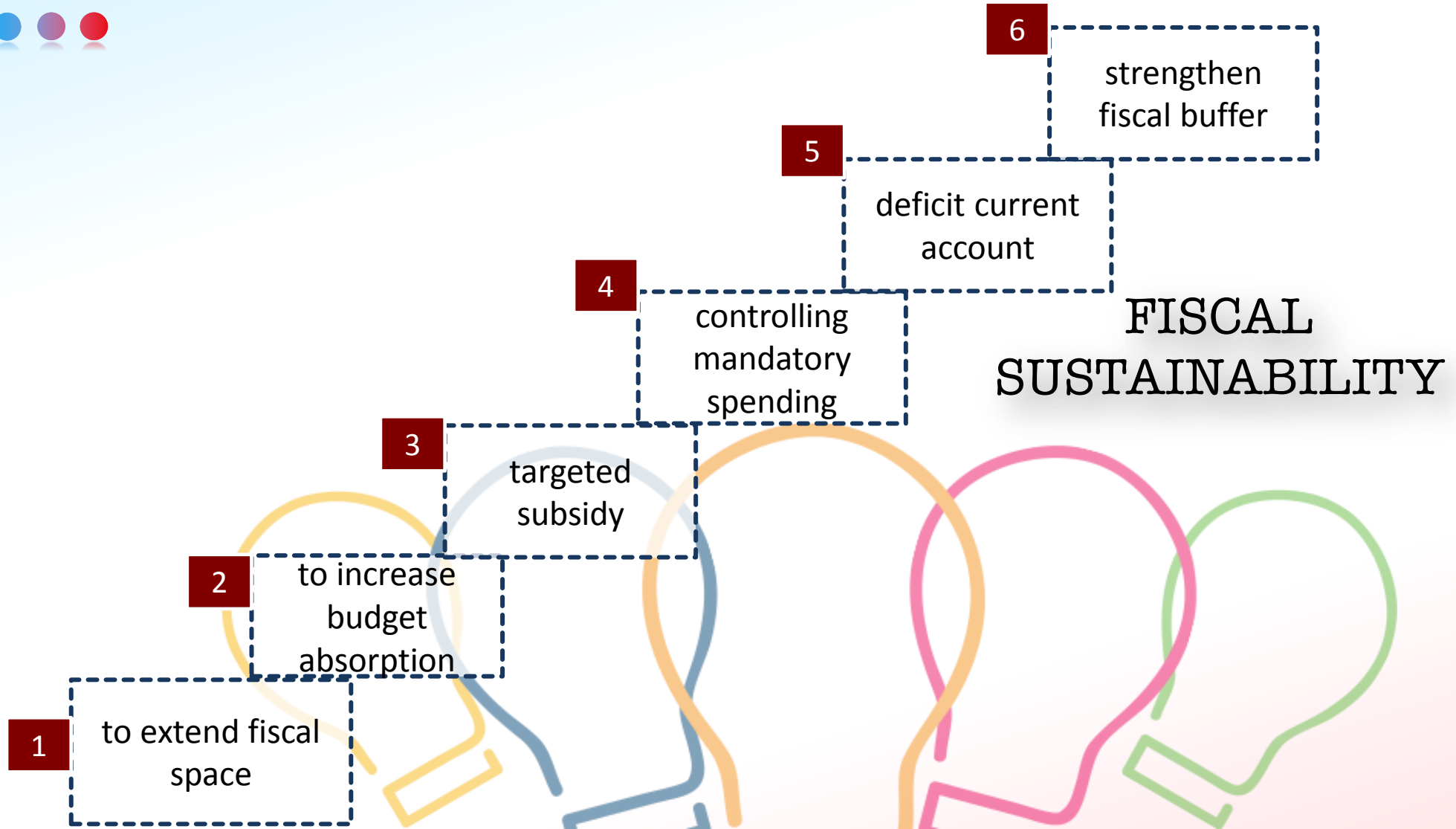
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FISCAL REFORMS TO SUPPORT STRONG AND EQUITABLE GROWTH



