CHAPTER II

Policy Synergy

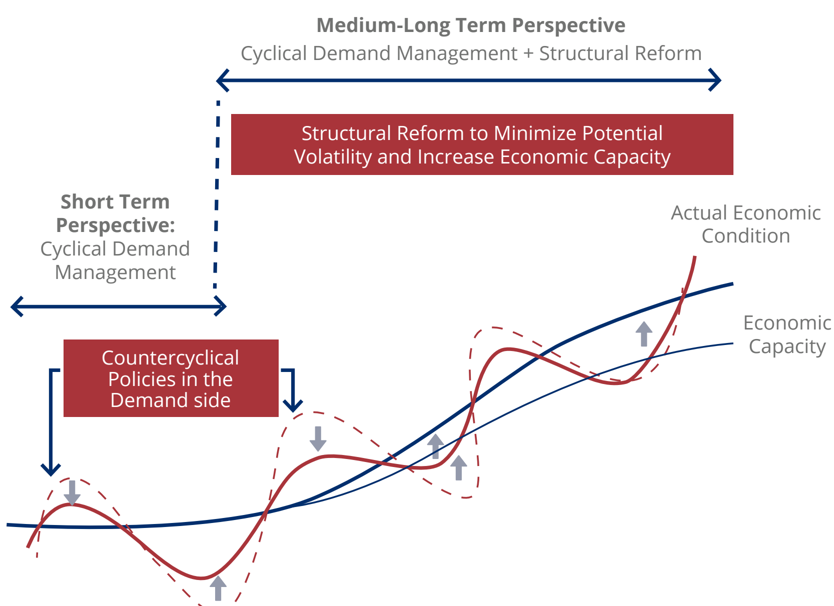
In 2019, policy synergy was oriented towards stimulating economic growth, maintaining financial stability and strengthening economic structure. The direction of policy took into account economic and credit growth conditions that were below their potential level amid managed economic stability. To that end, the policy responses have been conducted through increasing fiscal stimuli by the Government; an accommodative policy mix by Bank Indonesia; and structural policies to accelerate national economic transformation towards an advanced economy.

“Policy synergy in 2019 underpinned resilient economic growth in Indonesia, while maintaining stability”

Chapter 1 presented several aspects of economic dynamics that emerged in 2019 and that characterize the outlook. In 2019, economic growth in Indonesia stood at 5.02%, which is below the optimal path. Overall economic conditions were consistent with the global economic moderation that undermined export performance; supressed investment, particularly non-building investment; and keep household consumption growth stable. Suboptimal economic growth, coupled with the banking industry’s desire for higher lending standards, restrained credit growth. These conditions were accompanied by the maintenance of economic stability, mild inflation and an appreciation of the rupiah, driven by foreign capital inflows in the fourth quarter. Moreover, the financial system remained stable in line with solid bank capital and sound loan quality.

The policy responses aimed to stimulate economic growth towards a more optimal path. Based on the business cycle illustrated in Figure 2.1, sluggish economic growth and low credit growth called for attention. Stimuli were required to lift economic growth towards a more optimal trajectory, with immediate effect, using the space provided by maintained macroeconomic and financial stability. As noted in Chapter 1, inflation tracked a declining trend to 2.72% in 2019. On the external side, stability improved in line with strong foreign capital inflows during the fourth quarter of 2019. At this time, global financial uncertainties eased, and domestic financial assets became more attractive, especially in light of favorable perceptions of the economic outlook for Indonesia. The maintenance of financial stability ultimately served the foundation for stimulating economic growth without risking sound economic fundamentals.

Figure 2.1. Aggregate Demand Management



Source: Warjiyo and Juhro (2016)[1]

1 Warjiyo, P., & Juhro, S. M. (2016). Central Bank Policy: Theory and Practice. PT Raja Grafindo Persada

Policy sinergy were implemented by the Government, Bank Indonesia and other authorities in response to the domestic economic dynamics and the outlook. A wide range of policies were directed towards restoring economic growth; maintaining price and financial system stability; and strengthening the economic structure. To this end, the Government increased fiscal stimuli in 2019 in order to boost economic growth, while assuring fiscal sustainability. Bank Indonesia conducted an accommodative mix of monetary, macroprudential, payment system and other policies to catalyse economic growth momentum without risking macroeconomic stability. In addition, several structural policies expedited improvements to long-term economic capacity and supported Indonesia's transformation towards an advanced economy. In general, policy synergy in 2019 underpinned resilient economic growth in Indonesia, while maintaining stability.

