ESCAP High-level Policy Dialogue
Ministry of Finance of the Republic of Indonesia International Economic Summit 2013
Eleventh Bank Indonesia Annual International Seminar

“Macroeconomic Policies for Sustainable Growth with Equity in East Asia”

15-17 May 2013, Yogyakarta, Indonesia

Jointly organized by
UN ESCAP, Ministry of Finance of the Republic of Indonesia and Bank Indonesia

Session 3 – Fiscal Policy for Development and its Budgetary Implications

Presentation

Indonesia Fiscal Policy:
Stimulus in the crisis time & long term development

by

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May 2013

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Indonesia Fiscal Policy: Stimulus in the crisis time & long term development

ESCAP High Level Policy Dialogue & 11th Bank Indonesia Annual Seminar
Yogyakarta, 15 May 2013

OUTLINE

2. Indonesia economic drivers & stimulus in the current crisis
3. Fiscal Policy to Promote Sustainable & Inclusive Development
Fiscal Stimulus: Crisis Period 2008/2009

Global crisis impacted on the deterioration of export and purchasing power in the domestic market.

Government policies focused to increase citizen’s purchasing power through fiscal stimulus.

Global Economic Crisis and Stimulus Package 2009

### 2009 Fiscal Stimulus Package

<table>
<thead>
<tr>
<th>Description</th>
<th>Allocation</th>
<th>Realization</th>
<th>% Real</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Tax saving</strong></td>
<td>43.0</td>
<td>43.0</td>
<td>100.0</td>
</tr>
<tr>
<td>1. Reducing and simplifying the personal income tariff (35% → 30%)</td>
<td>13.5</td>
<td>13.5</td>
<td>100.0</td>
</tr>
<tr>
<td>2. Increasing the income tax threshold from Rp12.6 million to Rp15.8 million</td>
<td>11.0</td>
<td>11.0</td>
<td>100.0</td>
</tr>
<tr>
<td>3. Reducing the corporate income tax (single tariff: 30% → 28%) and further discount of 5% for the listed companies</td>
<td>18.5</td>
<td>18.5</td>
<td>100.0</td>
</tr>
<tr>
<td>4. Fiscal tax abolishment on NPWP</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>5. Amendment to VAT</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>B. Tax incentive</strong></td>
<td>13.3</td>
<td>2.8</td>
<td>21.4</td>
</tr>
<tr>
<td>1. VAT on cooking oil</td>
<td>0.8</td>
<td>0.8</td>
<td>100.0</td>
</tr>
<tr>
<td>2. VAT on biodiesel</td>
<td>0.20</td>
<td>0.0</td>
<td>14.0</td>
</tr>
<tr>
<td>3. VAT on oil and gas exploration</td>
<td>2.5</td>
<td>1.0</td>
<td>40.3</td>
</tr>
<tr>
<td>4. Income tax on geothermal</td>
<td>0.8</td>
<td>0.8</td>
<td>100.0</td>
</tr>
<tr>
<td>5. Income tax article 21</td>
<td>6.5</td>
<td>0.2</td>
<td>3.2</td>
</tr>
<tr>
<td>6. Facilities on import duties</td>
<td>2.5</td>
<td>0.0</td>
<td>0.3</td>
</tr>
<tr>
<td><strong>C. Non tax subsidies</strong></td>
<td>17.0</td>
<td>14.3</td>
<td>84.4</td>
</tr>
<tr>
<td>i.e. - Reducing diesel oil price Rp300/litre</td>
<td>2.8</td>
<td>2.8</td>
<td>100.0</td>
</tr>
<tr>
<td>- Discount on electricity tariff for industries</td>
<td>1.4</td>
<td>1.4</td>
<td>100.0</td>
</tr>
<tr>
<td>- Stimulus expenditure package</td>
<td>12.2</td>
<td>10.1</td>
<td>83.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>73.3</td>
<td>60.2</td>
<td>82.1</td>
</tr>
</tbody>
</table>
Countercyclical Policy has given positive impact to economic growth through fiscal stimulus

- Fiscal stimulus in 2009 had a big impact when the economy experienced a slowdown. This is indicated by economic growth higher compared without stimulus, unemployment and poverty rates declined.

- Lesson Learned:
  a. Tax cut policy would be more effective than expenditure policy. This matter is supported by Indonesia demographic profile which is dominated by young/productive generation and higher MPS (marginal propensity to spend).
  b. Considering high infrastructure needs, government should always improve its infrastructure expenditure.

Indonesia economic drivers & stimulus in the current crisis
Global economy is still facing downside risk...

