ISEAS YUSOF ISHAK INSTITUTE

ISSUE: 2021 No. 141
ISSN 2335-6677

PERSPECTIVE

RESEARCHERS AT ISEAS – YUSOF ISHAK INSTITUTE ANALYSE CURRENT EVENTS

Singapore | 5 November 2021

Indonesia's Budget Stretched to Control a Pandemic and to Revive a Struggling Economy

*Manggi Habir and Siwage Dharma Negara**

This aerial picture shows motorists commuting in Jakarta on 15 September 2021. Photo: BAY ISMOYO, AFP.

** Guest writer, Manggi Habir, is an independent commissioner for three companies, PT ABM-Investama Tbk, PT Berdayakan Usaha Indonesia, and PT Adira Dinamika Multi Finance Tbk. Siwage Dharma Negara is Senior Fellow at ISEAS – Yusof Ishak Institute.*

ISSUE: 2021 No. 141
ISSN 2335-6677

EXECUTIVE SUMMARY

- The second major Covid-19 surge driven by the Delta variant in the second half of 2021 has led to another round of social restrictions, thereby slowing down the economy's fragile recovery. This complicates budget implementation for the remaining part of the year as well as the planning for 2022.

- This year's improved budget disbursement has helped to fund the expansion of the government's critical health and social assistance programmes, while material and capital expenditures have declined.

- Expecting state revenues to be squeezed, the government has introduced a new tax law, which parliament has just passed. This tax law consists of a rise in value-added tax (VAT) and income tax rates next year, a second tax amnesty programme and a new carbon tax, among others. However, the desired outcomes are not assured, as the pandemic is still evolving.

- Policymakers have to calibrate a delicate balance in catering for public health requirements while ensuring that growth objectives remain intact. While funds are sorely needed for social spending and economic programmes, fiscal prudence is critical to avoid any downgrading of Indonesia's risk and debt ratings.

ISSUE: 2021 No. 141
ISSN 2335-6677

INTRODUCTION

This year, the Indonesian economy had been showing signs of recovery from last year's pandemic-driven slump. The 2Q 2021 grew at a promising 7.07% year-on-year rate. But in August, this recovery was disrupted by a massive second wave of delta-variant infections, once again overstretching health facilities and forcing the government to reimpose social restrictions. As a result, earlier 5% growth targets have been downgraded to around 3.5%. This has a complicated budget implementation for the remainder of 2021 and raises questions about next year's plan.

In this second pandemic year, the government's fiscal options are understandably quite limited. Revenues are down from a slowdown brought about by social restrictions, while expenditures are up, driven by extensive health and social assistance spending. This inevitably creates a widening budget deficit. The challenge is to find a balance between raising enough debt to cover the deficit while ensuring it does not overwhelm fiscal capacity, hurt debt ratings and ultimately damage market confidence.

Fiscal flexibility is badly required as the government rushes to impose social restrictions, hurting growth and government revenue during an infectious surge, and subsequently lifts restrictions and boosts spending when the positive-infected numbers drop to a manageable level. The parliament has just passed a new tax law to enhance fiscal flexibility and help reduce the budget deficit to meet the government's fiscal consolidation target in 2023.[1]

This brief will discuss some critical issues concerning the fiscal situation in Indonesia, focusing on government revenue and spending patterns before and during the pandemic. It will look at the ability of the government to fund the spending and the challenges it faces to maintain a budget deficit and a debt level that does not hurt its "investment grade" rating.

SPENDING FOR GROWTH

To deal with the impact of the pandemic, the Indonesian government has relied on an expansive fiscal policy to support the health sector and provide a lifeline for the economy. This government spending has kept the economy from further deterioration after the implementation of large-scale social restrictions, or PSBB, in April-June 2020. In the second half of 2020, while all GDP components experienced deep contractions, government consumption grew positively (Table 1), thanks to the massive stimulus package (PEN or Program Pemulihan Ekonomi National), amounting to Rp 695.2 trillion (US$ 48.8 billion).[2]

From Q2 to Q4 last year, government spending had grown at a two-digit level, indicating an aggressive counter-cyclical fiscal policy in response to the economic recession (Table 1). Still, the economy contracted by 2.07% last year.