2.1

Increasing Fiscal Stimuli

In 2019, the Government directed fiscal policy towards stimulating economic growth and maintaining fiscal sustainability. In 2019, fiscal policy followed three main strategies, namely: i) mobilising revenue by strengthening the investment climate; ii) improving expenditure quality to ensure more effective and productive spending in support of priority programs; and iii) promoting financial efficiency and innovation through creative financing. State revenues were optimised to support state expenditure, while simultaneously providing incentives for the business community. Quality of expenditure was improved through a shift away from consumption towards productive spending. Deficit financing was broadened to include creative financing schemes, like Green Bonds and Green Sukuk, often directed towards achieving the Sustainable Development Goals (SDGs).

On the state revenue side, the Government focused on increasing tax revenues. Tax revenues are critical because they are the primary source of state revenue and an instrument to improve the investment climate and competitiveness. To that end, tax policy in 2019 pursued increased state revenues through better tax compliance and expanding the tax base through simple, transparent tax reforms. In addition, the Government implemented reforms to non-tax state revenues (PNBP), while maintaining the quality of public services by improving PNBP governance and integrating technology in the PNBP payment system.

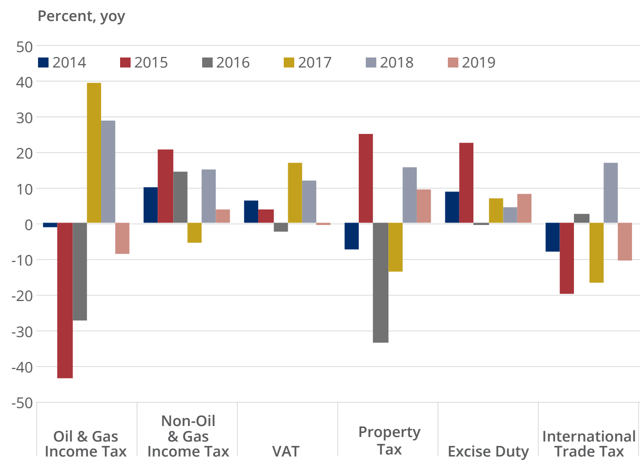
In addition, several tax incentives were offered to support economic growth. Fiscal incentives were provided to improve the investment climate and competitiveness, including expediting tax refunds; providing super deductions for specific businesses and industries; tax holidays for export-based service industries; and fiscal incentives to accelerate the electric vehicle program. Faster tax refunds were implemented to increase investment by minimising costs. Super deductions tax aimed to boost investment in labor-intensive industries in order to create new jobs; to stimulate research and development activities for the sake of increased competitiveness; and to engage the private sector in enhancing the quality of human resources via the 'link and match program'.[2] In addition, value added tax (VAT) exemptions were extended to export-based service industries.

State revenue slowed in 2019. In 2019, state revenue realisations stood at IDR1,957.2 trillion, reflecting growth of 15.9% compared with 16.6% the year before. State revenue growth in 2019 was supported by solid tax revenues from income tax levied on the non-oil and gas sector as well as VAT. These largely offset lower tax receipts from the oil and gas sector and international trade tax in line with subdued world trade and sliding commodity prices (Chart 2.1). Lower international commodity prices also adversely impacted non-tax state revenues (PNBP) from natural resources. Nonetheless, total PNBP realisations remained high at IDR405.0 trillion, equivalent to 107.1% of budgeted (APBN) amounts (Chart 2.2).

On the state expenditure side, the Government enhanced the quality of spending to support the

2 The 'link and match' program encourages compatibility between educational materials in schools and universities with the needs of industry and other business sectors.

