



**WORLD BANK GROUP**

# **Indonesia Economic Quarterly October 2016**

***Pressures easing***

***Ndiamé Diop***

***Practice Manager, Macroeconomics and Fiscal  
Management, South East Asia and the Pacific***

**October 25, 2016**

# Key takeaways

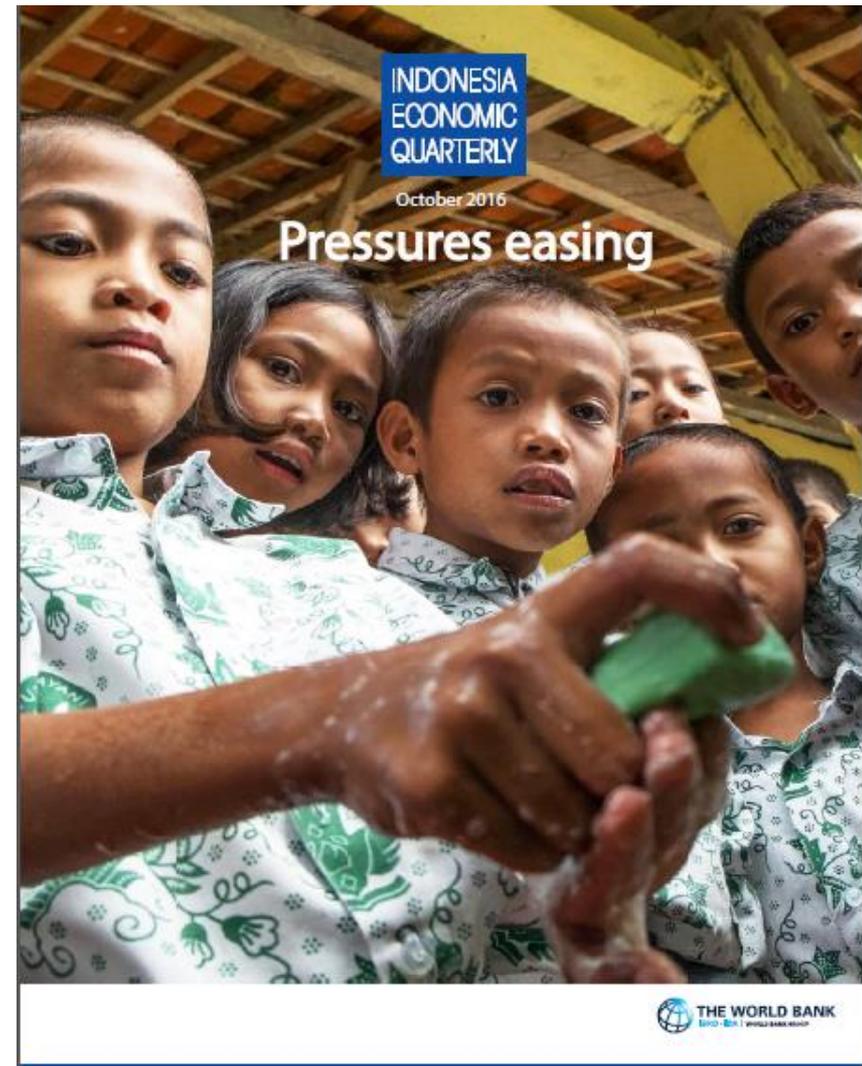
## Macroeconomic pressures easing

- Thanks to good macro-fiscal management, short-term macro pressures, in particular fiscal risks and inflation, have eased. This should support growth:
  - Low inflation and stable Rupiah => monetary policy easing
  - Greater policy predictability
  - Allows policymakers to focus more on structural reforms

## Fiscal spending reforms key to inclusive growth

- Efficient and effective spending of public resources critical to strengthening human capital and reducing poverty and inequality. It requires:
  - Spending resources in the right areas & right
  - Better fiscal allocation across programs within sectors (social assistance, agriculture, education)
  - Public spending in rural water and sanitation provides an example: smart spending has borne results