CHALLENGING OF FISCAL POLICY

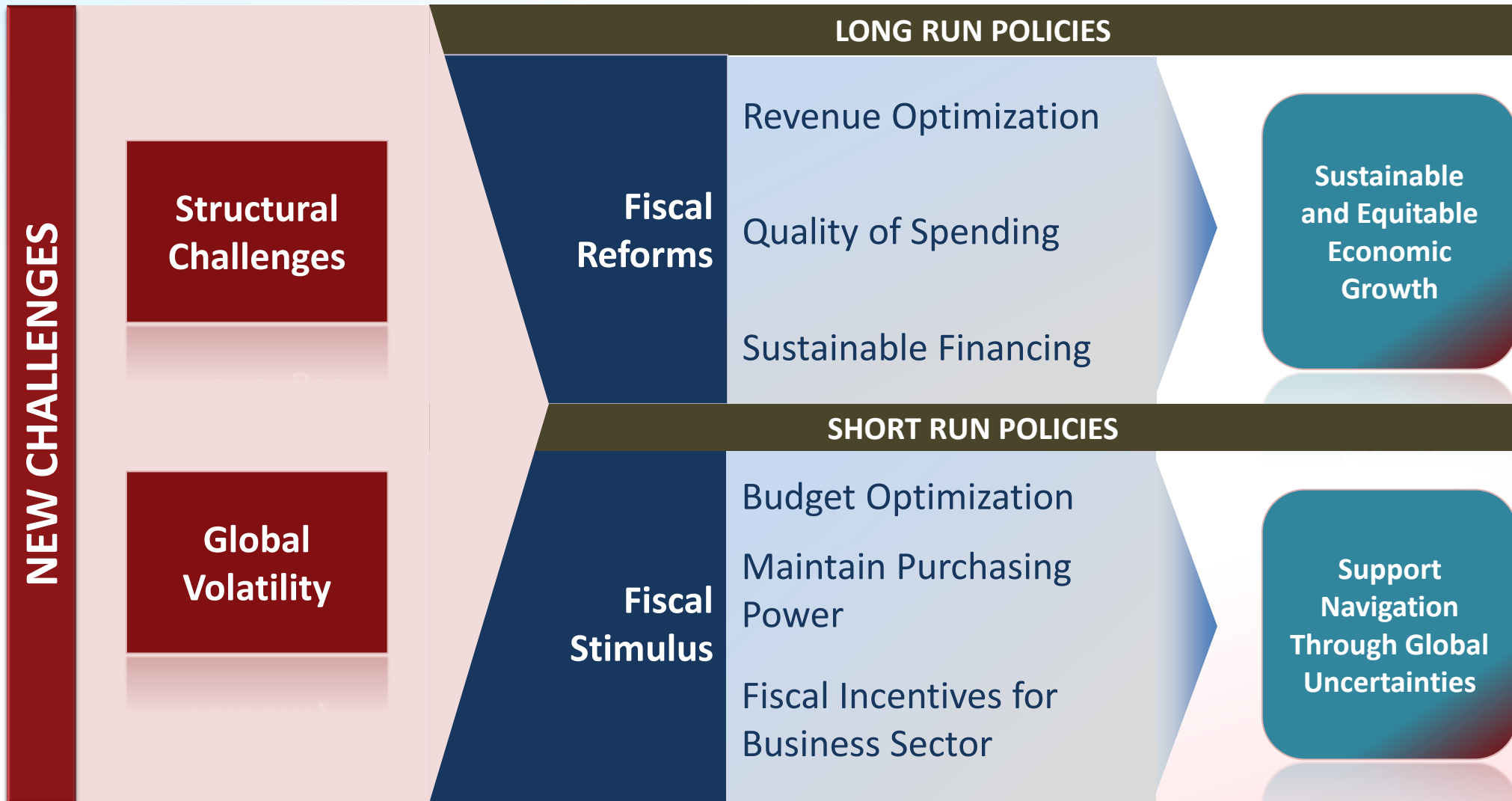
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COORDINATED SHORT RUN AND LONG RUN POLICIES

...to ensure sustainable and equitable economic growth

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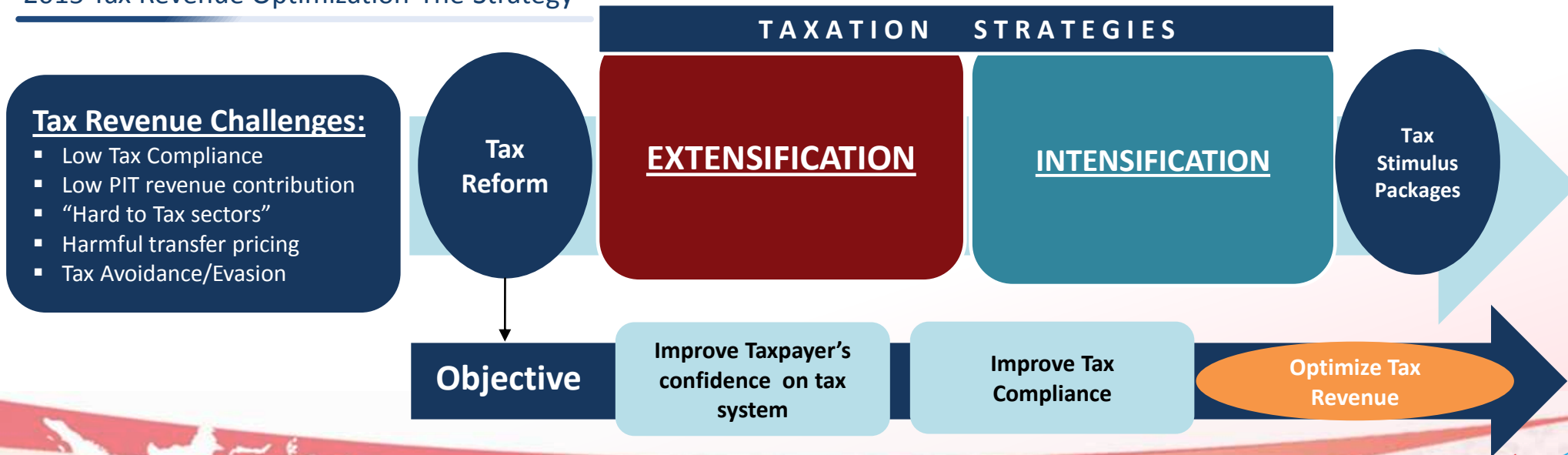
TAX REFORM: PHILOSOPHY AND STRATEGIES