Chart 2.1. Growth of Tax Revenue

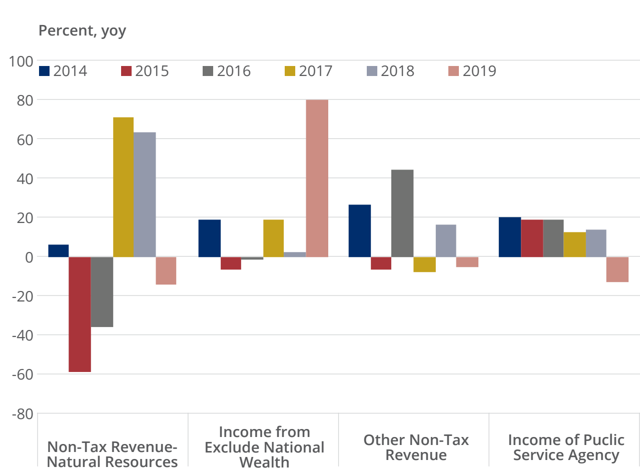


Source: Ministry of Finance, calculated

priority programs more effectively. This government strategy entailed optimising the government budget for productive spending; reducing material expenditure; strengthening capital expenditure; reforming personnel expenditure; synergising social aid programs (bansos); subsidising social protections; and improving the quality of fiscal decentralisation. Productive government spending was directed towards enhancing the quality of human resources; strengthening social protections by expanding the Family Hope Program (PKH); and completing infrastructure development, bureaucratic reform and fiscal decentralisation.

The government's expenditure strategy was bolstered by more efficient spending. Efficiency was improved by paying due regard the value of all monies spent through efforts to

Chart 2.2. Growth of Non-Tax Revenue



Source: Ministry of Finance, calculated

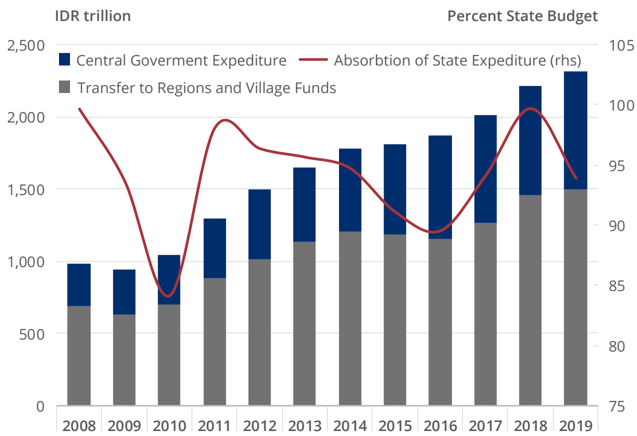
"The Government directed fiscal policy in 2019 towards stimulating economic growth and maintaining fiscal sustainability"

increase the quality of state apparatus, especially control of materials expenditures, optimisation of capital expenditure and strengthening the social aid program (bansos). Control of materials expenditures targeted three levels, namely: stronger procurement processes; greater efficiency in the purchase of consumption goods; and refining materials spending that had been transferred to the public and local governments. Capital expenditure was also optimised by increasing production capacity and connectivity; expanding basic transportation infrastructure in border and disadvantaged areas; developing new destinations; and using creative financing schemes to increase the private sector's contribution to economic development. Meanwhile, the social aid programs (bansos) strengthened the nation's social safety net by increasing synergy across programs and utilising integrated databases to target beneficiaries more accurately.

The expenditure strategy increased central government spending and optimised productive expenditure. The realisation of central government expenditure in the 2019 State Revenue and Expenditure Budget (APBN) totalled IDR1,489.9 trillion, up 3.0% from the previous year (Charts 2.3 and 2.4). This increase stemmed primarily from personnel expenditure and disbursements for social aid programs (bansos). In line with the government's frontloading policy, spending on social aid programs increased by 34.1% to IDR113.1 trillion in 2019. Meanwhile, subsidy spending declined, and interest payments were well managed. Subsidy spending decreased from IDR216.9 trillion in 2018 to IDR201.8 trillion in 2019, while interest payments stood at IDR275.5 trillion in 2019 as growth dropped to 6.8% from 19.2% the year before.

