

PERSPECTIVE

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Singapore | 8 September 2017

Promoting Growth with Equity: Indonesia's 2018 Budget

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EXECUTIVE SUMMARY

- Indonesia's 2018 budget proposal maintains a fiscally expansionary approach in support of infrastructure development, poverty alleviation and social assistance programmes. The latter has received a significant allocation for next year, the year before the 2019 election.
- Based on the Indonesia National Survey Project, President Jokowi's approval rating remains strong. The public generally think that he has improved the economy, especially in terms of growth and infrastructure development.
- However, there is public dissatisfaction over inflation and difficulty in finding jobs. Jokowi needs to respond to these issues well in the run-up to 2019.
- The government will need a sound action plan for implementing the budget in a timely and efficient manner, as well as a strategy to achieve its revenue target.

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INTRODUCTION

President Joko “Jokowi” Widodo presented the 2018 budget proposal in his State of the Nation address on 16 August 2017. Three years into his Presidency, Jokowi’s approval rating remains strong. According to findings from the Indonesia National Survey Project (INSP) commissioned by the ISEAS – Yusof Ishak Institute, majority of Indonesians think that Jokowi has improved the economy in terms of higher growth and infrastructure development. However, some dissatisfaction remains with regards to inflation and job creation. In addition, there are rising concerns over poverty and income inequality spreading.

The proposed budget addresses some of these issues by increasing public spending on social assistance programmes.¹ Ambitious and challenging as it is, this budget will be difficult to implement for a variety of reasons. For one, it sets a higher economic growth target of 5.4 percent for 2018 - up from 5.1 percent for 2017 – despite the slower global growth projections. Lethargic growth worldwide could weaken Indonesia’s tax revenue collection, hence significantly raising the risks of a contraction in public spending.

This essay examines the extent to which Indonesia’s 2018 budget will be able to address some of the key economic challenges the country faces.

BUDGET PROJECTIONS & KEY PROGRAMMES

On 16 August 2017, President Jokowi announced the 2018 state budget during the State of the Nation address given before legislators (both in the *Dewan Perwakilan Rakyat* and the *Dewan Perwakilan Daerah*). Jokowi emphasized the need for everyone to work together with a positive attitude to achieve economic equality and social justice for the people. The president is concerned about increasing poverty and economic disparity despite efforts being taken to tackle these problems, and the new budget is designed to accelerate growth, help the poor and reduce income inequality.²

Given continuing uncertainties in the global economy, the government is setting relatively moderate projections. As can be seen in Table 1, economic growth for 2018 has been targeted at 5.4 percent (slightly higher than the 5.2 percent target for this year). The inflation rate is forecasted to be 3.5 percent for 2018, lower than this year’s target of 4.3 percent. The Rupiah exchange rate is set to Rp 13,500 per USD, slightly weaker than the value set for this year of Rp 13,400 per USD.

Based on the above projections, state revenue is targeted to reach Rp 1,878.4 trillion, and state expenditure to reach Rp 2,204.4 trillion (Figure 1). This means there will be a fiscal deficit of around Rp 325.9 trillion (or US\$ 24.5 billion) next year, i.e. 2.19 percent of the projected gross domestic product (GDP). This is much lower than this year’s projected

¹ Christine Novita Nababan, “Penduduk Miskin di Indonesia Capai 27,77 Juta Orang“, CNN Indonesia, 17 July 2017, <https://www.cnnindonesia.com/ekonomi/20170717132808-92-228339/penduduk-miskin-di-indonesia-capai-2777-juta-orang/>

² Kompas, “Kerja 2018 adalah Akselerasi”, 18 August 2017, p.17.

deficit, which is estimated to soar to around 2.92 percent of GDP, or Rp 397.2 trillion (US\$29.8 billion), given the expected shortfall in tax revenue collection.³ The government is legally bound to maintain the fiscal deficit at below three percent of GDP.

Table 1: Indonesia's Budget Projections, 2017-2018

	2016 Realised	2017 Revised budget	2018 Proposed budget
Growth (%)	5.0	5.2	5.4
Inflation (%)	3.0	4.3	3.5
Rupiah per US \$	13,307	13,400	13,500
Three-month treasury bills (%)	5.7	5.2	5.3
Budget deficit (% of GDP)	2.46	2.92	2.19
Oil price (US\$/barrel)	40	48	48
Oil lifting (000 barrel/day)	825	815	800
Gas lifting (000 boe/day)	1,193	1,150	1,200

Source: Ministry of Finance

Figure 1 indicates that the 2018 budget proposal will continue to be expansionary in response to global economic uncertainties and the sluggish domestic economy. Government spending is directed at accelerating infrastructure development and at connectivity improvement, especially in regions outside Java and Sumatera. The goal is to reduce the wide development gap between Java-Sumatera and other parts of Indonesia, i.e. Kalimantan, Sulawesi, Maluku, Papua and Nusa Tenggara. According to the 2016 Economic Census by Statistics Indonesia (BPS), almost 80 percent of businesses are concentrated in Java and Sumatera, while the two islands only represent 30 percent of total land area of the country.⁴ In view of the need to reduce this wide economic disparity, the government wants to improve connectivity between those less-developed islands with the growth centres in Java-Sumatera. If this can be successfully done, it will integrate the fragmented domestic market, thus providing opportunities for the lagging regions to catch up.