Tax reform addresses the taxpayer's confidence and compliance to optimize tax revenue

Tax Reform Philosophy



2015 Tax Revenue Optimization-The Strategy



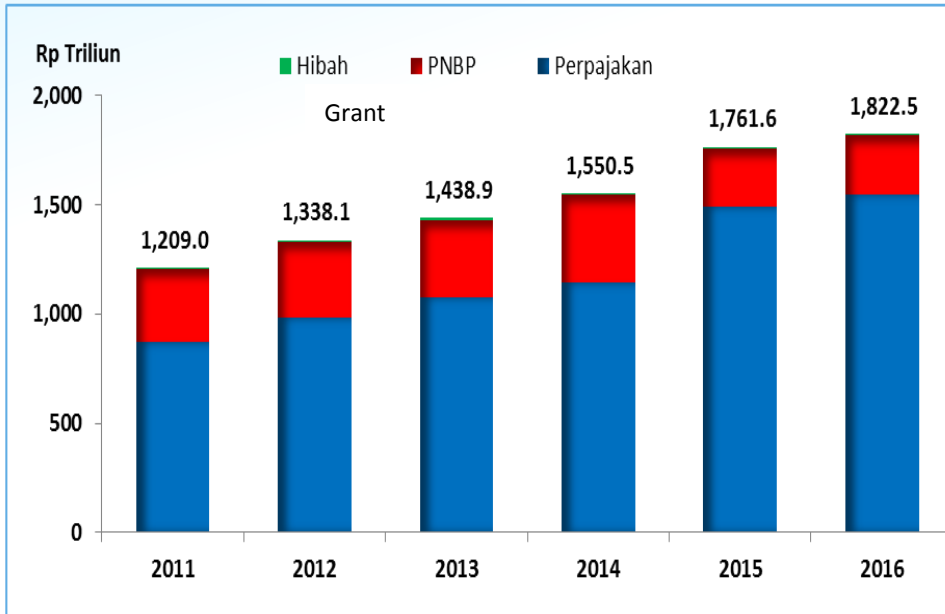


INCREASING TAX PORTION

...increase in tax revenue is in line with the economic improvement

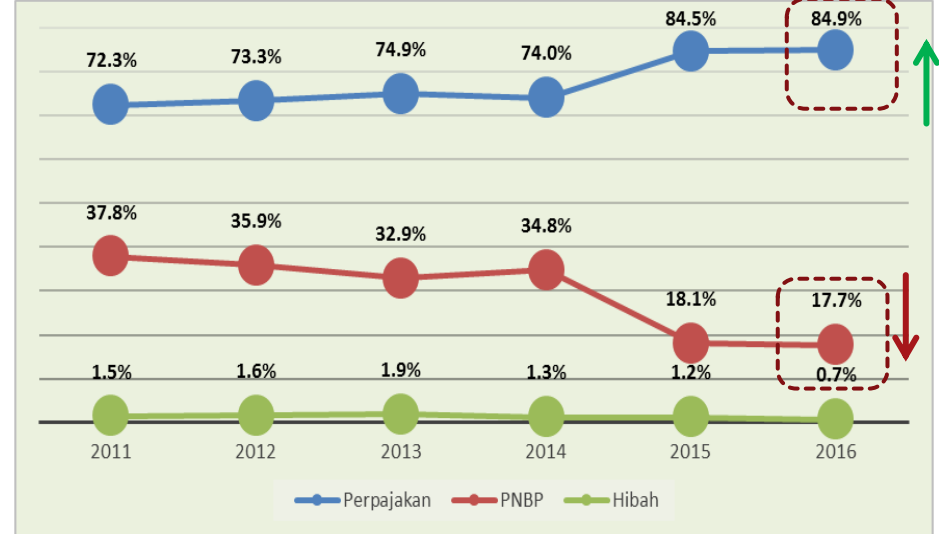
Revenue

Source: Kemenkeu



Composition of Revenue (%)

Source: Kemenkeu



Shift from commodity-based revenues

Tax revenue policies to achieve target, such as:

Tax Optimallization with maintaining investment climate;

Maintaining economic stability and purchasing power;