## Recent fiscal reforms are lowering poverty and inequality



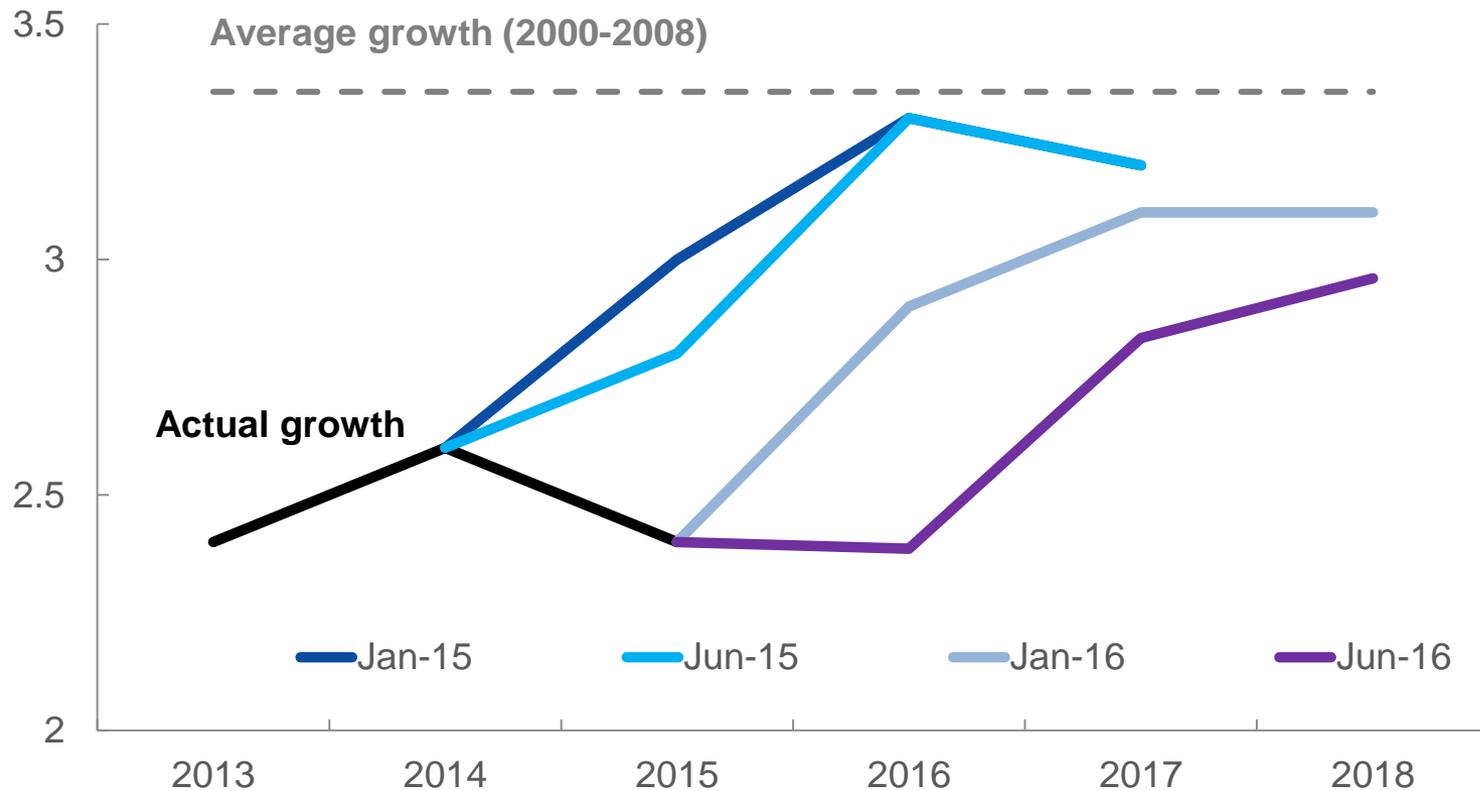
**Macroeconomic pressures easing**

**Fiscal spending reforms and inclusive growth**

**Fiscal policy and welfare**

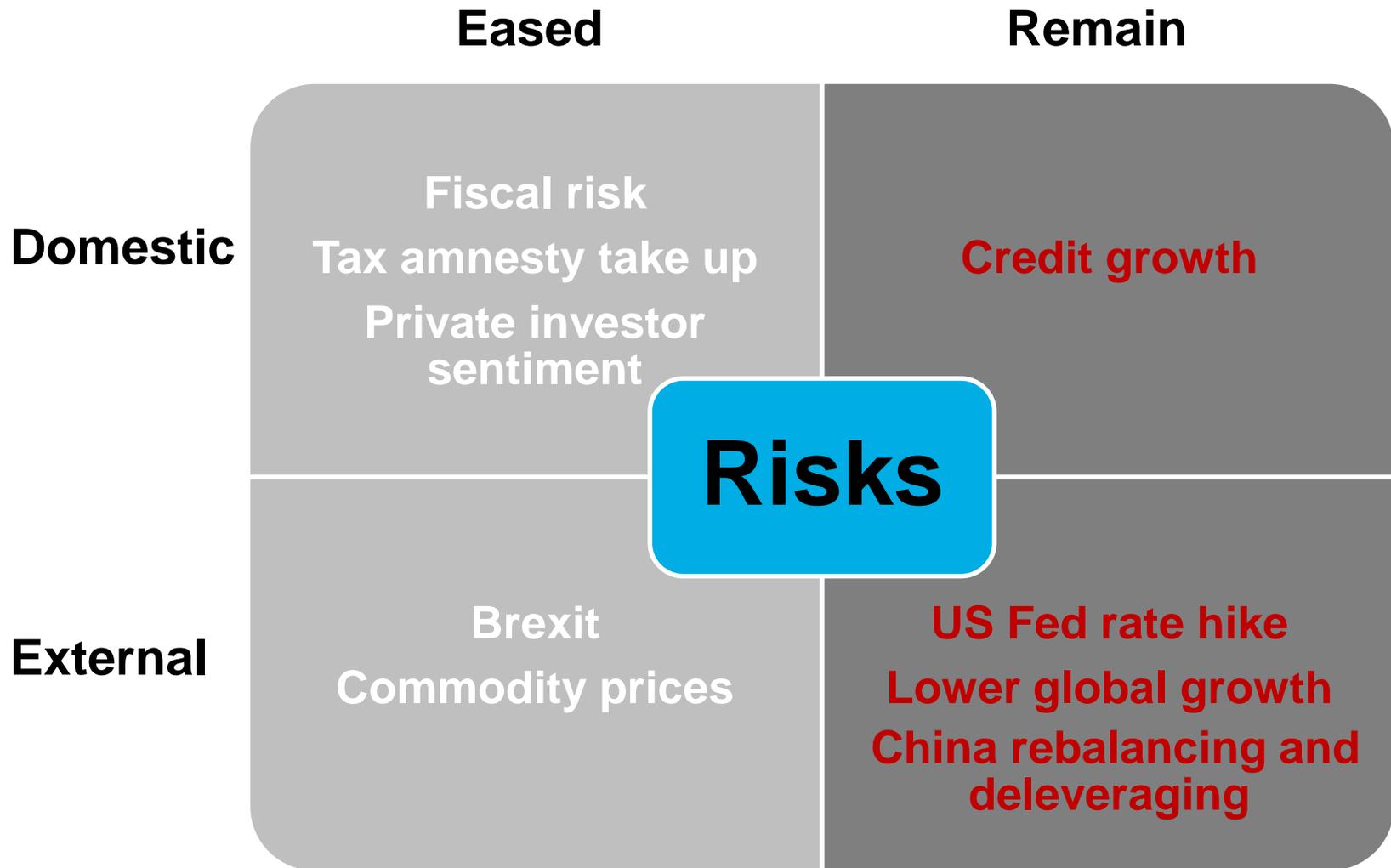
# External conditions remain unsupportive to growth