With infrastructure development remaining high on the agenda, the Ministry of Public Works and Public Housing will receive the biggest allocation of the budget, around Rp 107 trillion (US\$8 billion), or around 5 percent of central government spending. For connectivity improvement, the government increased the budget allocation of the Ministry of Transportation by 31.3 percent, to Rp 48 trillion (US\$3.6 billion). This will be used to build and maintain 856 km of new roads, 25 km of toll roads, 8.8 km of bridges and 639 km of railway track.⁵

Concern over persistent poverty and economic inequality has prompted the government to increase the budget for poverty alleviation and social assistance programmes. BPS has recently released poverty and inequality data that show that the number of poor people has increased and inequality (in terms of the Gini ratio) has been relatively unchanged between

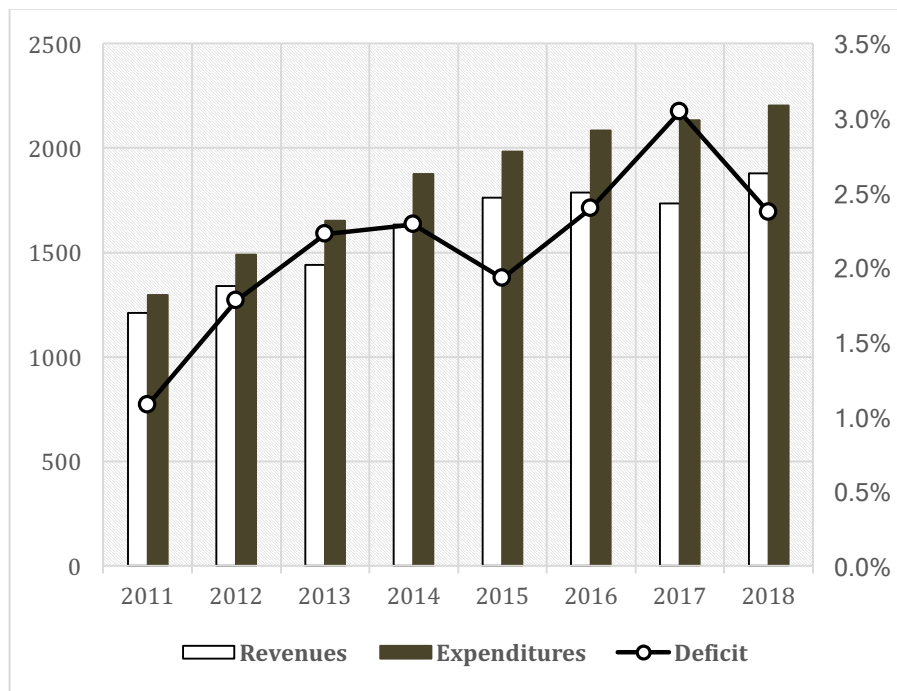
³ Anton Hermansyah, "Economy still needs govt spending", the Jakarta Post, 10 August 2017.

⁴ Kompas, "Ekonomi Makro: Mengurangi beban", 19 August 2017, p.17.

⁵ Kementerian Keuangan, Buku II: Nota Keuangan & RAPBN 2018.

September 2016 and March 2017.⁶ There are 27.7 million poor in Indonesia based on a survey in March 2017, an increase by 6,900 people from the number in September 2016. The Gini ratio, which is a measure of income inequality (zero represents perfect equality and one represents complete inequality), is still high and has not changed much from 0.394 in September 2016 to 0.393 in March 2017. During his election campaign, Jokowi had promised to reduce the poverty rate to 7-8 percent by 2019 (it is now 10.6 percent) and to reduce inequality, targeting a Gini ratio of 0.36 by the end of 2019.

Figure 1: Indonesia’s Fiscal Balance, 2011-2018 (Rp Trillion)



*Note: Deficit is expressed as percentage of GDP (right axis)
Source: Ministry of Finance*

Rising inequality (increasing gap between rich and poor) can become a “time bomb” that weakens social cohesion and makes a country more prone to social unrest. In view of this, the government’s focus has shifted from achieving higher growth to a lower but more sustainable and inclusive growth. The proposed budget reflects this new focus on improving economic equality. The programs of land redistribution to landless farmers, housing for urban poor, credit for micro and small businesses, education assistance and health care for low income earners are some key programs aimed at alleviating poverty and reducing inequality under the Jokowi Administration.⁷

In January 2017, the government has decided to remove the electricity subsidy gradually, as part of ongoing reform in the energy sector. The policy aims to create much needed fiscal

⁶ Elisa Valenta Sari, “Penduduk Miskin Bertambah, Tingkat Ketimpangan Stagnan”, CNN Indonesia, 17 July 2017. <https://www.cnnindonesia.com/ekonomi/20170717160147-78-228406/penduduk-miskin-bertambah-tingkat-ketimpangan-stagnan/>

⁷ The Jakarta Post, “Government all out in narrowing economic gap”, 9 August 2017.