To encourage competitiveness and value added of domestic industry;

Correcting for externalities (excise)

GOVERNMENT SPENDING REALLOCATION TOWARDS MORE PRODUCTIVE

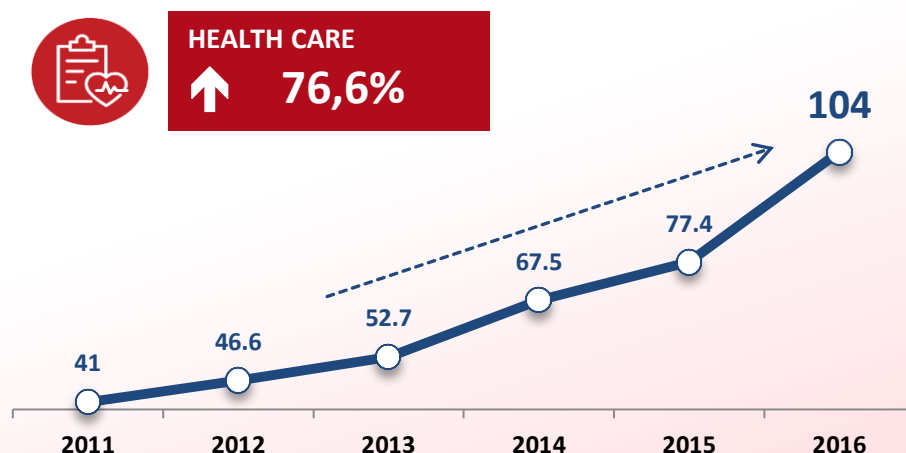
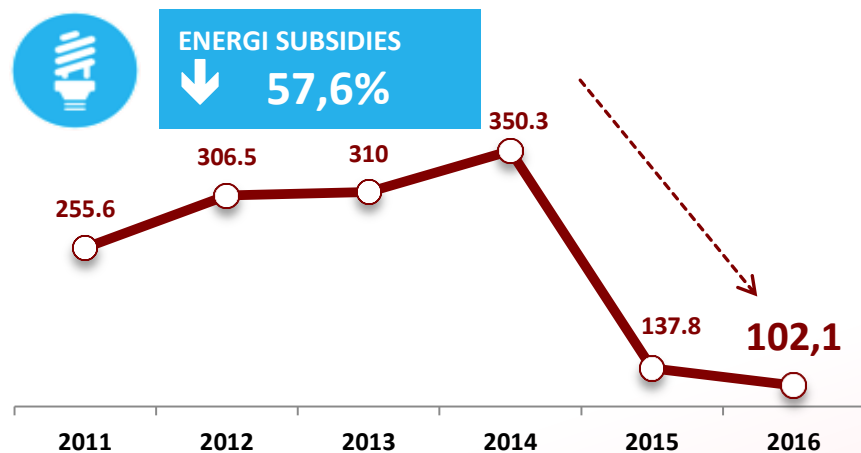
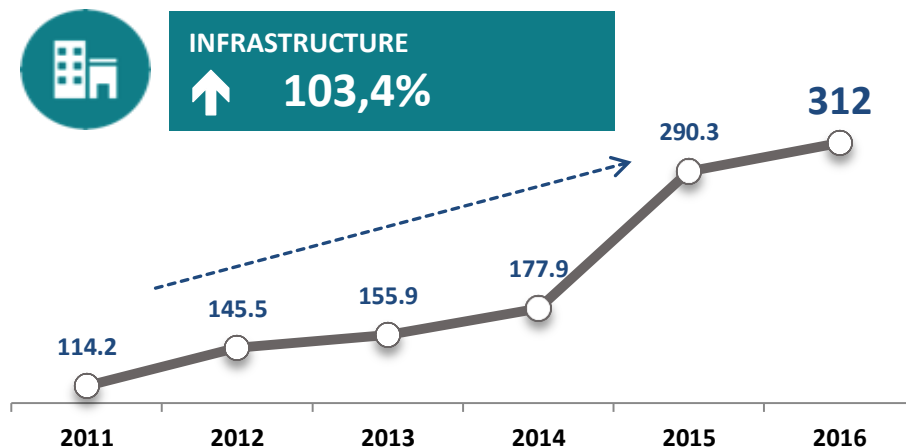
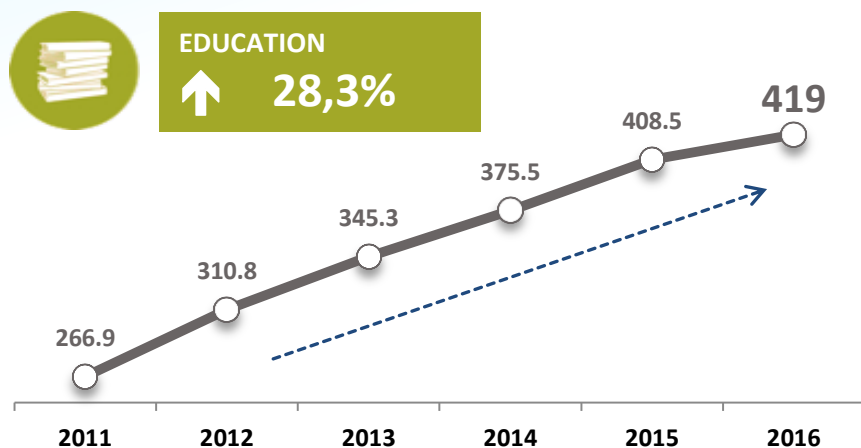
...for the first time, the infrastructure development budget in 2015 is higher than energy subsidies, and it will continue