*World Bank projections for global growth by date of forecast*



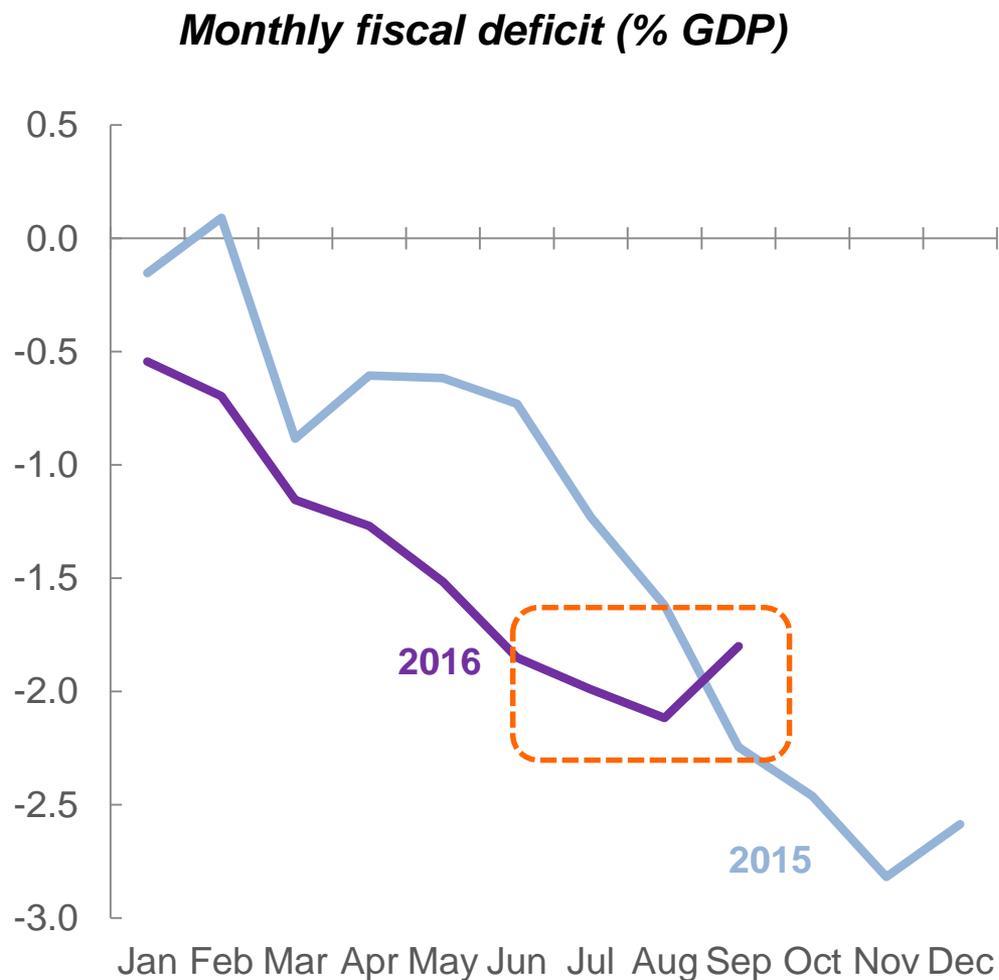
Source: World Bank Global Economic Prospects; WDI

# But key domestic risks have eased, reducing macro-fiscal pressures



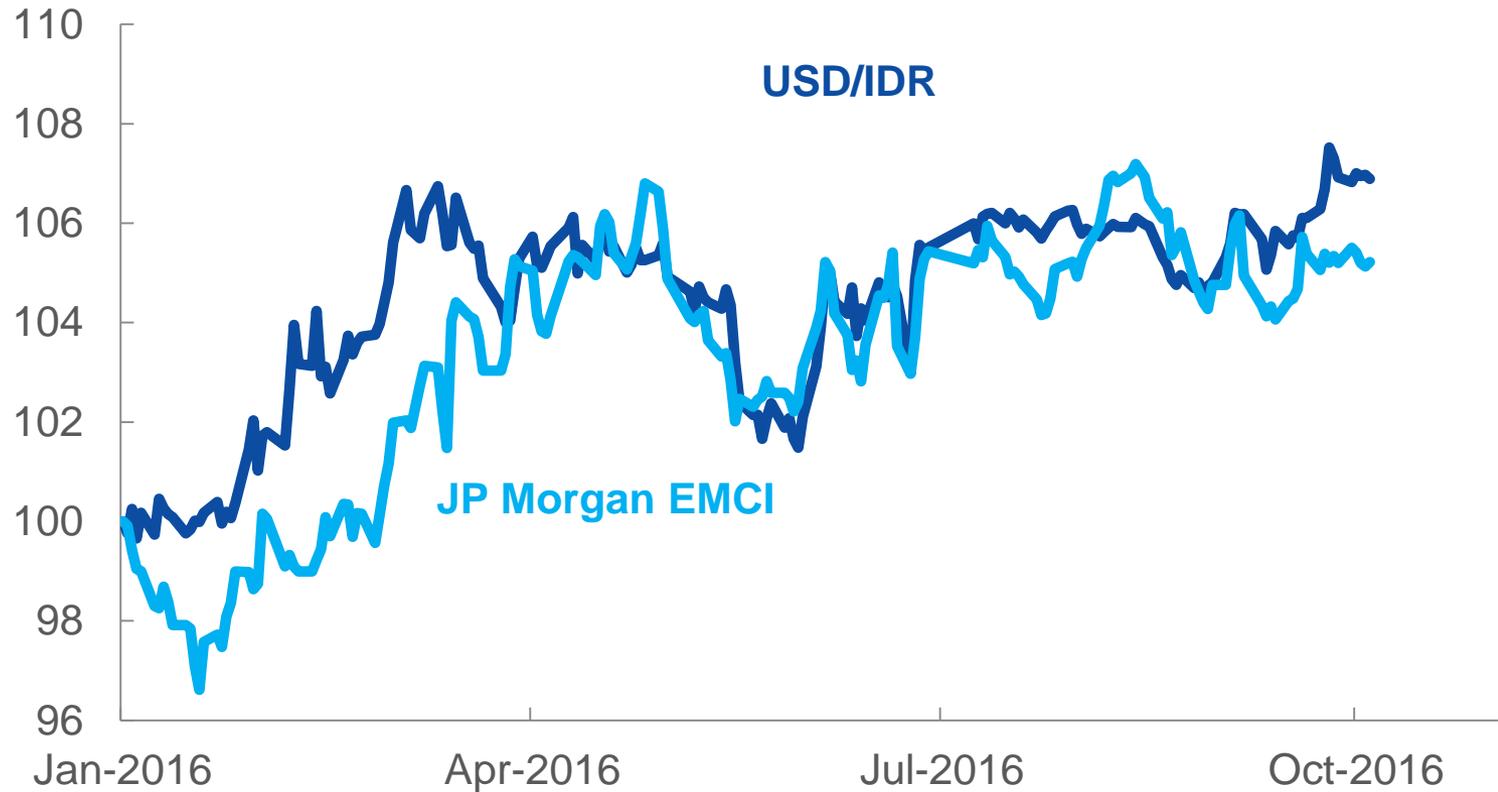
# Prudent fiscal policy choices and high tax amnesty take-up reduced fiscal risks