space for other more productive spending, such as infrastructure development, health care, education, and other social assistance programmes.⁸ According to TNP2K (the National Team for the Acceleration of Poverty Reduction), the subsidy is mostly benefiting the non-poor households (middle income earners).⁹ While the policy has sound economic and social objectives, it nevertheless adversely impacts household purchasing power and may explain the weakening of consumption growth in the first two quarters of this year.¹⁰

With the removal of the electricity subsidy, the government plans to expand non-cash social assistance in order to reduce the living cost burden for the poor. For instance, under the Family Hope Program (PKH or *Program Keluarga Harapan*), the government will provide Rp 1.9 million (US\$ 142.5) worth of aid per year for each poor household. Currently, the PKH covers 7 million households and the program will be expanded to 10 million households this year. By 2018, the PKH will be reaching out to 15 million poor households.

WILL THE 2018 BUDGET IMPROVE JOKOWI'S APPROVAL RATINGS?

Does the proposed Budget adequately address the economic concerns of Indonesians? This question can be considered by examining the findings on public opinion from the INSP.¹¹ During his election campaign Jokowi promised to promote economic growth to 7 percent.¹² He also promised that the government will improve the ease of doing business in the country by removing red tape to make the economy more competitive. Figure 2 shows how Indonesians appraised Jokowi's economic achievements in comparison with his predecessor, Susilo Bambang Yudhoyono (SBY). It reveals that under the Jokowi Administration, 52 percent of respondents agreed that the economy had grown faster, 55 percent agreed that the economy had become more competitive, and 48 percent agreed that it had become easier to do business.

However, only 43 percent agreed that Jokowi had improved conditions for the poor which suggests that there are reservations over the success of Jokowi's poverty eradication

⁸ Tempo, "Terkejut Pencabutan Subsidi Setrum", 23 Juli 2017, pp. 82-83.

⁹ The subsidy removal affects 19 million middle income households (in 450-900 VA category). There are four planned increases of electricity charges for this consumer group in 2017. <http://ekonomi.kompas.com/read/2017/06/14/155255826/jonan.subsidi.listrik.untuk.pelanggan.900.va.dicabut.agar.pln.lebih.efisien>

¹⁰ Kompas, "Pelambatan pertumbuhan konsumsi rumah tangga perlu diwaspadai", 14 August 2017.

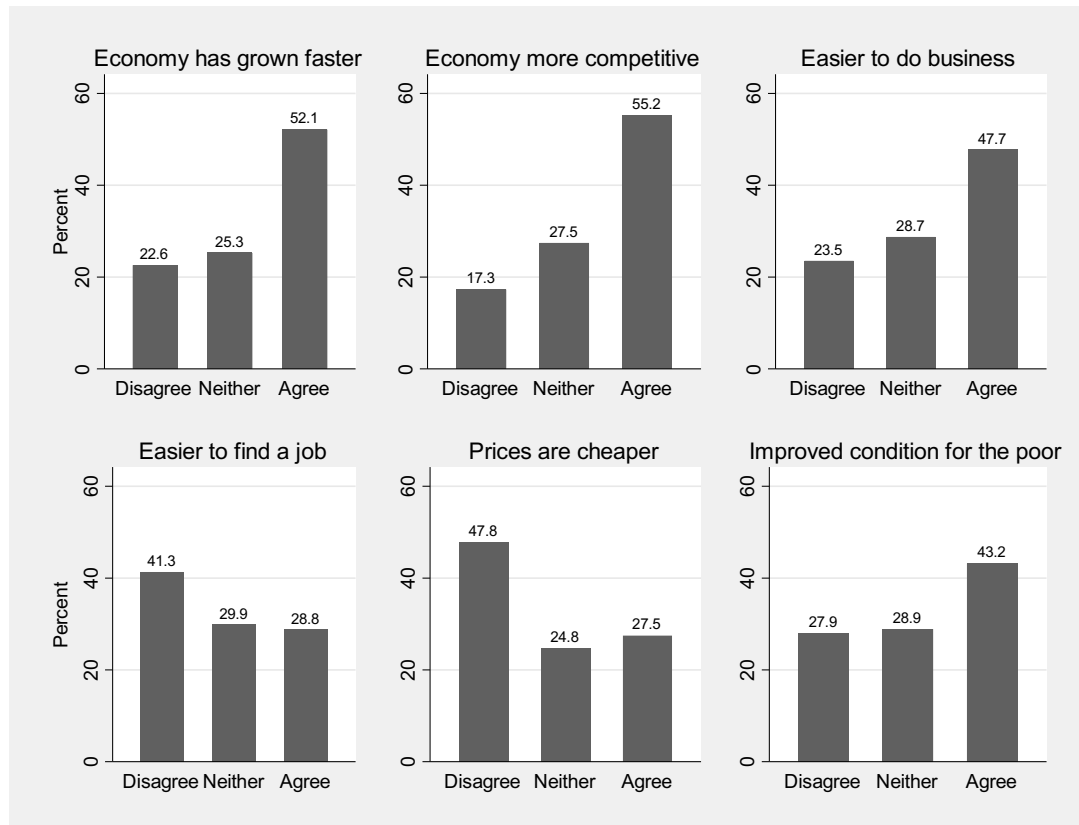
¹¹ The Indonesia National Survey Project (INSP) was conducted in May 2017 to collect information on public opinion in a wide range of areas, such as macroeconomic performance, economic policy, the state, political participation, political parties, infrastructure, Islam, ethnicity, and international relations. It covers 1,620 respondents in all 34 provinces in Indonesia.