The government's spending strategy was also supported by efforts to strengthen the allocation of regional transfers and village fund disbursements (TKDD).

Chart 2.3. State Expenditure

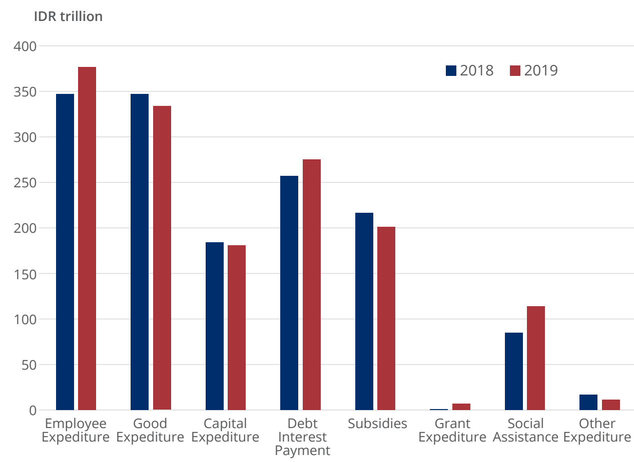


Source: Ministry of Finance, calculated

Regional transfers and village fund disbursements were harmonised with government ministry and agency expenditure policies and the policies managed in accordance with value-for-money principles. The policies focused on efforts to enhance the quality of regional public services, while actively reducing disparities between public services in different regions. Furthermore, final allocations of the General Allocation Fund (DAU) provided funding assurance for regional budgets, including budget funding assistance for rural areas. As for the Special Allocation Fund (DAK), it addressed gaps in basic public services with emphasis on the competitiveness of human resources, including education, overcoming childhood stunting and local infrastructure. TKDD policy also refined the Regional Incentive Fund (DID) to better reflect regional achievements and performance, while strengthening Village Fund allocation through more equitable distributions. TKDD realisation in 2019 totalled IDR811.3 trillion, up from IDR757.8 trillion in 2018, accompanied by faster disbursement. This increase was due to two factors: (i) higher DID realisations, including transfers to local governments impacted by natural disasters; and (ii) faster non-physical DAK disbursements in line with greater regional compliance in terms of submitting certain reports, namely School Operational Assistance (BOS), Teachers Allowance (TPG) and Special Teachers Allowance (TKG).

The revenue, expenditure and financing strategies supported fiscal sustainability. Despite widening from 1.5% of GDP in 2018, the 2019 state budget deficit remained manageable at 2.2% of GDP (Chart 2.5) and well below the legal limit of 3%. This was supported by a modest primary deficit, namely 0.48% of GDP. The maintenance of fiscal

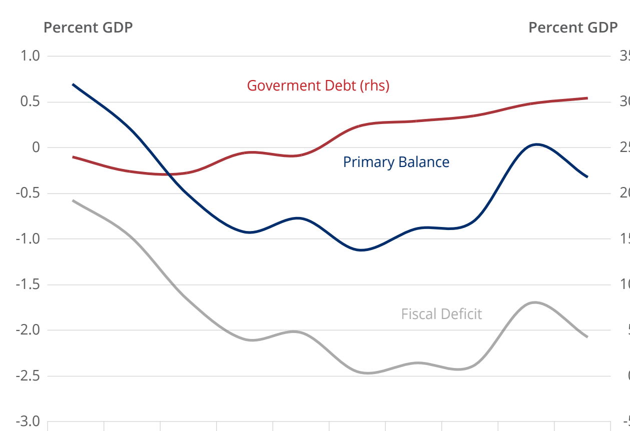
Chart 2.4. Composition of State Expenditure



Source: Ministry of Finance, calculated

sustainability was backed by prudent, efficient, balanced and productive deficit financing, which maintained the deficit and debt ratio well within manageable bounds. Total net financing increased from IDR305.7 trillion in 2018 to IDR399.5 trillion in 2019, supported by improvements in the composition of government debt. In net terms, government securities (SBN) issuances (the primary source of debt financing) totalled IDR446.3 trillion, while the loan component was recorded at negative IDR17.19 trillion. Such developments are in line with government strategy to diversify financing sources by optimising domestic financing and utilising supplemental foreign financing. In addition, the Government strived to increase domestic market deepening by optimising online issuances of tradeable government securities. Consequently, overall government debt in 2019 remained healthy, at 30.2% of GDP (Chart 2.5).