- **Expenditure cuts and expanded fiscal deficit for 2016 announced in July**
- **The draft 2017 Budget contains more realistic revenue targets**
- **Successful implementation of Phase I Tax Amnesty program**



# Sound macro management and record low global bond yields helped stabilize the Rupiah

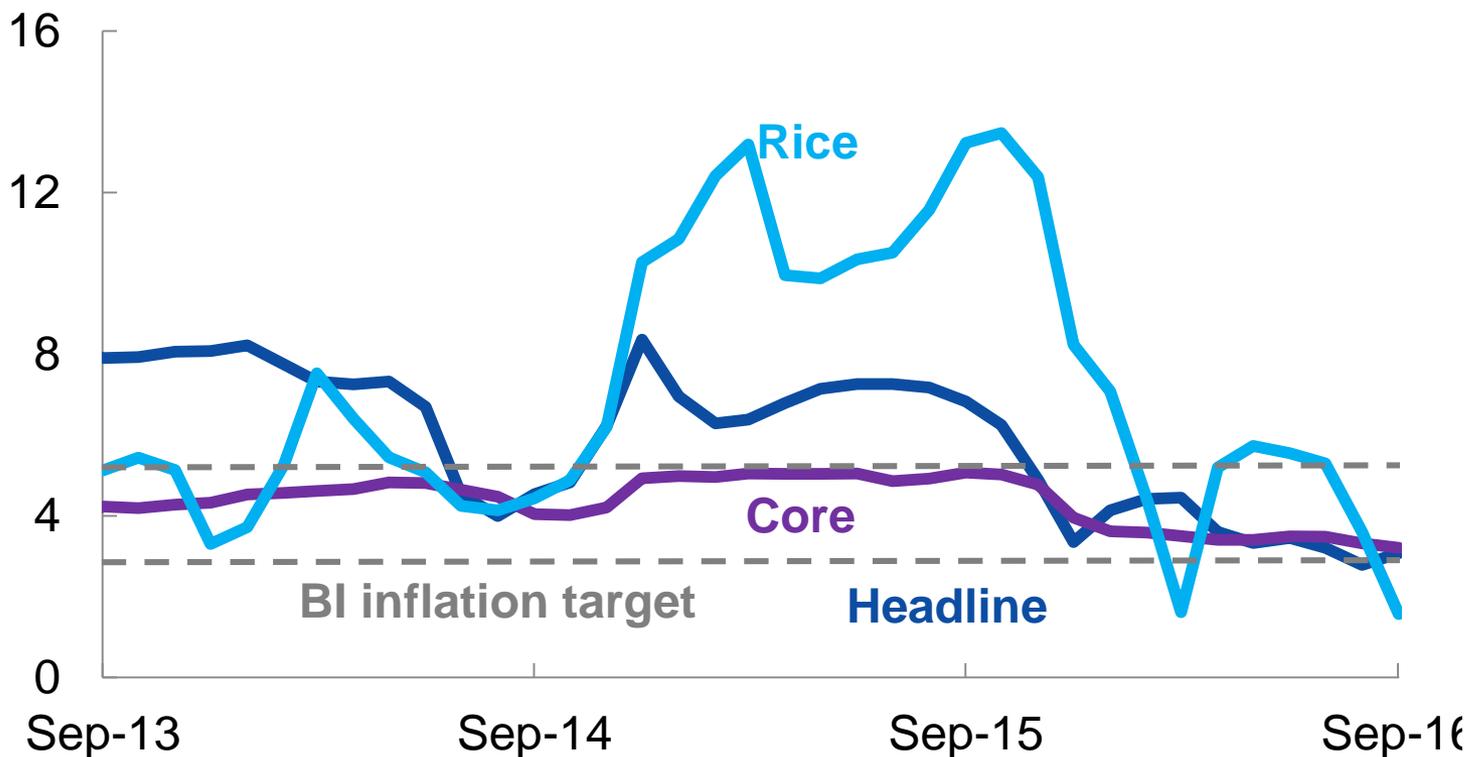
*Index, January 4 2016 = 100*



Source: BI;JP Morgan; World Bank calculations

# Improved rice import management helped inflation moderate further

*Year-on-year growth, percent*

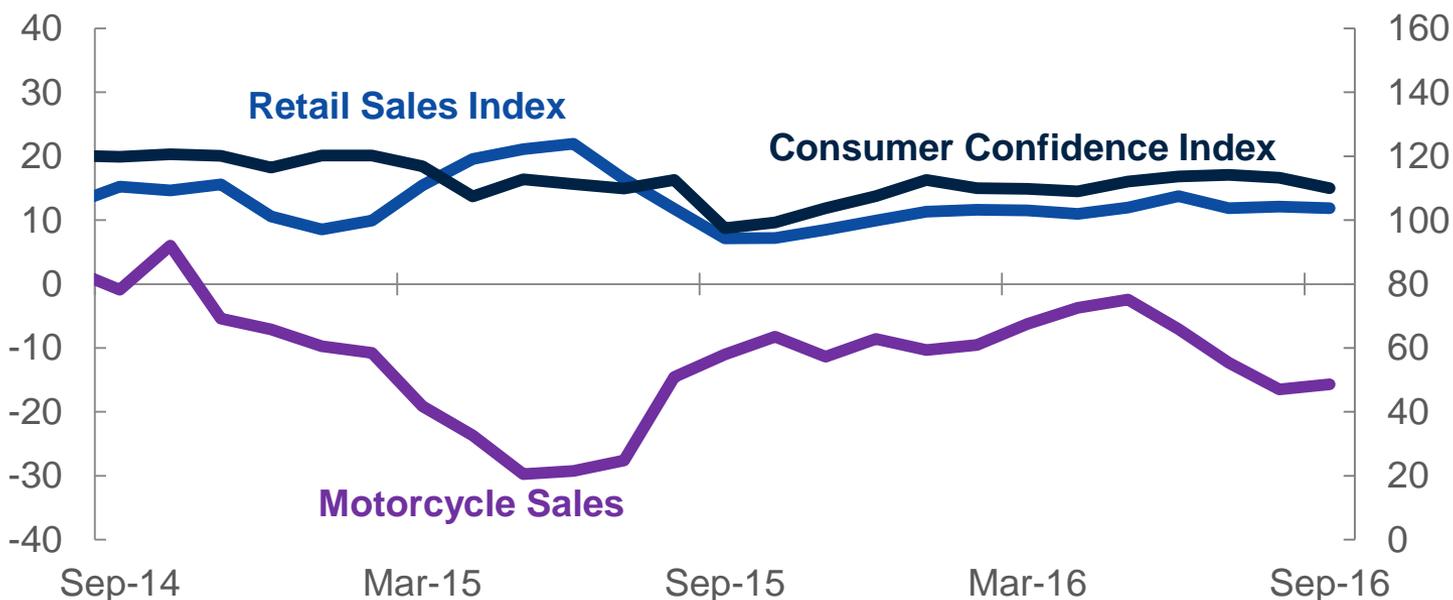


Source: BI; World Bank staff calculations

# Improved macro-fiscal environment should help near-term growth

- There are no signs in the data of a pickup in activity as yet