ISSUE: 2021 No. 141
ISSN 2335-6677

Table 1: GDP growth by components (%)

	2019	2020				2021	
	Q4	Q1	Q2	Q3	Q4	Q1	Q2
GDP (*year on year*)	5%	3%	-5%	-4%	-2%	-1%	7%
Household	5%	3%	-6%	-4%	-4%	-2%	6%
Government	1%	4%	-7%	10%	2%	2%	8%
Investment	4%	2%	-9%	-7%	-6%	0%	8%
Exports	0%	0%	-12%	-12%	-7%	7%	32%
Imports	-8%	-4%	-18%	-23%	-14%	6%	31%
	2019	**2020**				**2021**	
	Q4	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
GDP (*quarter on quarter*)	-2%	-2%	-4%	5%	0%	-1%	3%
Household	0%	-2%	-7%	5%	1%	-1%	1%
Government	37%	-44%	22%	17%	27%	-44%	29%
Investment	4%	-8%	-10%	9%	4%	-2%	-3%
Exports	-3%	-6%	-13%	12%	2%	8%	7%
Imports	4%	-13%	-15%	0%	16%	7%	6%

Source: Statistics Indonesia (BPS)

Traditionally, personnel expenditure takes the largest share of government spending, amounting to 22-23% (Table 2). The second-largest component is material expenditures, accounting for about 21% of total outlays before the pandemic. During the pandemic, the allocation for material expenditure[3] has declined dramatically by -21%. Likewise, capital expenditure had also declined by -27% in 2020. Meanwhile, spending for social assistance has jumped significantly by 71%, from Rp 102 trillion in 2019 to Rp 175 trillion in 2020. Moreover, interest payments jumped by 23%, from Rp 276 trillion in 2019 to Rp 339 trillion in 2020.

ISSUE: 2021 No. 141
ISSN 2335-6677

Table 2: National Budgets (APBN) by expenditure components (Rp trillion)

	2019		2020		2021		2022	
	Rp trillion	%	Rp trillion	%	Rp trillion	%	Rp trillion	%
Personnel	382	23%	404	20%	421	21%	427	22%
Material	345	21%	273	14%	362	18%	338	17%
Capital	189	12%	137	7%	247	12%	197	10%
Interest Payment	276	17%	339	17%	373	19%	406	21%
Subsidies	224	14%	192	10%	175	9%	207	11%
Social Assistance	102	6%	175	9%	161	8%	147	7%
Central Govt expenditure (total)	1,634		1,975		1,989		1,967	
Regional Transfer & Village Funds	795		725		761		742	

Note: % is share to total central government expenditure
Source: Ministry of Finance

As growth is expected to recover, the government has projected to reduce social assistance allocation from this year onward (Table 2). While understandable, given the risk of a prolonged pandemic, reducing government support too early can be risky for economic recovery.

Government spending has faced disbursement challenges. In 2019, the realisation of central government spending was around 91.7%. In 2020, the government slightly improved the spending realisation rate to 92.5% (Table 3). The low realisation rates are partly due to the highly bureaucratic process of disbursing the budget.[4]

ISSUE: 2021 No. 141
ISSN 2335-6677

Table 3: Budget Realisation (Rp trillion)

	Realisation as of 31 Aug 2019	%	Realisation as of 31 Aug 2020	%	Realisation as of 31 Aug 2021	%
Personnel	264.6	69%	265.9	66%	270.1	64%
Material	173.7	50%	159.5	58%	255.4	70%
Capital	63.0	33%	58.6	43%	102.6	42%
Interest Payment	172.4	62%	196.5	58%	213.2	57%
Subsidies	103.5	46%	95.3	50%	119.7	68%
Social Assistance	78.7	77%	139.1	80%	108.1	67%
Regional Transfer & Village Funds	530.7	67%	557.3	77%	472.9	62%
Central Govt expenditure (total)	857.7	52%	977.3	49%	1,087.9	55%

	Realisation as of 31 Dec 2019	%	Realisation as of 31 Dec 2020	%
Personnel	376.1	99%	380.5	94%
Material	334.4	97%	422.3	155%
Capital	177.8	94%	190.9	139%
Interest Payment	275.5	100%	314.1	93%
Subsidies	201.8	90%	196.2	102%
Social Assistance	112.5	110%	202.5	116%
Regional Transfer & Village Funds	813.0	102%	762.5	105%
Central Govt expenditure (total)	1,498.9	91.7	1,827.4	92.5

Source: Ministry of Finance

There is encouraging disbursement improvement this year. Table 3 shows that as of August 31, the realisation rate has reached 55%, higher than for the same period of last year or the year before the pandemic. Material spending (incl. vaccine and medical equipment), in particular, has seen the fastest realisation rate, followed by subsidies and social assistance. Nevertheless, capital expenditure remains sluggish, reaching only 42% as of August 31. Based on the 2020 experience, capital spending[5] accelerated at year-end. Last year, health and business sector disbursements only started to pick up in August.