Chart 2.5. Fiscal Deficit and Primary Balance



Source: Ministry of Finance, calculated

2.2

Bank Indonesia's Accommodative Policy

As elaborated in Chapter 3, in 2019 Bank Indonesia conducted accommodative policies to stimulate growth and economic stability. Economic dynamic in 2019 provided adequate room for Bank Indonesia to implemented accommodative policies. On the one side, economic growth and the growth in loans disbursed by the banking sector were below their respective optimal levels, motivating price stability stimuli. On the other side, price stability remained well. In addition, external stability was preserved in line with inflows of foreign capital in the fourth quarter of 2019, coupled with a manageable current account deficit, both of which underpinned rupiah appreciation. Moreover, the financial system remained stable, bolstered by a solid capital base in the banking industry and sound loan quality. This combination provided adequate room for Bank Indonesia to stimulate economic growth, while maintaining economic stability.

Consistent with the direction of the policy mix, Bank Indonesia conducted an accommodative monetary policy to maintain stability and boost economic growth. Accommodative monetary policy was consistent with controlled inflation in the target and managed external stability, while serving as a pre-emptive measure to maintain domestic economic growth momentum. Accommodative monetary policy was implemented in a cautious, stepwise fashion, beginning near mid-year and using two instruments, bank reserve requirements and policy interest rates (see Chapter 3 for details). By year-end, the BI 7-Day (Reverse) Repo Rate (BI7DRR) and reserve requirements were both down by a total of 100bps. Furthermore, exchange rate policy was directed towards maintaining the rupiah in line with the currency's fundamental value and market mechanisms. Bank Indonesia also continued to strengthen monetary operations in order to ensure adequate liquidity monetary in the money market and accelerate monetary policy transmission.

Bank Indonesia also continued the accommodative macroprudential policies to strengthen credit as a source of financing, while preserving financial system stability. In 2019, Bank Indonesia continued accommodative macroprudential policies by refining the Macroprudential Intermediation Ratio (MIR) and relaxing the Loan-to-Value (LTV) and Financing-to-Value (FTV) ratios. These policies increased the property sector's ability to absorb labour and induced a multiplier effect through backward and forward linkages with other sectors, while complying with prudential principles. Such efforts to boost intermediation were balanced against the maintenance of sufficient bank capital and adequate liquidity. In 2019, Bank Indonesia maintained the Countercyclical Capital Buffer (CCB) and Macroprudential Liquidity Buffer (MLB) at 0% and 4% respectively.

"Bank Indonesia's accommodative policy stimulated economic growth while maintaining stability"

Financial market deepening was accelerated to strengthen the effectiveness of accommodative policies. These measures focused on developing financial market instruments, infrastructure and credibility, as well as strengthening coordination with other relevant authorities under the Financial Market Development and Deepening Coordination Forum (FK-PPPK). To stimulate infrastructure financing, Bank Indonesia strengthened coordination with the Government and other relevant authorities to enrich innovative financial instruments that emphasized the private sector's contribution to infrastructure, while providing mentorship programs and facilitation.

Bank Indonesia directed payment system policy to support economic activity through electronification and efficiency of payment system. Bank Indonesia proceeded with expanding and accelerating non-cash payment electronification to broaden financial access, increase economic efficiency as well as support quality and sustainable economic growth. Non-cash payment electronification was expanded and accelerated in various areas, including government social aid programs and the transportation sector. In addition, efforts to increase payment efficiency in various other economic transactions were strengthened. For instance, Bank Indonesia continued to improve the efficiency of retail payments, including the standardisation of national QR code, known as QRIS or Quick Response Code Indonesian Standard, while bolstering an

efficient, straightforward, affordable, secure and reliable National Clearing System (SKNBI). Furthermore, payment efficiency was boosted by better infrastructure using the National Payment Gateway (NPG), which facilitates interconnectivity and interoperability among payment instruments.