*3 mma, percent yoy (LHS); consumer confidence index (RHS)*



Source: BI; BPS; World Bank staff calculations

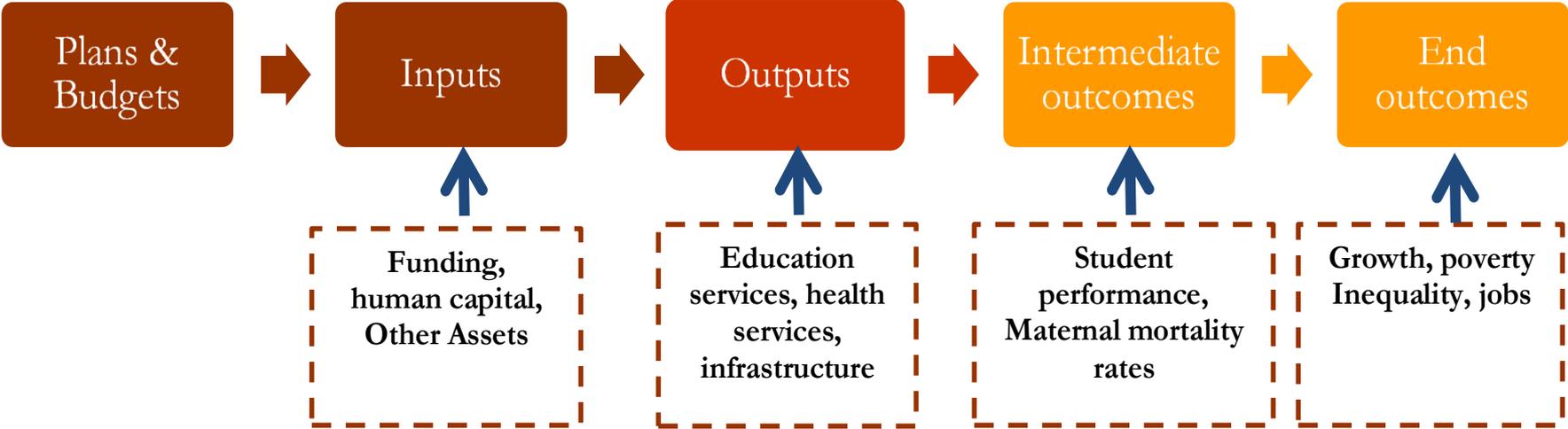
- But improved macro-fiscal conditions may help going forward:
  - Low inflation and stable Rupiah => monetary policy easing
  - Low fiscal risk => using fiscal policy to stimulate the economy
  - Greater policy predictability and improved investor sentiment

**Macroeconomic pressures easing**

**Fiscal spending reforms and inclusive growth**

**Fiscal policy and welfare**

# Public spending reforms crucial to greater access to services and inclusive growth



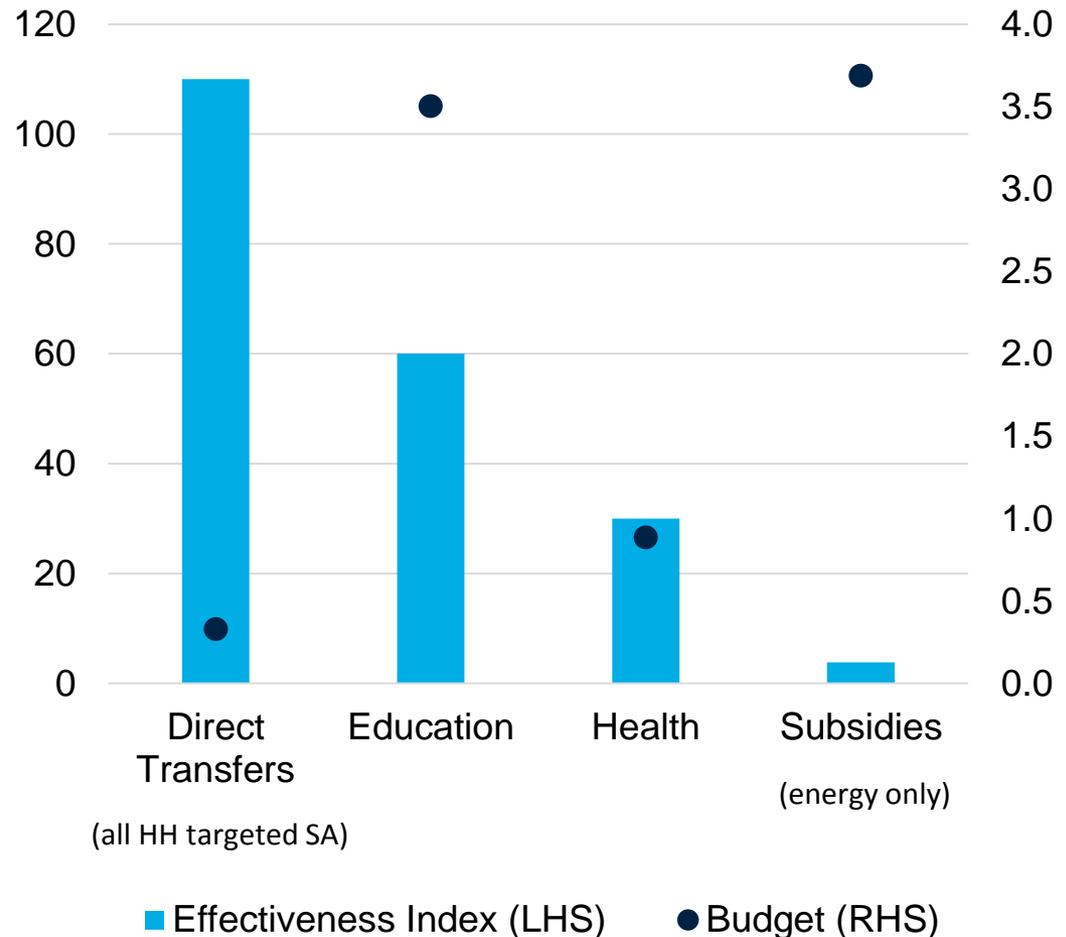
Source: World Bank staff.