This year, the government has raised the National Economic Recovery Program (PEN) by 7% to Rp 744.8trn (US$52.3 billion). This programme supports the health sector, maintains people's purchasing power through social assistance programmes, and prevents further deterioration for MSMEs and the business world through subsidies and tax relief.

The realisation of the PEN programme in 2020 only reached 82.83% of the budget ceiling or Rp 575.8 trillion.[6] The government could only spend 64% of the budget for health support and 47% of the budget for business incentives by late 2020.[7] It did, however, manage to

ISSUE: 2021 No. 141
ISSN 2335-6677

spend 96% of the household support budget, the most significant component of PEN. This higher disbursement performance was made possible by scaling up existing programmes, such as the Hopeful Families Program (PKH), food assistance programmes, and the village fund programme.

A medium and long-term implication of the pandemic relates to increased debt burden. In 2020, interest payments increased significantly, reaching Rp 338.8 trillion from Rp 275.9 trillion pre-pandemic. This year, interest payments are projected to increase further by 10%. By 2022, about 20% of central govt expenditure will be spent on paying interest. This means that only 80% of the spending can be used to support the economy.

Given the shrinking fiscal space, improved revenue collection is imperative for ensuring fiscal sustainability. The following section will discuss the issues surrounding revenue collection during the pandemic.

REVENUE COLLECTION

State revenue trends: When the pandemic first spread in 2020, state revenue of Rp 1,648 trillion dropped by 16% from the pre-pandemic year of 2019. Tax revenue accounted for Rp 1,285 trillion, followed by non-tax revenue at Rp 344 trillion. [8]

For January-July 2020, a more detailed breakdown of state revenue sources shows income tax as the largest contributor (40% of state revenue), shrinking by the same 16%, reaching Rp 370 trillion (see Table 4). All other state revenue sources declined, except for excise tax, largely from resilient tobacco sales and custom charges. It is interesting to note that Value-added Tax (VAT), the second-largest contributor to state revenue (24% of state revenue), showed a lower drop than income tax due to the ongoing production and consumption of essential goods.

Table 4: State Revenue Trend for Jan-Jul 2019, 2020 and 2021 periods

In Rp trillion	Jan-Jul 2019	Jan-Jul 2020	Change %	Jan-Jul 2021	Change %
Income tax	439	370	-16.0	373	+0.9
VAT	250	220	-12.0	258	+17.4
Other (Land)	16	13	-20.1	17	+32.0
Sub-total Tax	**707**	**603**	**-14.7**	**648**	**+7.6**
Excise/Customs	106	110	3.7	141	+29.5
Total Tax Revenue	**813**	**713**	**-12.3**	**789**	**+10.7**
Non-Tax Revenue	**242**	**209**	**-13.5**	**242**	**+15.8**
Total State Revenue	**1,053**	**922**	**-12.4**	**1,031**	**+11.8**

Source: APBN Kita, Kinerja dan Fakta Agustus 2021 and Agustus 2020

With the recovery picking up in early 2021, state revenue for the January-July period rose by 11.8%, reaching Rp 1,032 trillion. Still, this remains below pre-pandemic levels.
Tax revenue, including customs and excise tax, amounted to Rp 789 trillion, with non-tax revenue reaching Rp 242 trillion. Once again, VAT revenue growth far exceeded growth in income tax, as consumption grew early this year.

ISSUE: 2021 No. 141
ISSN 2335-6677

The adverse impact from the resumption of social restrictions during August-September 2021, however, is a concern. Bank Indonesia has already adjusted downward its forecasts for the country's 2021 growth to a 3.5-4.3% range, which is much lower than the 2021 state budget's 5% growth target (see Table 1 in Appendix). As a result, this year's last quarter recovery will be critical to cover lost ground from the August-September social restrictions.