Bank Indonesia also consistently strengthened efforts to provide rupiah currency throughout the Indonesian archipelago in accordance with public demand. As the rupiah currency management authority, Bank Indonesia committed to fulfill the demand for rupiah currency throughout Indonesia, thereby supporting solid and balanced economic growth. To this end, Bank Indonesia enhanced rupiah currency distribution effectiveness by expanding the coverage of services to all Indonesian regions, particularly in frontier, outlying and remote (3T) areas. Cash services were also expanded through cooperation with the banking industry to fulfill the demand for cash in specific regions. Bank Indonesia also strived to contain the risk of counterfeiting by improving the quality of currency in circulation, while simultaneously providing public education services.

Bank Indonesia has added a range of innovations to the policy mix to increase policy effectiveness and support the efforts to strengthen the structure of the economy. In response to the proliferation of economic digitalisation, Bank Indonesia launched the Indonesia Payment System Blueprint 2025 (IPSB 2025) to ensure that digitalisation develops in the wider public interest (see Chapter 5). Digital innovation will be oriented towards supporting digital economic and financial integration, which will strengthen the effectiveness of currency in circulation, monetary policy transmission, financial system stability as well as financial and economic inclusion. Further in this regard, digital innovation will strengthen linkages between economic agents, from the smallest to the largest, and from individual consumers and MSMEs to large corporations. Furthermore, Bank Indonesia is also coordinating with the Government and other relevant authorities to explore new sources of economic growth and strengthening of the structure of the Indonesian economy, as discussed immediately below. Financial market development has been continued to ensure the sustainability of economic financing and to support solid, sustainable and inclusive economic growth.

2.3

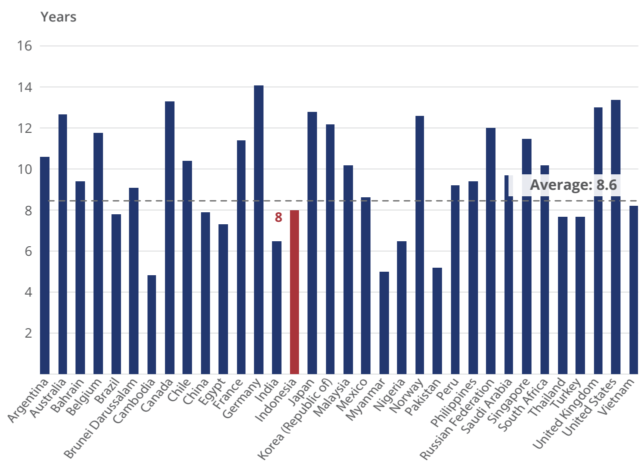
Strenghthening Structural Policies

Structural policies have also been implemented to accelerate economic transformation towards an advanced economy. The vision for Indonesia's economic transformation is to be implemented through the Medium-Term National Development Plan (RPJMN) 2020-2024 as the final phase of the Long-Term National Development Plan (RPJPN) 2005-2025. During this final phase of implementation, RPJPN 2005-2025 represents a strategic element in achieving Indonesia's vision of becoming an advanced economy. This economic transformation is supported by policy synergy among Bank Indonesia, the Government, the Indonesian Financial Services Authority (OJK) and other relevant authorities, which have consistently implemented structural reform policies.

The Government has identified five priorities to accelerate economic transformation. First, human resource development through greater competence, expertise, knowledge and technological proficiency. Second, infrastructure development oriented towards industry and tourism connectivity, thus driving the creation of new jobs and increasing value added. Third, streamlining regulations through draft Omnibus Laws on Job Creation and Taxation to strengthen the economy. Fourth, bureaucratic reform to improve the investment climate through simpler and streamlined licensing and bureaucracy. And fifth, economic transformation to reduce dependence on natural resources in favor of manufacturing and services with high value added and competitiveness.