# Re-allocation within the budget can help make growth more inclusive

- **Direct social assistance transfers are the most effective at reducing poverty and inequality, followed by education and health spending**
- In 2012, total spending on SA and health sectors was small relative to energy subsidies
- Subsidy reform and expansions of SA programs since 2012 have helped, however more can be done
- **In addition to increased SA spending, re-allocation with the SA budget is needed:**

- **One rupiah spent on PKH reduces inequality by 2.5 times more than a rupiah spent on Rastra, yet Rastra's budget is more than 10 times higher.**

Effectiveness at reducing inequality relative to spending  
*Index (LHS); percent of GDP (RHS), 2012*

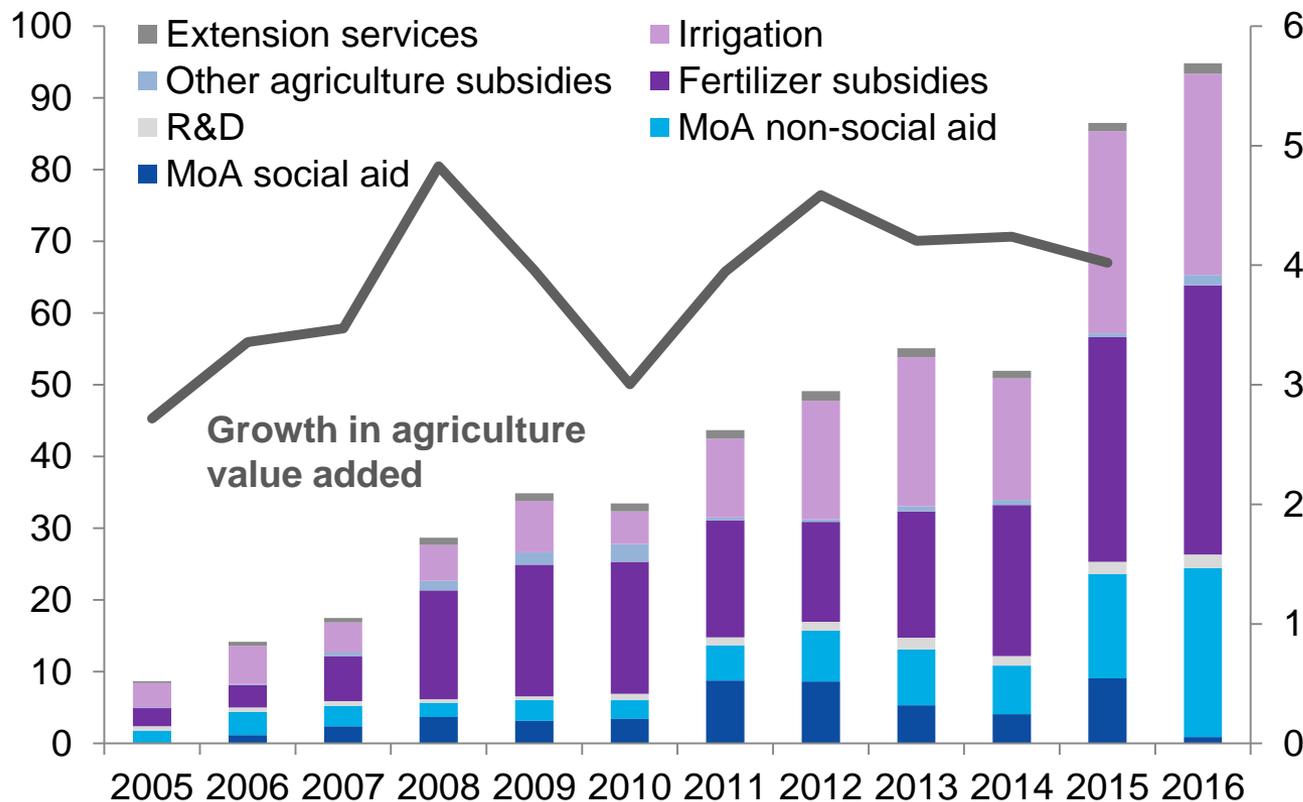


Source: Susenas 2012, World Bank calculations.

Note: Effectiveness Index is Change in Market Income Gini to Final Income Gini / Budget as % of GDP

# In agriculture, much of the rising spending goes to private input subsidies rather than public goods

**Central government spending on agriculture and irrigation  
IDR trillion (LHS); Year-on-year growth, percent (RHS)**



Note: Spending figures refer to realized spending up until 2015 and the revised Budget for 2016. MoA reclassified the majority of its social aid spending to goods and services in 2016. Source: World Bank COFIS database using MoF data

- In 2015, 47% of CG public spending was used to subsidize private inputs rather than provide public goods. Only 3% was spent on R&D and extension services
- Increased central spending on agriculture has not led to similar increases in agriculture output
- Reallocation => higher productivity

# In education, better spending is required to achieve outcomes

## *Example of the teacher certification program*

### Challenge

- Increasing enrollment
- Improving learning outcomes

### Policy response

- Teacher certification program
- Large fiscal investment: **doubling of teacher pay** following certification

### Design

- Certification required a university degree, other training, and experience
- Requirement to demonstrate competency was dropped