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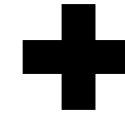
The average of productive spending in 2015-2016 increases significantly compared to 2011-2014

2015: APBNP, 2016: APBN



IMPROVING THE QUALITY OF SPENDING

...government encourage to move the spending from a consumptive economy to a more productive economy



Energy Subsidy Reallocation: Its share of GDP is projected to decline in the next five years

<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
3,2	1,2	0,8	0,5	0,4	0,3

Capital Expenditure (percent of GDP) is projected to increase in the next five years

<u>2014</u>	<u>2015</u>	<u>2016^{*)}</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
1,4	2,2	3,1	4,0	4,6	5,3

A more targeted social programs in the next five years (social assistance spending as percentage of GDP)

<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
0,9	0,9	0,6	1,2	1,1	1,0

^{*)} APBN 2016 included DAK

INFRASTRUCTURE DEVELOPMENT

...spending reform enhances infrastructure development

Infrastructure Progress 2015

Source: Setkab



Jatigede Dam
Have stalled for
50 years



Nipah Sampang Dam
Have stalled for 8 years



PLTU Batang
Have stalled for 4
years



Solo Toll Road
Have Stalled for 10
years



LRT
Have Stalled since
2013

**Additional
New Toll Road
(average)**

Before Oct 2014:
25 km/year
t 2014 – present:
100 km/year

Infrastructure Financing Scenarios

Source: Bappenas' calculation

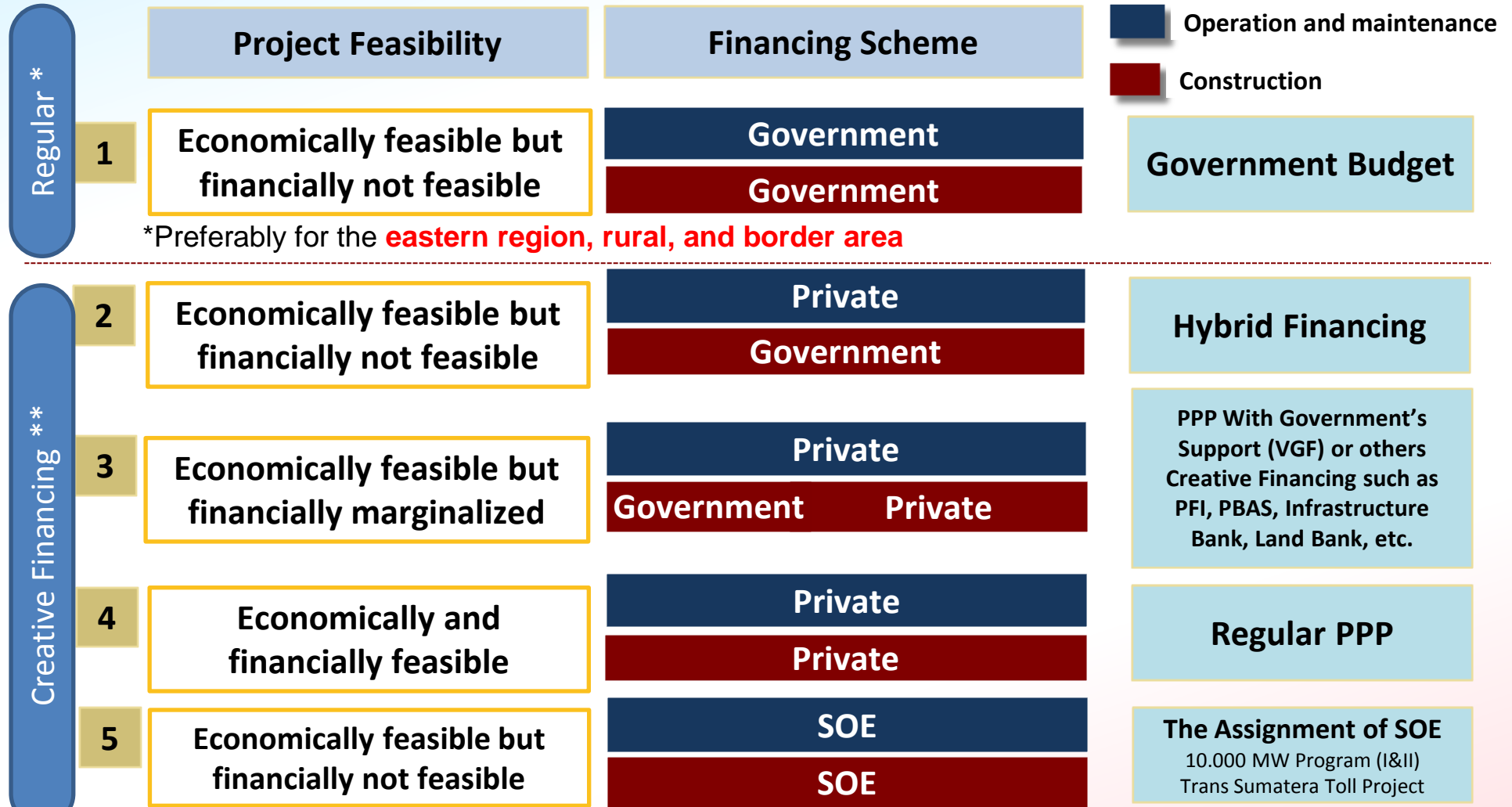
Investment Needs 2015-2019 (Rp. Trillion)