Global Economic Growth Forecast (%)

<table>
<thead>
<tr>
<th>WEO-MNF</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Oct'11</td>
<td>Nov'11</td>
</tr>
<tr>
<td>World</td>
<td>3.2</td>
<td>4.5</td>
</tr>
<tr>
<td>US</td>
<td>2.2</td>
<td>2.5</td>
</tr>
<tr>
<td>Europe</td>
<td>-0.6</td>
<td>1.5</td>
</tr>
<tr>
<td>China</td>
<td>7.8</td>
<td>9.3</td>
</tr>
<tr>
<td>India</td>
<td>4.0</td>
<td>8.1</td>
</tr>
<tr>
<td>ASEAN-5</td>
<td>6.1</td>
<td>5.8</td>
</tr>
<tr>
<td>Indonesia</td>
<td>6.2</td>
<td>6.7</td>
</tr>
</tbody>
</table>

Trade Vol.:

<table>
<thead>
<tr>
<th>WEO-MNF</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<tr>
<td>US</td>
<td>0.8</td>
<td>1.8</td>
</tr>
</tbody>
</table>

1. Global economy is still facing downside risk, however is expected to rebound in the 2nd semester of 2013.
   - Fiscal cliff potential impact; sluggish Europe crisis solving; China improves but still under 10%.
2. Global liquidity volatility potential
   - Loose monetary policies in several advance economies and Eurozone.
3. Global commodity prices volatility (including oil price and Indonesia’s export commodities)

Outlook of Indonesia economic growth: revised down yet still strong and stable...

Strong and consistent real GDP growth

Even stronger real sector GDP growth excluding Oil & Gas

Stable and resilient growth compared to peers

5 years average growth vs. peers (%)

Source: Ministry of Finance, BPS
Note: Figures in $b, price, median from S&P

Stable growth rate (in the last 9 quarters has grown above 6%), keeping up with India and China

Source: BPS, Bloomberg
Note: India economic growth constant price at factor cost
Private consumption is the main economic keydriver, supported by young and dynamic population...

Of the 240 million people in Indonesia, over 60% of the population is under 39 years old, providing a dynamic workforce.

Investment as the second engines of growth, helping in rebalancing economic growth as external side weakens...

Direct investment (US$ bn)

Direct investment growth (%)

Total investment (% GDP)

Source: IMF
Note: IDR/USD exchange rate of 9,000; USD values for convenience only

Source: BKPM
Source: Ministry of Finance
Source: UNPP
Source: Economic Policy Committee and European Commission, IMF, national projects
Source: BPS
Source: IMF
Source: IMF
Source: IMF
Investment in manufacturing has been growing quite rapidly, attracted by potential domestic market. Investment has also been growing across regions...

**FDI by Regions**

<table>
<thead>
<tr>
<th>Region</th>
<th>2005</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jakarta Capital Territory</td>
<td>37%</td>
<td>35%</td>
<td>30%</td>
</tr>
<tr>
<td>West Java</td>
<td>29%</td>
<td>29%</td>
<td>29%</td>
</tr>
<tr>
<td>East Java</td>
<td>8%</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>Banten</td>
<td>7%</td>
<td>6%</td>
<td>7%</td>
</tr>
<tr>
<td>Bali &amp; Nusa Tenggara</td>
<td>1%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Sulawesi</td>
<td>2%</td>
<td>3%</td>
<td>5%</td>
</tr>
<tr>
<td>Kalimantan</td>
<td>14%</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>Central Java</td>
<td>11%</td>
<td>13%</td>
<td>13%</td>
</tr>
</tbody>
</table>

**FDI by Sectors**

- **Chemical & Pharmaceutical Industry**: 17.4%
- **Metal, Machinery & Electronic Industry**: 14.8%
- **Motor Vehicles & Other Transport Equip. Industry**: 12.3%

Leason learned from 2008-2009, tax cut is the best stimulus for a country that rely on private consumption with demographic gift...

Indonesia benefits from a well diversified economy

<table>
<thead>
<tr>
<th>Q1 2013 GDP by sector (% of total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
</tr>
<tr>
<td>Private Consumption</td>
</tr>
<tr>
<td>Govt Consumption</td>
</tr>
<tr>
<td>Investment</td>
</tr>
<tr>
<td>Export</td>
</tr>
<tr>
<td>Import</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Q1 2013 GDP by expenditure (% of total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Consumption</td>
</tr>
<tr>
<td>Investment</td>
</tr>
<tr>
<td>Private Consumption</td>
</tr>
<tr>
<td>Export</td>
</tr>
<tr>
<td>Import</td>
</tr>
</tbody>
</table>

2013 economic growth key drivers:

- Investment and domestic consumption remain as the two main engines of growth.
- Government Consumption: stimulus policy by increasing non-taxable income threshold by 54%, general election, demographic dividend.
- Investment: infrastructure programs and continued investment climate improvement (national logistic system/NSW, Special Economic Zones/KEK), employment improvement.
- International Trade: global demand recovery, Rupiah depreciation impact, and competitiveness improvement.
Fiscal Incentives Policy to support investment...

**Tax Holiday**

- Tax Holiday is a tax facility provided for new capital invested in Pioneer Industry. It is aiming to support the development and growth acceleration of the Pioneer Industry.
- The Corporate Income Tax Facilities comprise of the following:
  1. Corporate income tax relief, which is provided for a minimum period of 5 to the maximum period of 10 years, commencing from the beginning of the fiscal year of commercial production.
  2. Additional reduction of 50% on the corporate income tax payable for the period of 2 years commencing from the end of the year the tax relief ended. This additional facility is provided as transition period’s facility towards the implementation of full tax obligation period.
- The Pioneer Industries are:
  1. Base metal industries;
  2. Oil refinery and/or oil and gas sourced chemical organic industries;
  3. Machinery industries;
  4. Renewable resources industries; and/or
  5. Telecommunication equipment industries.
- From 6 companies that have applied for the facilities, 2 companies have been granted.