### Evaluation

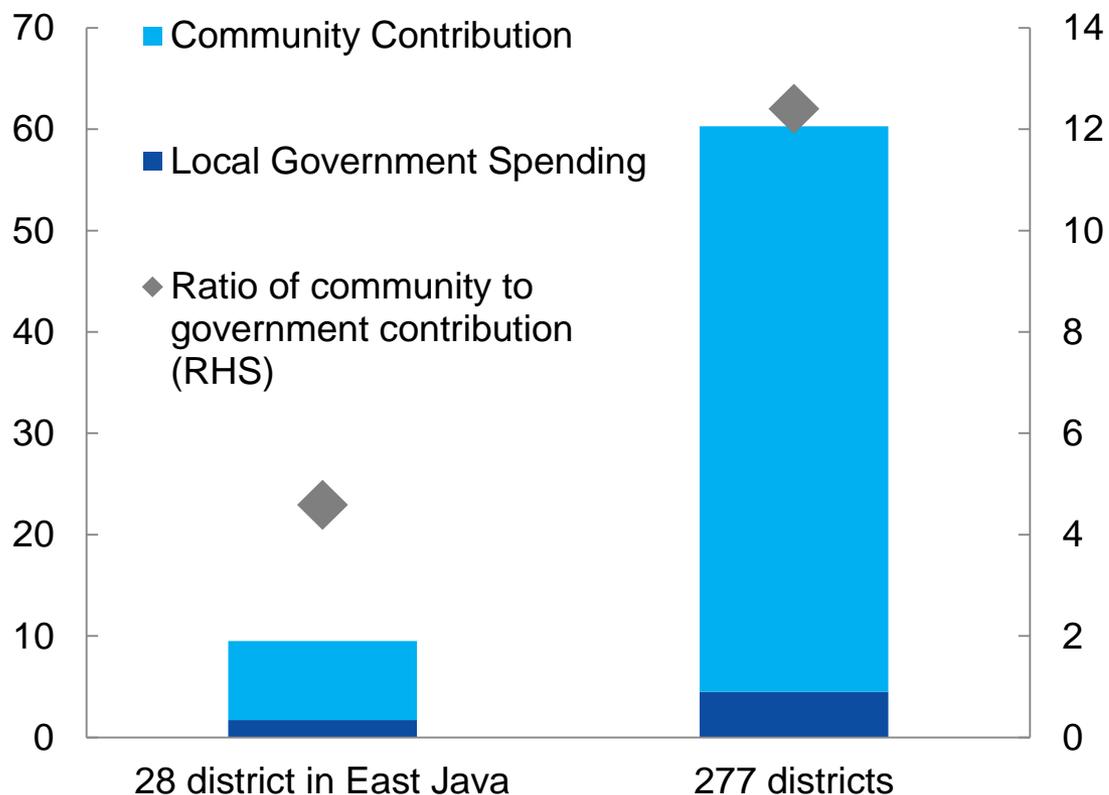
- Many teachers were incentivized to upgrade their qualifications
- But **no impact on student learning (test scores)**

### New opportunity

- Teaching has become a popular profession
- **Prioritize demonstrated professional competencies over education level and seniority**

# In sanitation, targeted public investments triggered much larger investment by rural communities

*Investment in rural sanitation, 2 data samples*  
*USD million, LHS; ratio, RHS*



## Government spending directed to:

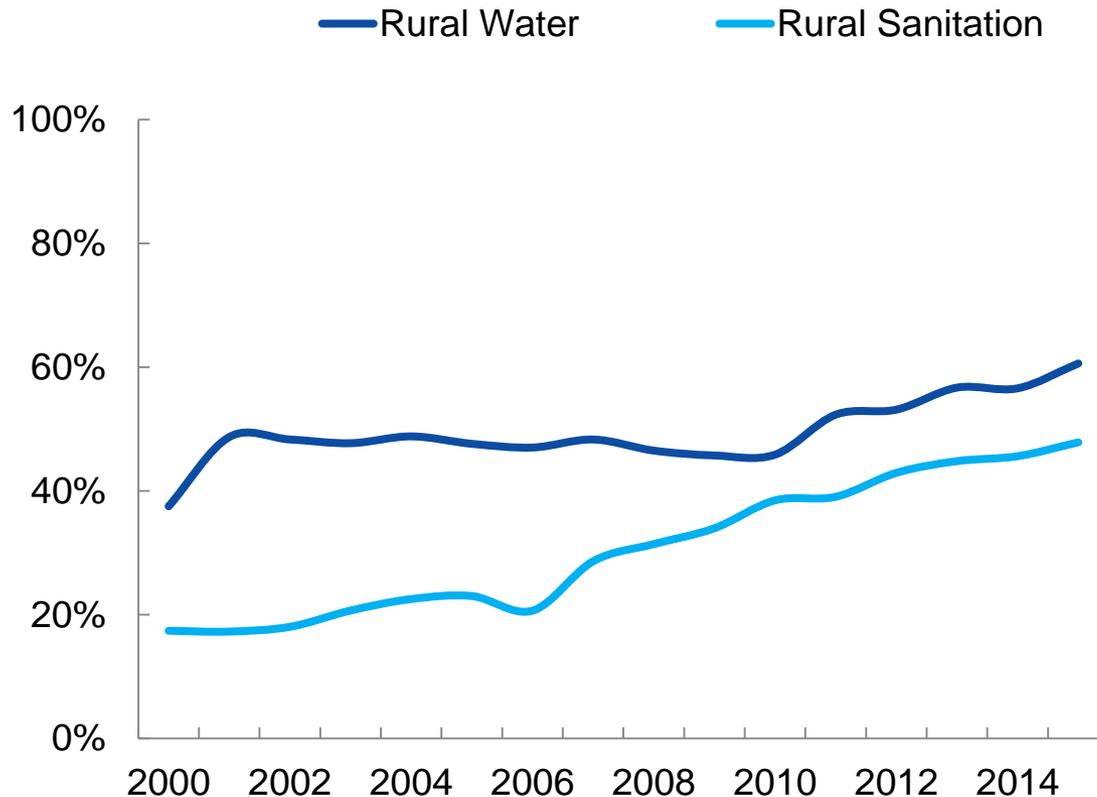
- creating demand for safe sanitation and hygiene through community empowerment and behavior change
- increasing the supply of affordable and aspirational sanitation facilities by the private sector
- enhancing the enabling policy environment