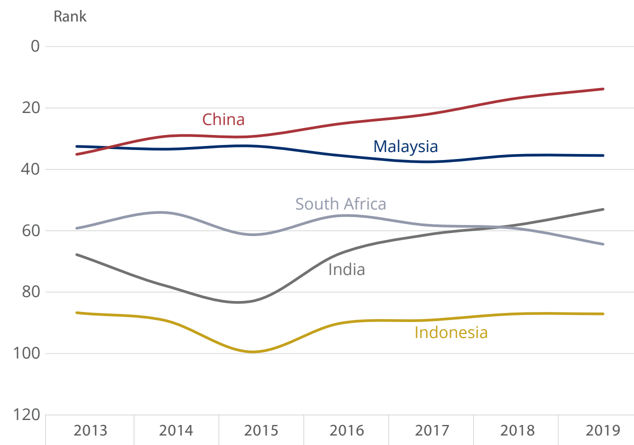
Further on these priorities and concerning human resource development, education in Indonesia continues to improve. This development is supported by policies regarding: compulsory education; better educational facilities and infrastructure; development of vocational schools; and curriculum improvements (Chart 2.6). Meanwhile, the pool of skilled workers has grown along with Research and Development (R&D) activity, thus driving innovation (Chart 2.7). Moving forward, greater expertise and competence will be critical to meet the commercial need for highly skilled workers to support manufacturing sector. To this end, policy to strengthen the quality of human resources will be continued, by utilising the impetus of the current demographic dividend, which is expected to peak in 2030. Meanwhile,