Sector	Scenario 1 (100%)	Scenario 2 (75%)	Baseline (50%)
Roads	1,274	851	637
Rail System	278	222	140
Urban Transportation	155	115	75
Sea Transportation	563	424	282
Ferry and Other Waster Transporation	91	80	60
Air Transportation	182	165	100
Electricity	1,080	762	714
Other Energy dan Gas	535	420	268
Waer Resources	1,091	845	645
Water and Sanitation	666	450	330
Public Housing	384	247	180
Information and Communication Tech	242	200	130
Total	6,541	4,781	3,561

POLICIES OF INFRASTRUCTURE FINANCING SCHEME

...financing strategy to overcome financial needs, involving private sectors

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* Preferably for the **eastern region, rural, and border area**

** Preferably for **the western region and urban**

FINANCIAL SUPPORT FROM FINANCIAL MARKET

...financing from financial market is mostly derived from the banking sector

Source: Bank Indonesia

FUND SUPPLIERS (Rp.Trillion)		% GDP
Bank	Rp. 5418.8	55%
Insurance	Rp. 733.9	7%
Finance Companies	Rp. 439.8	4%
Mutual Funds	Rp. 224.3	2%
Pension Funds	Rp. 180.2	2%
Foreign Investors		
- Gov Bonds (Inc. SPN + Global)	Rp. 485.5	5%
- Corporate Bonds	Rp. 22.0	0%
- Stock	Rp.1840.8	19%
Foreign Debt	Rp.1990.2	20%

Economic
Funding
Needs

Potential
Economic
Growth

Indonesia funding to higher economic growth is dominated by banks, and this fund supply is limited by LDR...

In the meantime, source of funds from Foreign are important but subject to the availability and liquidity of hedging instruments