## Households purchase latrines

Source: World Bank, STBM

# ...leading to good outcomes: rapid rise in access to sanitation in rural areas

*Access to improved water and sanitation, percent*



Source: SUSENAS, BPS

## **Government is achieving its goals in WASH (urban + rural)**

- MDG for water supply achieved (87% in 2015)
- MDG for sanitation narrowly missed (61% in 2015; the target was 62.4%)

**Government now targeting universal access to improved water supply and sanitation services by 2019, in line with the SDGs**

**Macroeconomic pressures easing**

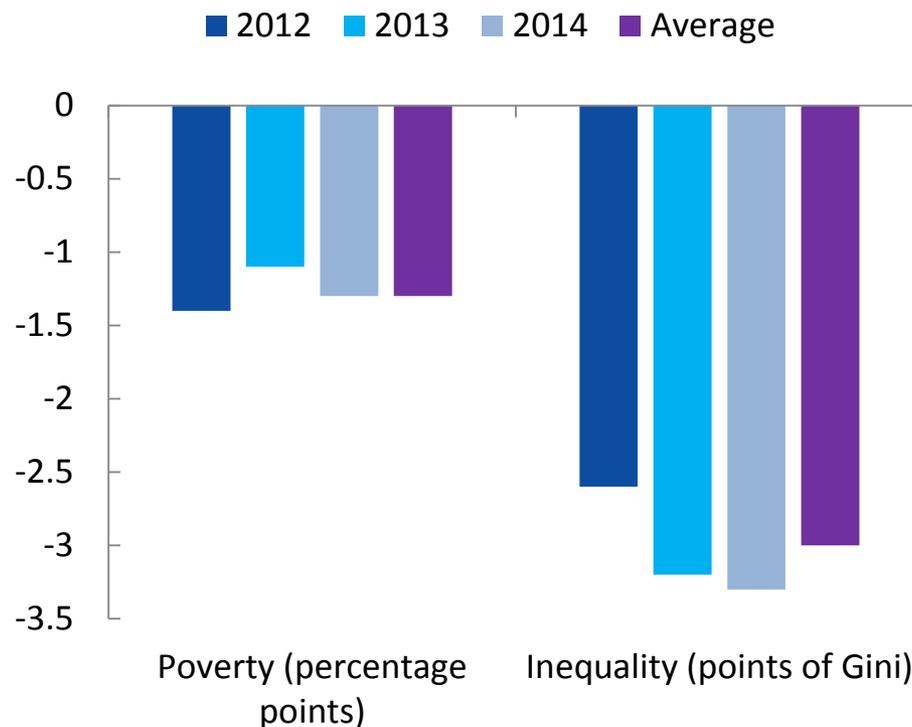
**Fiscal spending reforms and inclusive growth**

**Fiscal policy and welfare**

# Fiscal policy (2012-14) did relatively little to reduce poverty and inequality...

- Indonesian taxes and government spending reduced poverty by 1.1-1.4 percentage points and the Gini coefficient by 2.6-3.3 points (over 2012-14)
- Relatively small reductions by international standards, partly due to:
  - **personal income tax collection is low** with poor compliance
  - **social assistance spending is low**
  - **health spending is low** and much of it is not on the primary care which most benefits poorer households
  - education spending is high and has some impact on inequality, but not to the degree seen in other countries
- **Also partly due to high spending on energy subsidies which predominantly benefit richer households.**

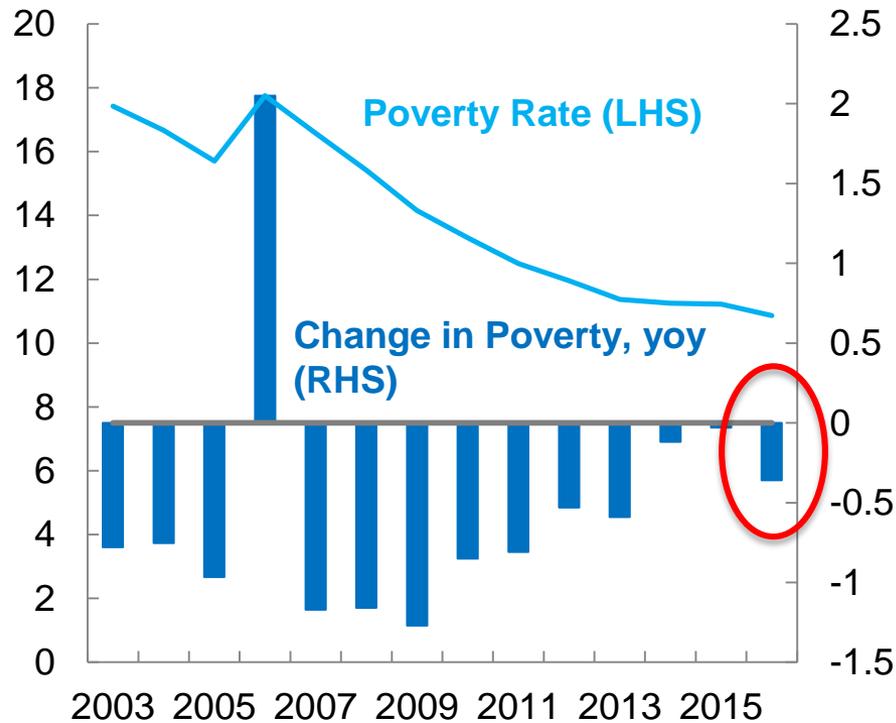
## Baseline Fiscal Policy Impact on Poverty and Inequality 2012-14



Source : The 2012 result is from a fiscal incidence paper (World Bank and Ministry of Finance 2015), and the 2013 and 2014 results are from a coming update to that paper. The analysis is based on the Commitment to Equity framework ([commitmenttoequity.org](http://commitmenttoequity.org)), and applies standard fiscal incidence analysis to the majority of Gol taxes and spending

# ...but recent choices are delivering more positive results: poverty and inequality fell in 2016... thanks to efforts to stabilize rice prices and social assistance expansion (PKH)

**Poverty rate, percent (LHS); change in poverty, percentage points (RHS)**



Source: Susenas

**Gini coefficient, points (LHS); change in Gini coefficient, points (RHS)**