Chart 2.6. Average Years of Schooling



Source: UNDP

Chart 2.7. Innovation Ranking



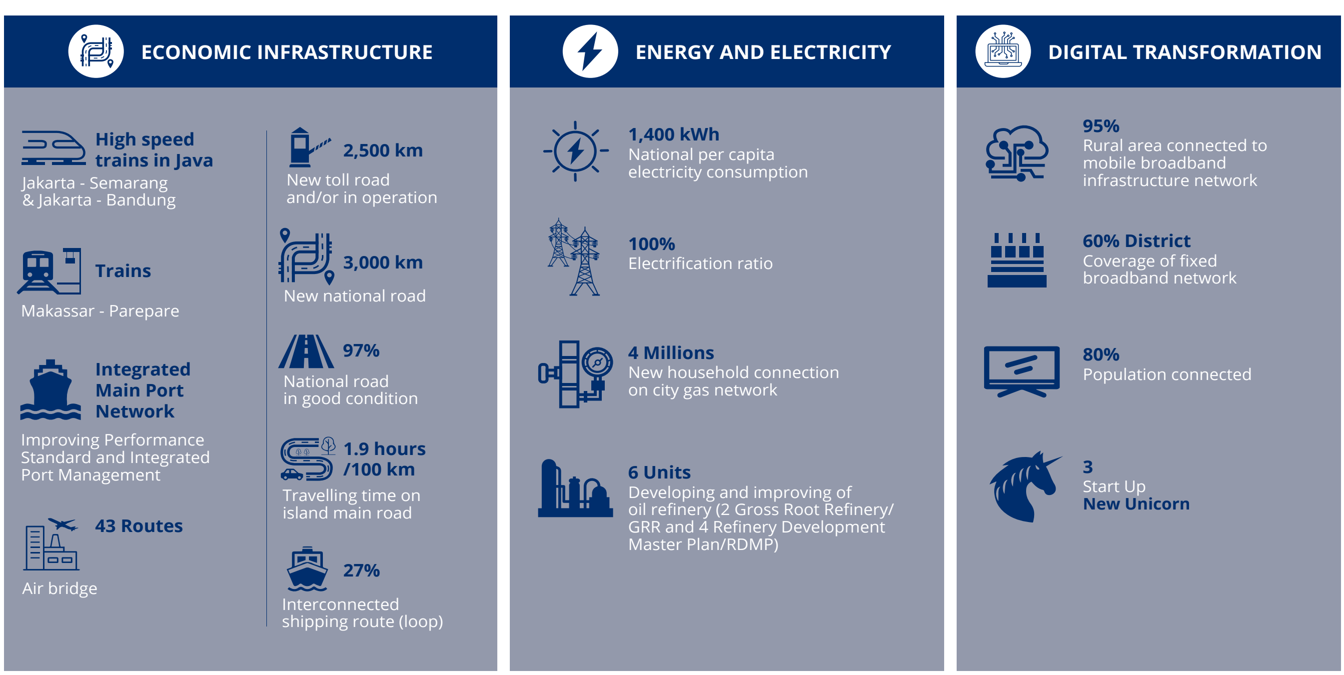
Source: Global Inovation Index

knowledge and technological proficiency will increase economic competitiveness through R&D activities.

Infrastructure development is accelerating in support of economic competitiveness. Infrastructure capacity is increasing in support of national connectivity, which aims to connect economic zones (like industry, tourism and MSMEs) to the distribution network, while ensuring economic equality. In addition, infrastructure development will improve energy security, thereby increasing industrial competitiveness through assured supplies and lower energy prices. In addition, infrastructure development will optimise digital technology through greater uptake of information technology. Overall, infrastructure development policy supports economic competitiveness, and progress will continue in the form of better roads, bridges, railways, seaports, irrigation and electricity infrastructure (Figure 2.2).

Structural policy is furthered by streamlining regulations. As of October 2019, deregulation to support

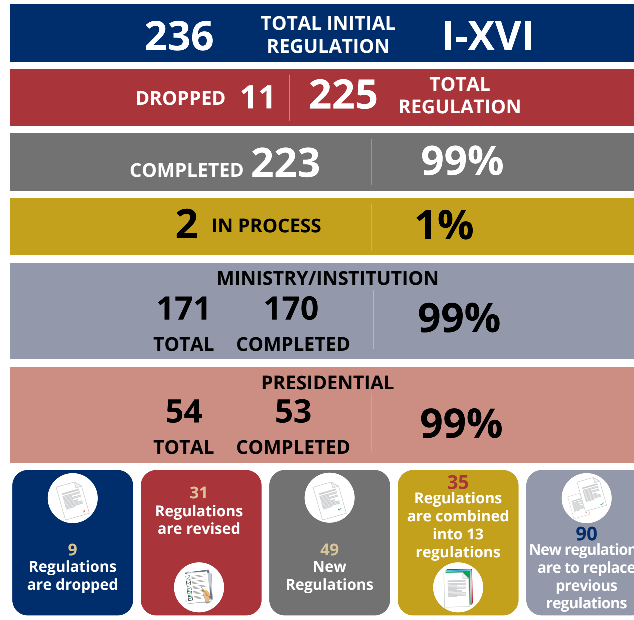
Figure 2.2. Policy for Strengthening Medium Term Infrastructure



“The Government has streamlined regulations through a omnibus law”

business development had effectively streamlined a total of 223 regulations. This effort includes: (i) repealing regulations that constitute economic barriers; (ii) amending regulations to remove specific articles and provisions that impede the economy; (iii) combining regulations to simplify licensing and the regulatory landscape; (iv) issuing new regulations to supersede existing regulations that are no longer relevant; (v) issuing new regulations to accommodate new policies (Figure 2.3). Looking ahead, institutional reform will continue in support of a more conducive business climate.

Figure 2.3. Deregulation through Economic Policy Packages I-XVI



Source: Presidential Regulation No.18/2020 on National Medium-Term Development Plan 2020-2024

The Government is also streamlining regulations through omnibus laws. Regulatory reform will focus on promulgation of Omnibus Laws on Job Creation and Taxation. The omnibus laws aim to simplify, repeal or combine many regulations, including: government regulations; presidential regulations; ministerial regulations; and provincial regulations, with the substance harmonised across regulations. Simplification is important in order to avoid conflicting regulations and overlapping jurisdiction between government ministries, agencies and local governments that could impede the pace of economic transformation.