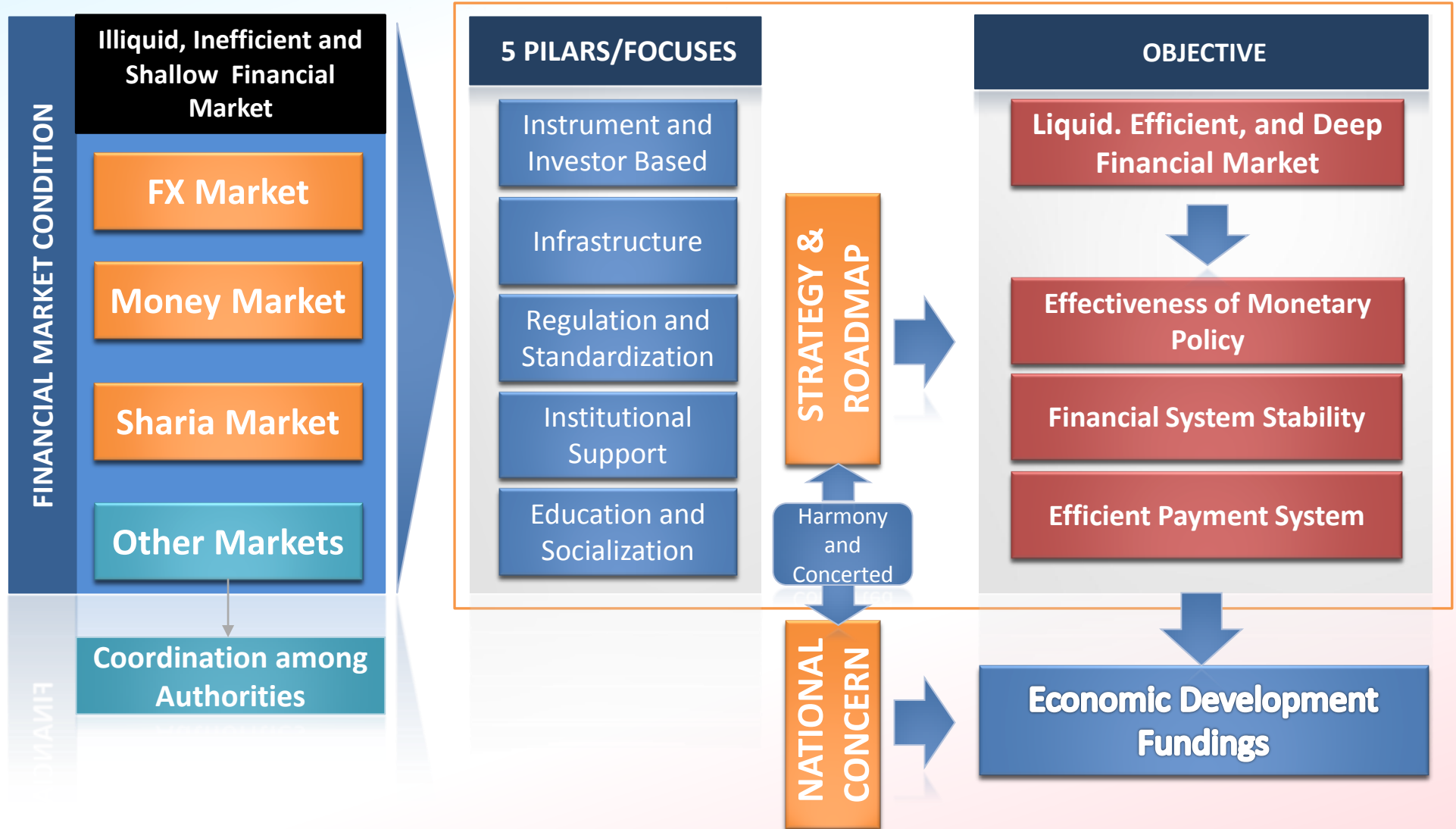
FINANCIAL MARKET DEVELOPMENT FRAMEWORK

...monetary authority has been focusing on financial market deepening since 2014

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A Framework to accelerate financial deepening program will focus on 5 pillars:

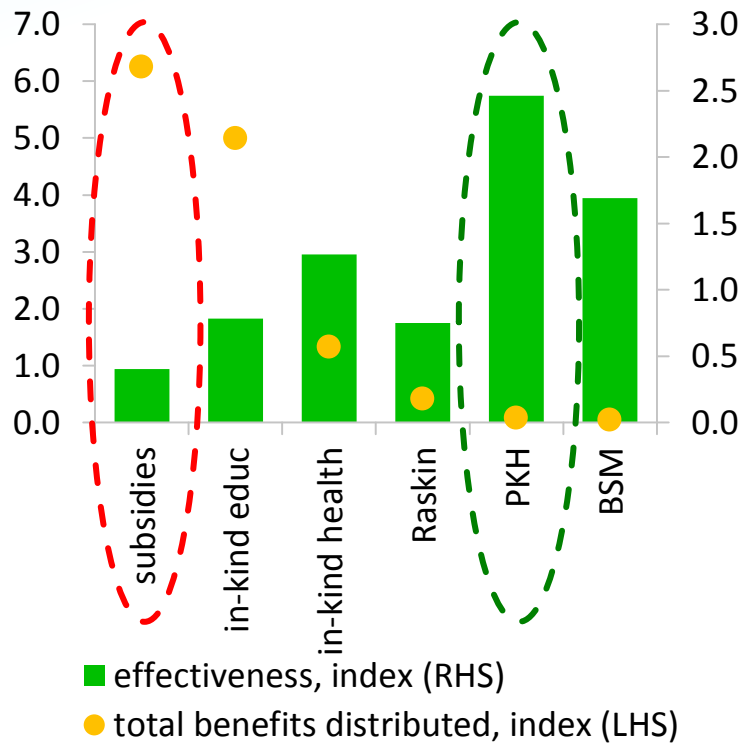
Source: Bank Indonesia



Fiscal incidence on various social welfare programs

...PKH (Conditional Cash Transfer – CCT) is the most effective program, while fuel subsidies appears to be the least effective

Source: MoF and World Bank



Pro Poor Subsidy Scheme

- Eliminating gasoline subsidy & fixed subsidy for diesel oil
- Direct subsidy for electricity
- Improved seeds and fertilizer subsidy

Contributory Social Protection

- Universal health insurance
- Pension and employment
- One Million House also covered by mortgage liquidity support (low DP, low interest, and wider accessibility)

Non Contributory Social Welfare

- Conditional transfer (PKH)
- Rice for Poor
- Equal education opportunities (BOS)
- Direct transfer BLSM
- Increased non taxable income

