EABER East Asian Bureau of Economic Research
SABER South Asian Bureau of Economic Research

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Newsletter

Welcome to the East Asian Bureau of Economic Research (EABER) and South Asia Bureau Research (SABER) Newsletter.

EABER and SABER strive to be the premier economics research forums and to provide a single point of reference for the economics, finance and governance research community throughout the region and beyond. Through building research capacity and partnering initiatives, EABER and SABER facilitate high-level analysis and forward thinking on issues of importance to the East and South Asian economies.

Analysis

Indonesia an oasis of economic stability but questions remain

Mari Pangestu

Despite major domestic and external challenges, Indonesia is expected to grow at around 5 per cent again this year — much like last year — and only slightly below the official estimate of 5.3 per cent but much lower than the 7 per cent the new government had targeted. Compared to continued downward global growth, including that of China and its ASEAN neighbours, Indonesia's stable growth looks quite respectable.

Stable growth is still driven by domestic consumption, even though many indicators remain flat or negative. Net exports contribute negatively to growth because of unfavourable external conditions and weak commodity prices. Domestic investment is also weak despite an expansionary monetary policy and 14 economic deregulation packages since September 2015.

A lower inflation rate has allowed the central bank to reduce its benchmark interest rate several times, bringing it down 150 basis points. This has led to an actual reduction in interest rates by 60 basis points, but it has failed to boost domestic investment and credit growth among all the uncertainties.

Despite limited fiscal space, government spending contributed most to growth in the first half of 2016, especially in the second quarter.

Overall, the biggest issue in 2016 was the risk to sustainable fiscal policy. The root cause was the unrealistic tax revenue target set in 2015 to support the priorities of the president and the government in infrastructure, health and other sectors. Despite the average growth of tax revenues in the last three years being less than 10 per cent and a general slowdown in the economy, the 2015 growth target was set unrealistically at 30 per cent. Realised revenue growth was only 8 per cent. But again in 2016 a 24 per cent target was set, raising the question of fiscal sustainability.

To meet the shortfall in tax revenue, the government would have had to undertake budget cuts to the tune of 200 trillion rupiah (some US$15 billion). But the budget cut (of 60 trillion) that was passed in the revised budget fell short of that by around 140 trillion rupiah (approximately US$11 billion). Instead, an ambitious tax amnesty program was promoted to address the shortfall. These steps did little to address the problem of fiscal sustainability.

In a merciful economic policymaking coup in August, President Joko Widodo brought back the highly respected and experienced Finance Minister Sri Mulyani to re-set fiscal course.

Paper of the Month

The most viewed paper for the month of November 2016 was Paul Hubbard and Dhruv Sharma's working paper on "Understanding and applying long-term GDP projections".

Events

EABER hosted the 38th Pacific Trade and Development (PAFTAD) Conference in Canberra on 22-24 November. The topic discussed was 'Asian Economic Integration Strategies'.

ADBI will host an event on 5 January 2017 in Tokyo on 'Public Debt and Private Firm Funding: Evidence from Cities in the People's Republic of China'.

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Sri Mulyani hit the ground running. She took charge of implementing the ambitious tax amnesty program, which faced considerable scepticism and implementation problems. The President undertook a huge and intensive public outreach campaign to the private sector. This included his calling on large corporations himself to seek for their participation and commitment. The result has been better than expected in terms of the tax amnesty targets, but less so on the tax reform front.

Indonesia's tax amnesty program has done better in terms of assets declared as a percentage of GDP than similar programs elsewhere — at 35 per cent compared to 32 per cent in India and 8 per cent in Chile. In terms of penalties paid, it clocked up 0.8 per cent of GDP, the second highest after India at 0.9 per cent.

But Indonesia has been less successful in widening the tax base and in undertaking comprehensive tax reform program. The number of tax payers that registered with the tax amnesty was 370,000; only 16,000 new tax payers signed on. Indonesia's tax-to-GDP ratio has fallen from 11.9 per cent to 10.8 per cent from 2012–2015, compared to its ASEAN neighbours of 13–17 per cent.

Increased tax scrutiny in the last two years due to ambitious tax revenue targets have hurt both investment and consumption confidence. Yet the President and the Finance Minister have announced that there are more tax reforms to come, including reducing the corporate tax rate from 25 per cent to 18 per cent.

Soon after resuming office, Sri Mulyani predicted another 210 trillion rupiah shortfall in tax revenue. A revised budget was passed with more realistic targets to increase tax revenue and cut spending by 184 trillion rupiah. The revised budget was welcomed as more realistic although it choked back the government's contribution to growth.

Last quarter growth fell to 5.02 per cent. Budget plans for 2017 realistically project a 13.5 per cent increase in tax revenues and 9.8 per cent increase in government spending. But fiscal sustainability is still at risk, given that fiscal revenue targets are unlikely to be met with lower growth in 2017 and less than effective reforms on tax collection and on the spending side, especially around fuel and electricity subsidies.

The big issue for 2017 is how to revive private investment growth, including in infrastructure. The key here is real structural reform. The 14 economic regulation packages so far fall short on reform even though they focus on reducing the costs of doing business, facilitating trade and investment and people movement for tourism. What they fail to do is to address the fundamental issues for investors of land clearance, pricing and clarity on public private partnerships and the investment processes they face. And there is continued ambivalence on protectionism and localisation policies.

Dealing with these issues is necessary to lifting Indonesia's 5 per cent trajectory path or, worse, preventing it from drifting further below potential.

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