¹² Estu Suryowati, "Jokowi Yakin Pertumbuhan Ekonomi RI Bisa Tembus 7 Persen", Kompas 15 June 2014,

<http://ekonomi.kompas.com/read/2014/06/15/2127459/Jokowi.Yakin.Pertumbuhan.Ekonomi.RI.Bisa.Tembus.7.Persen>. Accessed 7 August 2017.

programmes.¹³ What can be more worrying are the instances in which more people “disagree” than “agree”: 41 percent of respondents disagreed that it has become easier to find a job, and 48 percent disagreed that the Jokowi Administration had been able to lower the prices of goods.¹⁴

Figure 2: Compared with the SBY years, has the economy improved since Jokowi took office?



Source: INSP

The survey results on the lack of job creation is in line with the findings of Dong and Manning (2017), who found that total employment growth in the first two years of Jokowi’s Administration was slower than it was during the period under SBY.¹⁵ This is partly because of slower economic growth and structural changes in the economy. The latter affects the share of employment in different sectors.

To cope with this issue, under the proposed budget, the government has allocated funding to support vocational education and training, national apprenticeship program, skill

¹³ Diego Fossati, Hui Yew-Foong and Siwage Dharma Negara, “The Indonesian National Survey Project: Economy, Society and Politics”, Trends in Southeast Asia, No. 10, 2017, ISEAS Publishing. pp. 8-9.

¹⁴ Ibid p. 9.

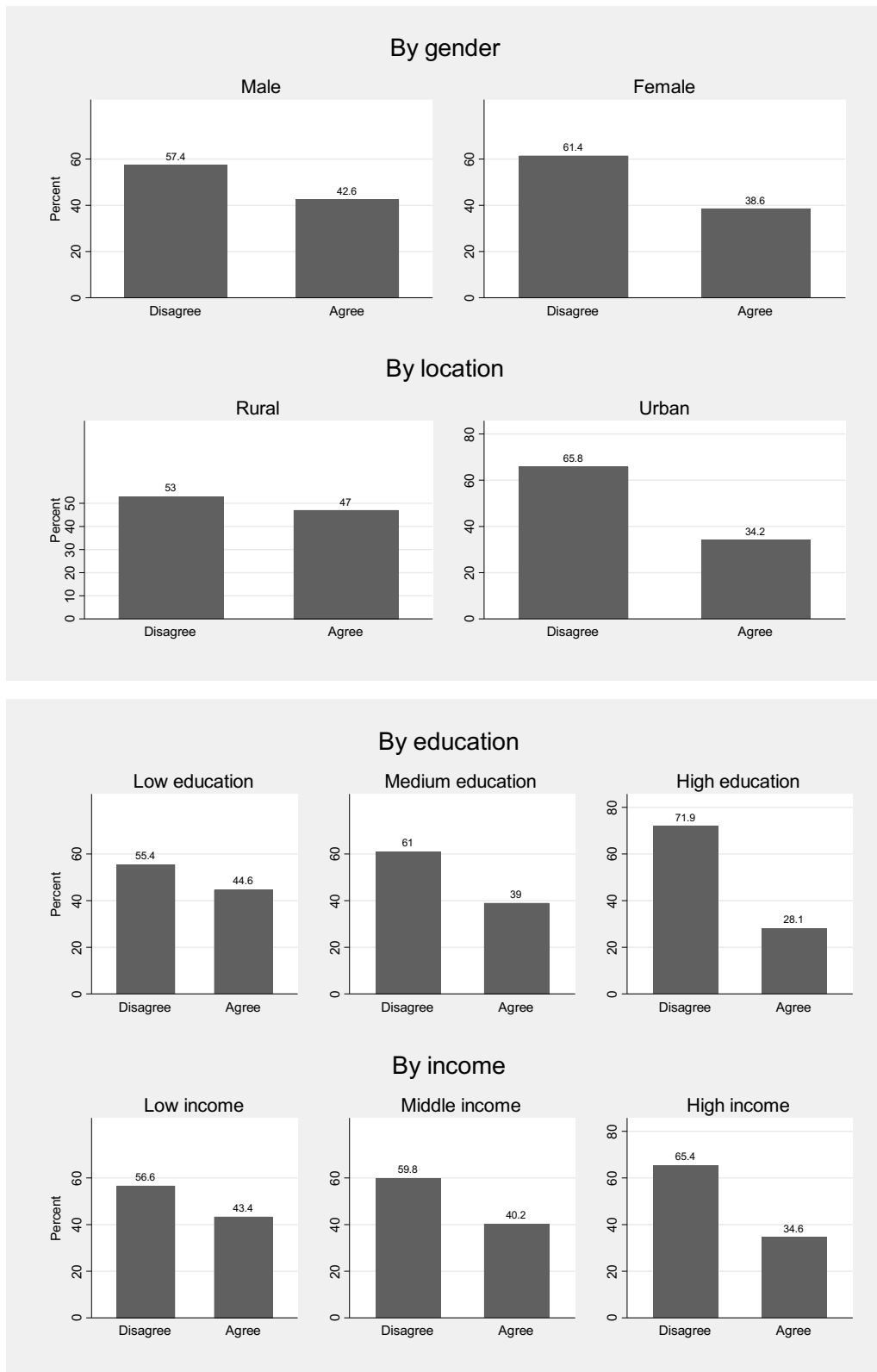
¹⁵ Sarah Xue Dong & Chris Manning, “Survey of Recent Developments: Labour-Market Developments at a Time of Heightened Uncertainty”, Bulletin of Indonesian Economic Studies, Vol. 53. No. 1, 2017: pp.12-14.