ROADMAP OF VILLAGE FUND

...total villages 74.754

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Village Fund (VF): Rp46,98 Trillion
VF Average per village: Rp628,5 Million
ADD: Rp36,72 Trillion
Revenue Sharing PDRD: Rp2,65 Trillion
TOTAL: Rp86,36 Trillion
TOTAL AVERAGE PER VILLAGE:
RP1.115,2 MILLION

Village Fund (VF): Rp103,79 Trillion
VF Average per village: Rp1.400,8 Million
ADD: Rp55,94Trillion
Revenue Sharing PDRD: Rp3,05Trillion
TOTAL: Rp162,79 Trillion
TOTAL AVERAGE PER VILLAGE:
RP2.197,1 MILLION

**APBN-P
2015**

2016

2017

2018

2019

Village Fund (VF): Rp20,77 Trillion
VF Average per village: Rp280,3 Million
ADD: Rp32, 67 Trillion
Revenue Sharing PDRD: Rp2,09 Trillion
TOTAL: Rp55,5 Trillion
TOTAL AVERAGE PER VILLAGE:
RP749,4 MILLION

Village Fund (VF): Rp81,18 Trillion
VF Average per village: Rp1.095,7 Million
ADD: Rp42,29Trillion
Revenue Sharing PDRD: Rp2,73Trillion
TOTAL= Rp126,2 Trillion
TOTAL AVERAGE PER VILLAGE:
RP1.703,3 MILLION

Village Fund (VF): Rp111,84Trillion
VF Average per village: Rp1.509,5 Million
ADD: Rp60,28Trillion
Revenue Sharing PDRD: Rp3,38Trillion
TOTAL: Rp175,49 Trillion
TOTAL AVERAGE PER VILLAGE:
RP2.368,6 MILLION



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COMMITMENT TO CREATE MACROECONOMIC STABILITY BY CONTINUING BUDGET REFORM 2016



KEY MACROECONOMIC ASSUMPTIONS

..incorporating the most recent global economic environment and developments

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	2014	2015		2016 Budget
	Realized	Revised Budget	Oct. Realization	
Growth (%)	5.0	5.7	4,7 (Q3)	5.3
Inflation (%)	8.4	5.0	6,25 (YoY)	4.7
Exchange Rate (USD/IDR, Average)	11,878	12,500	13,324 (ytd average)	13,900
3-month-SPN (Treasury Bills)	5.8	6.2	5,9	5.5
Indonesia Crude Price (ICP) (USD / bbl)	97.0	60.0	51,4	50.0
Oil Lifting (thousand bbl / day)	793.5	825	765,5	830
Gas Lifting (thousand bbl / day oil equivalent)	1,224	1,221	1,188	1,155

2016 Growth Scenario

- HH Cons projected to be stable with a moderate inflation
- External condition will improved compared to 2015, although still moderate
- Govt. Cons is based on absorption of 93-95%
- 2016 investment will largely supported by infrastructure spending which reached IDR 313T





2015 Budget Key Focus

- **Quality of Spending**
 - Fuel subsidy savings of IDR 211.3 Tn
 - Re-allocation of savings to basic infrastructure (food security, connectivity and maritime) and social welfare
 - Additional allocation for village funds
 - Capital injection to SOEs
- **Revenue Optimization**
 - Improving tax compliance rate, closing tax leakage and expanding tax base

2016 Budget Key Focus

- **General Revenue and Expenditure Policies**
 - Continue Tax Extensification and Intensification program and improve tax compliance
 - Drive priority program to improve growth quality such as the 20% allocation for education, maintain 5% health allocation and increase regional and village fund allocation
- **Subsidy Policies – More Targeted Program**
 - Targeted subsidy scheme and direct subsidy to small households
 - Food & fertilizers subsidy and expand financing program for SMEs
- **Continue to drive key development projects:**
 - Develop infrastructure for Food Security and Connectivity
 - Improve the service and sustainability of national health, labor insurance program and sustainable social protection program

STRATEGIC POLICY OF 2016 BUDGET IN SUMMARY

33

1

Controlled expansion
at 2.15% GDP deficit



2

Efficient bureaucratic
system for Holiday
Allowance (THR) and
13th Salary



3

5% Healthcare Budget



4

Significant
Infrastructure Budget



5

20% Education Budget



6

Subsidy to the right
Recipient



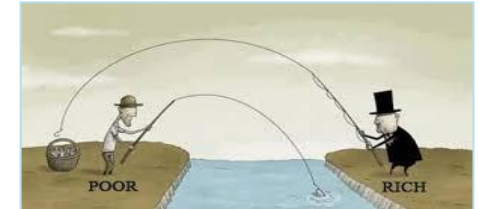
7

Support the
healthcare social
security program



8

Fasten efforts to
reduce income gap
(expansion of PKH)



9

**Support Fiscal
Decentralization** (Village
Fund & Reallocation of
DK/TP)



10

1 Million Home
Program





**MINISTRY OF FINANCE
REPUBLIC OF INDONESIA**

THANK YOU