Table 5: State Budget 2019-2022 Period

In Rp trillion	**2019** Actual	**2020** Actual	**Change %**	**2021** Forecast	**Change %**	**2022** Outlook	**Change %**
State revenue	**1,960.6**	**1,647.8**	**-16.0**	**1,735.7**	**+5.3**	**1,840.7**	**+6.0**
-Tax	1,546.1	1,285.1	-16.9	1,375.8	+7.1	1,506.9	+9.5
-Non-tax	409.0	343.8	-15.9	357.2	+3.9	333.2	-6.7
State expenditure	**2,309.3**	**2,595.5**	**+12.4**	**2,697.2**	**+3.9**	**2,708.7**	**+0.4**
-Central Gov	1,496.3	1,833.0	+22.5	1,927.0	+5.1	1,938.3	+0.6
-Regional transfer	813.0	762.5	-6.2	770.3	+1.0	770.4	+0.02
Primary Balance	**-73.1**	**-633.6**	**+766.8**	**-595.3**	**-6.0**	**-462.2**	**-22.4**
Surplus (Deficit)	**-347.8**	**-947.7**	**+171.8**	**-961.5**	**+1.5**	**-868**	**-9.7**
% of GDP	***-2.2***	***-6.1***		***-5.8***		***-4.85***	
Financing	**402.1**	**1,193.3**	**+196.8**	**961.5**	**-19.4**	**868.0**	**-9.7**

Source: APBN Kita, Kinerja dan Fakta Agustus 2021

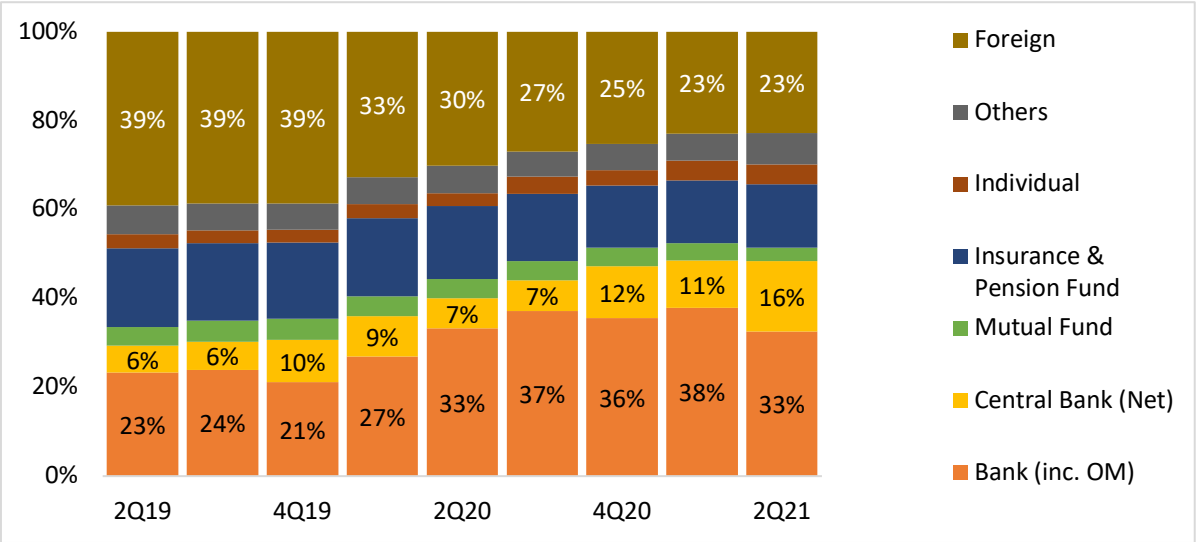
As noted in Table 5, the 16.0% decline in 2020 state revenue and the 12.4% rise in state spending, resulted in a budget deficit of 6.1%. The projected recovery in 2021 and 2022—i.e. a subsequent increase in state revenue and a more subdued rise in state spending—would reduce the budget deficit to 4.85% by 2022. The goal is to bring this further back under its earlier limit of 3.0% in 2023.[9]

Financing a widening deficit: As of July 30, 2021, the total government debt outstanding, consisting of Rupiah, foreign-denominated and Sharia Sukuk bonds, reached Rp 839.4 trillion. Last year, to ensure the take-up of these bonds, the government and Bank Indonesia (BI) came up with their Burden Sharing programme, where BI would purchase government bonds in the primary market. This was met with some trepidation by market observers who questioned BI's independence and voiced concern about potential inflationary pressures.