development fund, jobs creation through labor-intensive projects and job matching programme.¹⁶ However, most of the programmes were meant to address technical skill shortages and mismatches, while lacking a holistic view of the systemic failure. For instance, due to technological advancement, new investments now come into capital-intensive sectors rather than the labour-intensive ones.¹⁷ This means the labor market needs more highly skilled labour, which cannot be sufficiently supplied locally. As can be seen in Figure 3, difficulty in finding jobs is more common for female, for those who live in urban areas, those who have higher education and those with higher income. Given this, the government must ensure that the budget will support programmes that help these groups in finding jobs.

¹⁶ Kementerian Keuangan, Buku II: Nota Keuangan & RAPBN 2018.

¹⁷ Kompas, "Investasi makin padat modal", 9 August 2017, p. 19.

Figure 3: Do you think it is easier to find work now than under the previous government?

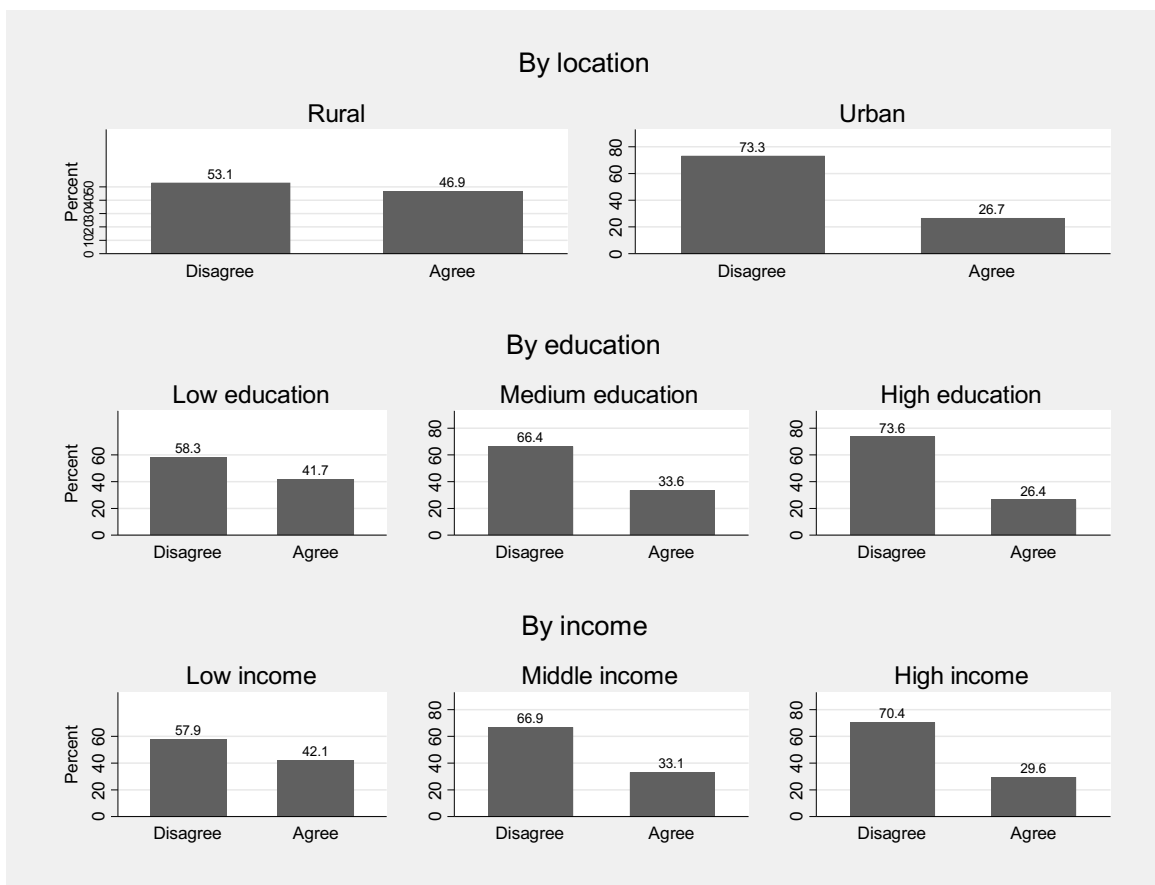


Source: INSP

Concerning the price of goods, as mentioned above, the policy to remove the electricity subsidy may have affected household purchasing power. While the government has designed some stimulus programmes to maintain and enhance purchasing power for households, such as by increasing the non-taxable income level and adjusting the wage policy, there are, however, other factors affecting household consumption. For instance, the rise of anti-import policies as part of a self-sufficiency agenda (Jokowi’s political platform under *Nawacita*) might have contributed to domestic prices that are higher than international prices. Moreover, as households have difficulty in finding jobs, this may adversely affect their consumption behaviour and also purchasing power.