**Investment Allowance (Tax Allowance)**

- Investment Allowance is a tax facility provided for capital investment in high priority business sectors in national scale. It is aiming to support the development and growth acceleration of the selected business sectors and/or the selected locations.
- The Facilities consist of the following:
  1. Reduction of taxable income, amounting 30% of investment value
  2. Accelerated depreciation (50% of normal case)
  3. Lower tax rate of Dividend (from 20% to 10%)
  4. Extended Loss Carry Forward Period (up to 10 years)
- Development of sectors receiving facilities:
  - 77 corporations have received the facility

**Government Support on Infrastructure Development:**

1. Master Plan for Indonesia Economic Development and Acceleration
2. Infrastructure Guarantees
3. Land Capping Fund
4. Land Revolving Fund
5. Land Acquisition Fund
6. Geothermal Fund facility

The Economists Wiggle Room Index: Indonesia has the second highest flexibility and cushion in terms of fiscal and monetary front compared to developing countries

- In The Economist analysis towards 27 developing nations, Indonesia is placed second after Saudi Arabia as the nation with the highest flexibility and cushion on fiscal and monetary front. Indonesia’s position are even above the other ASEAN countries such as Philippines, Thailand and Malaysia
- Inflation, foreign exchange rates, current account, deficit as well as a well managed debt are the factors that contribute to the conclusion
- China, Chile, S Korea, Singapore, Russia and Peru are also amongst the best in the wiggle room factor
- While Egypt, India, Poland, Brazil and Vietnam are considered to have limited wiggle room

Source: The Economist, January 2012
### Policies to Address and Mitigate Crisis

#### Pre-emptive measures
1. Implementing Crisis Management Protocol
2. Implementing Bond Stabilization Framework
3. Enhancing coordination between government institutions and continuous dialogue with market participants
4. Swap facility arrangements based on international cooperation
5. Chiang Mai Initiative Multilateralization

#### Bond Stabilization Framework
- **Buyback of government bonds by the DMO from the state budget**
- **Potential purchase of government bonds by State Owned Enterprises**
- **Purchase of government bonds by the DMO from accumulated cash surplus**

#### Fiscal Buffers to prevent and mitigate crisis
1. Deferred Drawdown Option facility
2. Specific articles in the 2013 State Budget Law that provide flexibility for Government to take quick mitigation action if necessary, with Parliament approval that has to be given within 24 hours

### Financial System Stability Coordination Forum (FKSSK)
Financial System Stability Coordination Forum (FKSSK) will closely monitor developments in the financial sector to prevent and mitigate crisis possibility. FKSSK is consisted of Minister of Finance (coordinator), Governor of Bank Indonesia, Chairman of the Board Commissioners Indonesia Financial services Agency (OJK) and Chairman of the Board of Commissioner Indonesia Deposit Insurance (LPS). FKSSK activities:

1. Exchange of data and information whether conducted on a regular basis or for special needs.
2. Evaluation, surveillance/general analysis, policy recommendation in order to maintain financial system stability as well as follow-up monitoring.
4. Human Resource Capacity Development in collaboration with several international agencies for several areas of knowledge / skills related to Financial Stability System.

### Fiscal Policy to Promote Sustainable & Inclusive Development
Prudent and sustainable fiscal policy management...

Indonesia Fiscal Deficit (%)

2012E deficit comparison (% GDP)

Indonesia Debt to GDP ratio

Debt to GDP ratio comparison (%)

State budget is directed to improve priority areas to unleash the optimum potential of demographic dividend..

Food Security (Rp billion)

Education (Rp billion)

Infrastructure Budget (Rp billion)

Poverty Reduction Budget (Rp billion)
Social assistance program target enhances significantly...

- Jamkesmas (Health care program)
  - 2007: 76.4 mil of people
  - 2013: 86.4 mil of people

- PKH (conditional cash transfer for poor households)
  - 2007: 2.4 mn of very poor HH
  - 2013: 2.4 mn of very poor HH

- PNPM (Community empowerment program) Rural
  - 2007: 752 Regencies
  - 2008: 3.6 mn
  - 2013: 10,922 Regencies
  - 2008: 14.2 mn

- Scholarships for poor students
  - 2007: 752
  - 2013: 720 thds of very poor HH

- Rural Social assistance program target enhances significantly...

Budget has been contributing in lifting up people wellbeing..

- Poverty Level
  - 2007: 17.7%
  - 2013: 13.3%

- Unemployment Rate
  - 2007: 10.0%
  - 2013: 5.0%

* State budget is designed under the framework of pro growth, pro job and pro poor.
* Poverty and unemployment rates have been consistently declining...
The challenge is... room for further expansion is still huge as mandatory spending and subsidy remain high...

Central Government Expenditures (Rp Trillion, 2005 – 2013)

Increased allocation of central government expenditure towards more productive uses

Source: Ministry of Finance

Thank You