BI's government bond purchase, as of August 16, 2021, amounted to Rp 131.96 trillion, comprising roughly 16% of total government bond ownership. Foreign ownership, which at 39%, was the largest holder of bonds during pre-pandemic times, has now been overtaken by Indonesian banks with 33% bond ownership holdings. Banks facing limited lending opportunities and holding considerable liquidity have become active buyers of government bonds. Meanwhile, inflation has dropped to an all-time low of 1.6% for 2021, with overall demand still weak.

ISSUE: 2021 No. 141
ISSN 2335-6677

Figure 1: Government Bond Ownership Breakdown, Q2 2019 - Q2 2021



Source: Ministry of Finance

The country's total debt level, as a percentage of GDP, is at 37.5% for 2Q 2021, slightly below its peak of 39.3% late last year. So far, Indonesia's debt rating remains at BBB with Fitch and S&P, while Moody's is at a similar Baa2 level. The difference is that Moody's and Fitch ratings come with a 'Stable' outlook, while S&P is keeping its 'Negative' outlook. Indonesia is just two notches above the investment-grade benchmark, and so it must cautiously manage its debt capacity as it has limited room to maintain its financial market access.

Some market players are already factoring in a lower rating in their valuation and pricing of Indonesia's government bond, given S&P's negative outlook. This explains the relatively rich 6.337% yield on its 10-year bond. The lowered portion of foreign-owned government bonds from 39% in the past to 23% also reduces the bonds' pricing volatility. However, with concerns about inflation and the potential rise in US interest rates, there could be upward pressure on government bond rates.

This is one reason behind recent plans to pass new tax legislation through parliament before year-end. This new tax law, which will become effective next year and is already factored into the government's 2022 forecast, is designed to boost government tax revenue to meet its 2022 and 2023 budget commitments.

One of the tax changes is to raise VAT rates from 10% to 11% starting April 2022, and further to 12% in 2025. In addition, VAT will further extend to basic goods and services (food, education, health and financial services), which is currently still exempted. VAT is becoming an increasingly important contributor to state revenue, given its acceptance, compliance, and implementation are much easier than income tax. And, during the pandemic, VAT has been shown to be more resistant to downward swings and more responsive to upswings than income tax.

ISSUE: 2021 No. 141
ISSN 2335-6677

Another, is a new income tax bracket of 35% for individuals with an annual income above Rp 5 billion (SGD 500,000). For lower income levels, the first income bracket of 5%, which currently applies for income up to Rp 50 million, will be extended further to cover income up to Rp 60 million. For corporates, the current corporate tax rate will be kept at 22% and not lowered to 20% as planned. For 2020 and 2021, the current tax rates still apply and the government has not issued any tax moratorium for these two years. There will also be a new carbon tax of Rp 30 for every kg equivalent of carbon dioxide emitted. Coal plants will be the first to be impacted next year.

The last change is a plan to have a second tax amnesty, which will closely follow the 2016 amnesty programme, but now with higher final income tax rates. This time, taxpayers will be allowed to declare assets not yet reported and pay a final income tax rate ranging between 12-18%. The earlier tax amnesty programme carried a 6-11% final income tax range. The rates applied would depend on the location of the assets, whether it would be brought back or kept abroad, and whether or not it would be invested in a designated investment area or type of government security.[10]

It is doubtful that this new amnesty programme will attract a similar level of participants, which in 2016 saw around 970,000 taxpayers declaring undisclosed assets of Rp 4,881 trillion (40% of GDP), and generate similar results, which comprised Rp 135 trillion in additional tax income in 2016. Surprisingly, most of the assets declared then were domestic assets, amounting to Rp 3,698 trillion, while foreign assets, which amounted to Rp 1,036 trillion, fell far short of the government's target.[11]

This time, the government's objective appears to focus more on registering and repatriating more undeclared offshore assets. A few months earlier, the Ministry of Finance established a specific task force to seek the repayment of still outstanding government liquidity credits (Bank Indonesia Liquidity Support or BLBI) totalling Rp 110.45 trillion from major borrowers, most of which were issued to bail out the banking sector during the 1997/98 Asian Financial Crisis.[12] This new amnesty programme would help these borrowers settle their government obligations. However, this might be a long drawn-out process.