Figure 4 shows that respondents who lived in urban areas, had higher education and high income were more likely to disagree that the Jokowi Administration had made progress in lowering inflation. This is understandable as most of the subsidies that are gradually being removed, e.g. fuel and electricity, affect those groups. In view of this, it is important for the government to control the inflationary effect of administered price adjustments, e.g. transportation fares.

Figure 4: Do you think the goods are cheaper now compared to previous government?

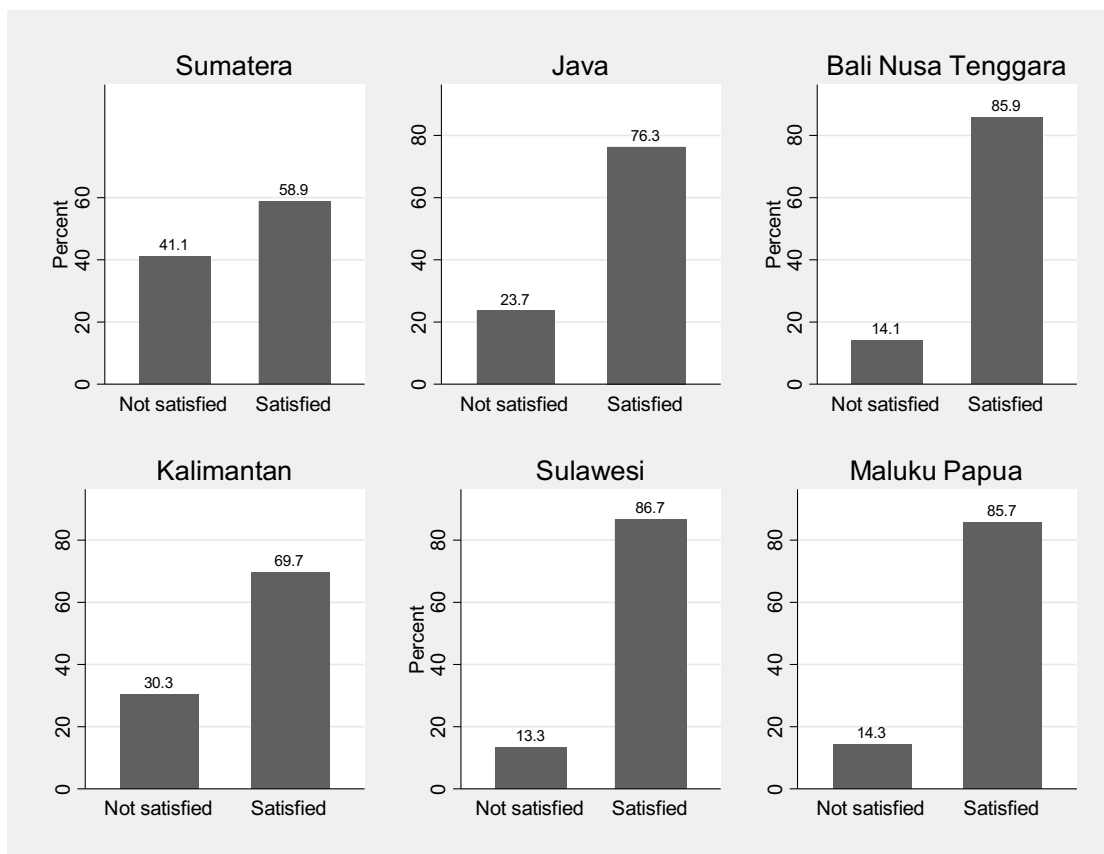


Source: INSP.

Infrastructure development remains the key point in the proposed budget. As much as 74 percent of respondents are satisfied with Jokowi’s efforts in developing infrastructure, while

26 percent are not satisfied.¹⁸ Moreover, rural respondents were more likely to be satisfied with Jokowi’s performance in infrastructure development. This is probably the result of Jokowi’s development focus being more on rural and less developed regions. Figure 5 shows how such a focus on the less-developed eastern part of Indonesia earns him high public satisfaction in Bali-Nusa Tenggara, Sulawesi, and Maluku-Papua. More than 85 percent of respondents in those areas are satisfied with Jokowi’s performance in infrastructure development. Respondents in Sumatera, however, show the least satisfaction (59 percent) with regard to government performance in developing infrastructure. Interestingly, respondents in Kalimantan also express less satisfaction (slightly less than 70 percent) than those in Java (76 percent). This is despite government efforts to develop the infrastructure of the resource-rich island.