The Ministry of Finance is projecting that the new tax laws will generate IDR 139 trillion in additional government revenue and reduce the government's budget deficit further by -0.37% to -4.43% next year.[13]

CONCLUSION

In a pandemic environment, the ability to successfully implement a country's budget will not just rely on political-economic factors as with previous budgets. There are also public health issues to address at this time, owing to the deadly virus that continues to mutate and evolve. Getting people vaccinated and ensuring that health protocols are adhered to remain challenges worldwide. Closely monitoring a relatively new set of public health metrics and responding with effective social policy and guidelines are becoming critical to ensure that the fragile recovery continues to gain strength.

ISSUE: 2021 No. 141
ISSN 2335-6677

Appendix:
Table 1: Key macroeconomic figures

	2019	2020	2021*)	2022**)
Economic Growth (%)	5.0	-2.1	3.7-4.5	5-5.5
Inflation (%)	3.0	3.0	1.8-2.5	3-3.3
Exchange Rate (Rp/US$)	14,130	14,625	14,200-14,600	14,350
3-month SBI/SPN (%)	6.8	5.4	6.34-7.24	6.82
Crude Oil Price (US$/barrel)	62.4	40.5	55-65	63
Oil Lifting (000 barrel/day)	746.0	707.0	680-705	703
Gas Lifting (mill barrel/day)	1062.5	975.0	987-1007	1036

Note: 2019 and 2020 figures are all realisation figures. *) Outlook; **) Budget assumptions
Source: Ministry of Finance, via CEIC

[1] https://www.thejakartapost.com/paper/2021/10/04/key-points-from-impending-new-tax-law.html. Accessed 7 October 2021.
[2] https://money.kompas.com/read/2021/07/15/155819626/sepanjang-2020-realisasi-program-pen-hanya-8283-persen. Accessed 27 September 2021.
[3] Material expenditures consist of spending on office equipment, replacement of office equipment and supplies as well as consumable goods and services, including vaccines and medical equipment.
[4] Robert Sparrow, Teguh Dartanto & Renate Hartwig (2020) Indonesia Under the New Normal: Challenges and the Way Ahead, *Bulletin of Indonesian Economic Studies*, 56:3, 269-299.
[5] Capital expenditures are used for procuring land, equipment and machinery, building, road, irrigation and network infrastructure, and other capital expenditures.
[6] https://money.kompas.com/read/2021/07/15/155819626/sepanjang-2020-realisasi-program-pen-hanya-8283-persen. Accessed 27 September 2021.
[7] Della Temenggung, Adhi Saputro, Rullan Rinaldi & Deasy Pane (2021) Managing Recovery and Seizing Reform Opportunities, *Bulletin of Indonesian Economic Studies*, 57:1, 1-28.
[8] APBN Kita, Kinerja dan Fakta Agustus 2021
[9] APBN Kita, Kinerja dan Fakta Agustus 2021
[10] Arys Aditya, Grace Sihombing and Claire Jiao, "Indonesia Eyes Top Income Tax Bracket", Raises VAT in New Bill, Bloomberg News, October 1, 2021
[11] "Trillions declared through Indonesia's tax amnesty programme", Oxford Business Group, https://oxfordbusinessgroup.com/analysis/taxing-questions-amnesty-programme-trigger-step-change-tax-compliance
[12] Sorta Tobing, "Daftar Pengutang BLBI, Ada 7 Debitur Masuk Prioritas Satgas", 19 September 2021, katadata.co.id, https://katadata.co.id/sortatobing/berita/614711c59ffd3/daftar-pengutang-blbi-ada-7-debitur-masuk-prioritas-satgas
[13] Ministry of Finance, Undang-Undang Harmonisasi Peraturan Perpajakan, Membangun Sistem Perpajakan Yang Adil, Sehat, Efektif dan Akuntabel, Jakarta, Oktober 2021

ISSN 2335-6677

ISEAS Perspective is published electronically by: **ISEAS - Yusof Ishak Institute** 30 Heng Mui Keng Terrace Singapore 119614 Main Tel: (65) 6778 0955 Main Fax: (65) 6778 1735 Get Involved with ISEAS. Please click here: https://www.iseas.edu.sg/support	ISEAS - Yusof Ishak Institute accepts no responsibility for facts presented and views expressed. Responsibility rests exclusively with the individual author or authors. No part of this publication may be reproduced in any form without permission. © Copyright is held by the author or authors of each article.	Editorial Chairman: Choi Shing Kwok Editorial Advisor: Tan Chin Tiong Managing Editor: Ooi Kee Beng Editors: William Choong, Lee Poh Onn, Lee Sue-Ann, and Ng Kah Meng Comments are welcome and may be sent to the author(s).