Figure 5: Are you satisfied with Jokowi’s infrastructure programmes?



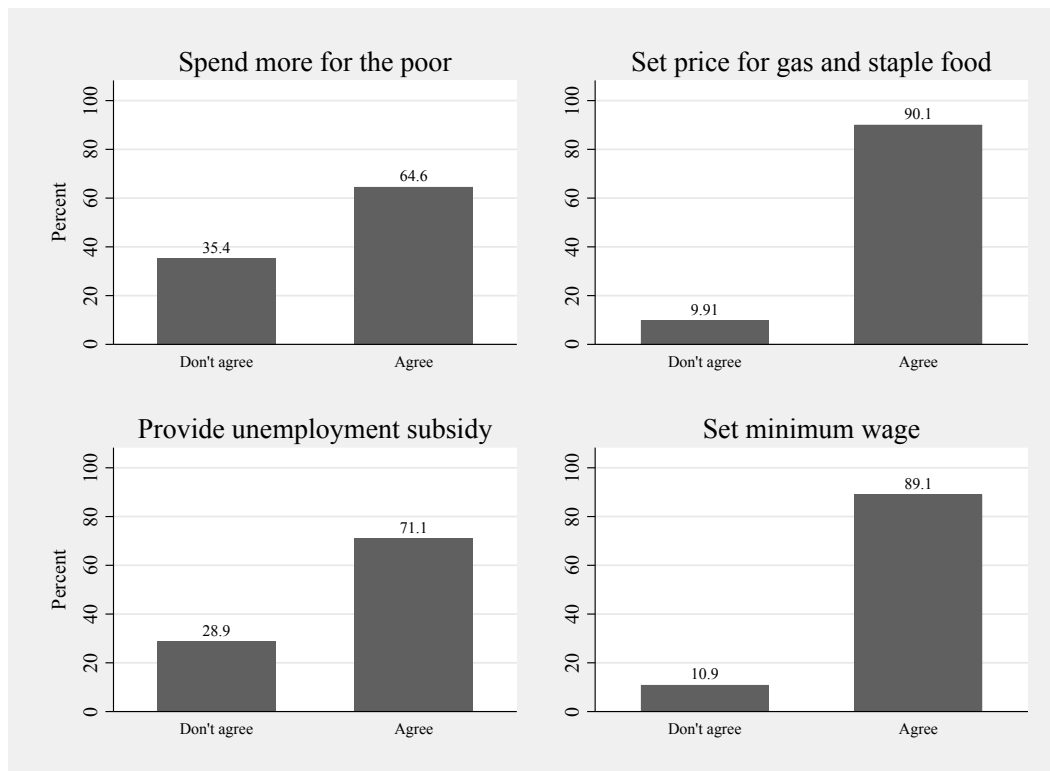
Source: INSP.

Regarding the role of the government in the economy, Figure 5 shows that 90 percent of respondents thinks the government should do more to lower the price of gas and staple foodstuff. This is in line with the finding that respondents consider the prices of goods to be too high. 89 percent of respondents also thinks that the government should do more in terms of setting the minimum wage (Figure 5). 71 percent of respondents thinks that the government should provide unemployment subsidies for those who lost their jobs and 65

¹⁸ Fossati, Hui, and Negara, p. 9.

percent of respondents wants the government to provide more support for the poor, even if this means hiking taxes.¹⁹

Figure 5: Do you think the government should do more in this area?



Source: INSP.

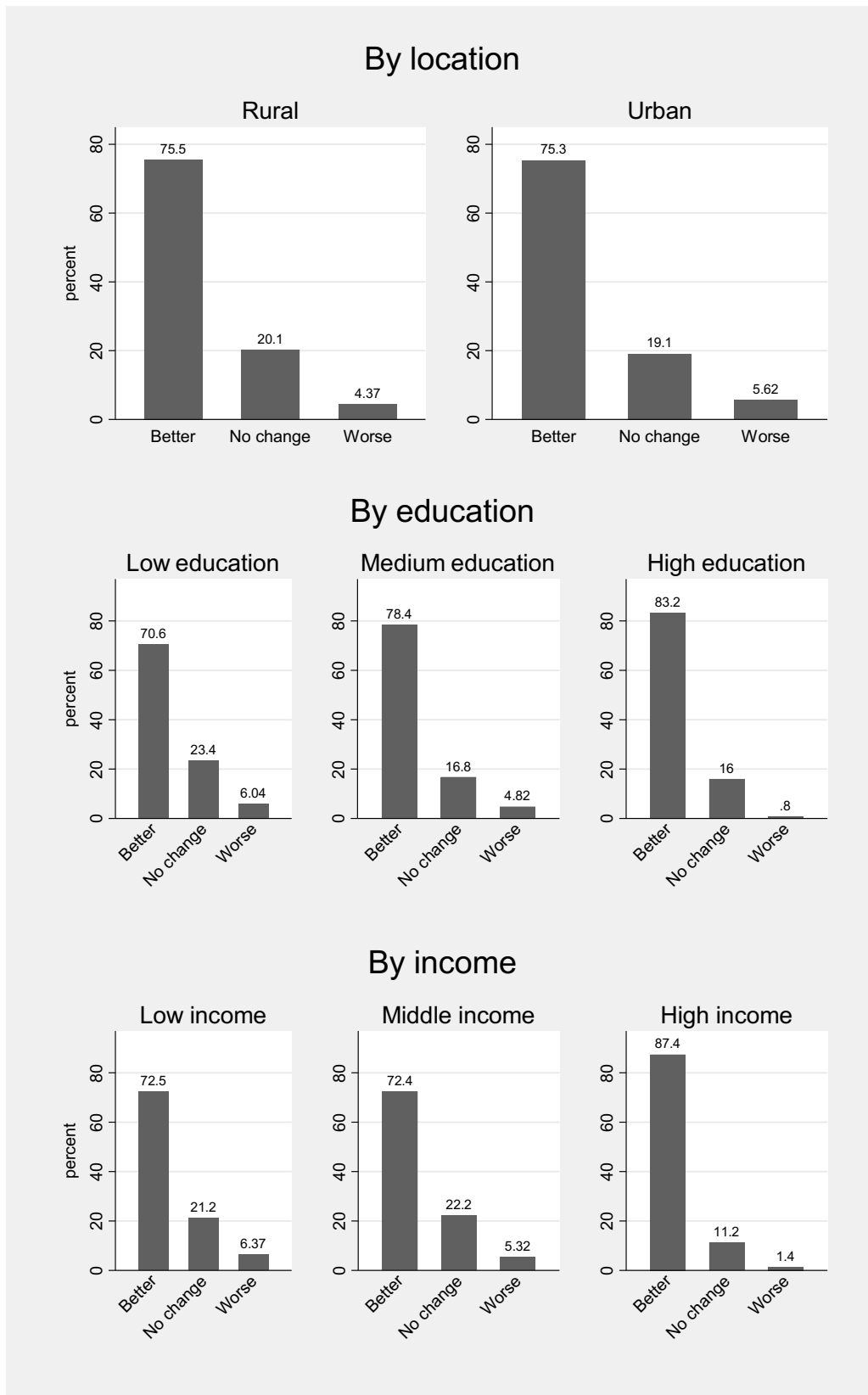
Despite the challenging economic situation today, Figure 6 shows that the expectation of households with regard to their economic condition remains optimistic. It indicates that the majority of rural and urban respondents (75 percent) expects their household economic condition to become “better” next year. In addition, the higher the educational and income levels of respondents, the more likely they are to hold this view. This demonstrates a strong public perception that Jokowi’s handling of the economy will bring real benefits for them.²⁰ Generally, Jokowi’s approval rating remains high; 68 percent of respondents approves of his overall performance, while 32 percent disapproves.²¹ However, whether or not the proposed budget will further improve his approval rating will depend on the implementation of his key economic and social programmes (infrastructure, connectivity, energy, social assistance, etc).

¹⁹ Fossati, Hui and Negara, pp 13-14.

²⁰ Ibid p. 5

²¹ This finding is similar to the opinion poll conducted by Saiful Mujani Research and Consulting (SMRC) in June 2017, which finds that 67 percent of their respondents is satisfied with Widodo’s performance, while 31 percent is not satisfied.

Figure 6: How do you see the economic condition of your household in a year's time?



Source: INSP

CONCLUDING REMARKS

Overall, the proposed 2018 budget shows a political commitment to maintain growth and improve economic equality. It proposes larger and better-targeted social programmes and redirects spending away from energy and electricity subsidies towards infrastructure development, health and other social assistance programmes. Here lies the government’s dilemma of balancing between better infrastructure and social services and reduced subsidies for lower-middle income earners. At the moment, Jokowi’s approval rating remains high, with almost 70 percent of the public approving of his performance. However, things may change depending on the outcome of his economic policies.

The proposed budget thus provides a sound fiscal base for Indonesia to achieve its moderate growth target of 5.4 percent. Given that the country will enter a political cycle next year, in which 171 districts will simultaneously conduct the direct election of regional leaders, the economy is expected to grow further supported by high election spending. However, to boost growth, the government must work seriously to remove long-standing bureaucratic constraints that delay the process of budget disbursement. The practice of back-loading project spending in the last quarter of the year is a classic problem that has not been fully solved despite the government’s efforts to expedite procurement and tendering processes. What is more worrying is that the country’s capacity to collect taxes is very low. Tax revenues remain around 10 percent of GDP. In the last two years, tax revenue realization reached only around 82-83 percent of the target.²² Weak tax revenue limits the government’s fiscal strength and its ability to meet big spending commitments, including those for infrastructure and social assistance. This will lead the economy to head for a “fiscal crunch”, given that the budget deficit is already close to the 3-percent deficit limit this year. There is significant risk that some of the key infrastructure programmes may be scaled down or even put on hold.

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²² Septian Deny, “Penerimaan Pajak Capai 81 Persen dari Target 2016”, *Liputan 6*, 2 January 2017, <http://bisnis.liputan6.com/read/2693979/penerimaan-pajak-capai-81-persen-dari-target-2016>.