INDONESIA ECONOMIC QUARTERLY

July 2014

Hard choices

THE WORLD BANK
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Preface

The Indonesia Economic Quarterly (*IEQ*) has two main aims. First, it reports on the key developments over the past three months in Indonesia's economy, and places these in a longer-term and global context. Based on these developments, and on policy changes over the period, the *IEQ* regularly updates the outlook for Indonesia's economy and social welfare. Second, the *IEQ* provides a more in-depth examination of selected economic and policy issues, and analysis of Indonesia's medium-term development challenges. It is intended for a wide audience, including policymakers, business leaders, financial market participants, and the community of analysts and professionals engaged in Indonesia's evolving economy.

The *IEQ* is a product of the World Bank's Jakarta office and receives editorial and strategic guidance from an editorial board chaired by Rodrigo Chaves, Country Director for Indonesia. The report is compiled by the Macroeconomic and Fiscal Management Global Practice team, under the guidance of Shubham Chaudhuri, Practice Manager, Ndiame Diop, Lead Economist, and Ashley Taylor, Senior Economist. Led by Alex Sienaert, Country Economist, and with responsibility for Part A, editing and production, the core project team comprises Arsianti, Magda Adriani, Masyita Crystallin, Fitria Fitrani, Ahya Ihsan, Yus Medina, Elitza Mileva (Part A lead), Michele Savini Zangrandi and Violeta Vulovic, with additional editing by Peter Milne. Administrative support is provided by Titi Ananto. Dissemination is organized by Farhana Asnap, Indra Irnawan, Jerry Kurniawan, Desy Mutialim and Nugroho Sunjoyo, under the guidance of Dini Sari Djalal.

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Executive summary: Hard choices

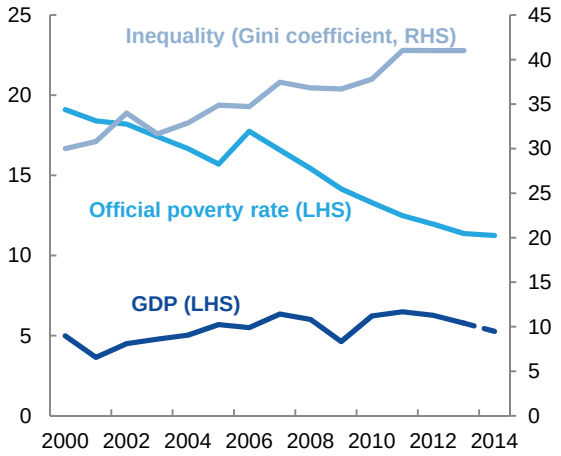
The people of Indonesia, the world's third most populous democracy, have voted for a new President…

Indonesians voted for their next President on July 9. With official results expected by 22 July, the country is looking ahead to the inauguration of a new President in October.

…who will take office facing hard choices necessary to address rising fiscal pressures and to implement much-needed reforms to deliver on the economy's enormous potential

Indonesia now faces hard policy choices. The past decade of solid growth has contributed to considerable development progress. Indonesia now has the world's 10th largest economy in purchasing power parity-adjusted terms, according to recently-released figures. However, there remains a clear risk that the recent moderation in economic growth could intensify. Against a backdrop of weakening revenue growth and rising energy subsidy spending, this would further constrain development expenditures in critical areas such as infrastructure, social protection and health. As highlighted in the World Bank's recent 2014 Indonesia Development Policy Review (*Avoiding the Trap*), there is therefore a need for policymakers to make the hard choices over urgently needed policy reforms and investments and to follow through with their implementation to increase the level of sustainable growth, to reverse the recent deceleration in the rate of poverty reduction (Figure 1) and to ensure the broader sharing of prosperity with all Indonesians.

Figure 1: There is a need to reinvigorate Indonesia's growth and poverty reduction, and combat inequality
(real GDP growth, percent; poverty rate, percent; 0-100 scale Gini)



Note: Poverty rates are March BPS estimates; 2014 GDP growth: World Bank projection; Gini data to 2013
Source: BPS; World Bank staff calculations

The need for reform in part reflects a changing global economic environment; hard choices need to be made if the economy is to benefit from improving global demand and to adjust to the continued softness of Indonesia's key commodity prices…

The new Government will face an evolving global environment, as the tail winds of the past decade – rising commodity prices and demand and low global financing costs – have waned. However, in the near term, the global economy, after a slower-than-expected start this year, is forecast to pick up speed. Most of the acceleration will come from high-income countries, in particular the U.S. and the Euro Area. Stronger growth in advanced economies means higher demand for developing country exports, but only to the extent that they can compete in global markets. At the same time, global financial conditions have improved so far this year, with the delay in the tightening of monetary policy in advanced countries. However, ongoing declines in commodity prices will cut into incomes and government revenues in commodity exporters like Indonesia. The price of Indonesia's top six exports, accounting for 50 percent of total export revenues, continues to soften, falling by 8.6 percent in 2014 through June, led by coal (down 15.2 percent). The recent volatility of oil prices, due in part to the turmoil in Iraq, highlights the ongoing vulnerability of Indonesia's fiscal position to higher international oil prices.

…as well as ensure that the continuing cyclical moderation in domestic growth does not become structural

Real GDP growth in Indonesia moderated to 5.2 percent year-on-year (yoy) and 4.3 percent quarter-on-quarter at a seasonally-adjusted annualized rate (qoq saar) in the first quarter of 2014. In contrast to Q4 2013, when economic activity received a significant boost from net exports, domestic demand remained robust, while the net trade contribution to growth was negative. Temporary election-related consumption spending may have played a role in supporting domestic demand in the first quarter, along with the continued strength of construction investment. As discussed below, the World Bank's baseline expectation remains for a moderate re-acceleration in economic growth through 2015, but without more policy measures to support investment and productivity growth the risks of a more structural deterioration in growth will mount.

A stable Q1 2014 current account deficit has masked challenges to the external adjustment process

The overall current account deficit was stable, at 2.1 percent of GDP, in the first quarter of 2014. However, Indonesia's external adjustment process appears to have slowed. The partial mineral export ban, introduced in January, has caused a significant decline in export volumes. This, coupled with weaker global commodity prices, has put export revenues under strain, proving to be a continuing drag on the overall current account. A renewed, largely seasonal, widening in the current account balance is expected in the second quarter. External financing has been ample in 2014 to date, as portfolio capital inflows into Indonesia (and other emerging economies) have benefited from prolonged accommodative monetary conditions in advanced economies and a recovery in global risk appetite, lifting offshore investor holdings of domestic government bonds to a record high.

Indonesian asset prices have picked up, but bank credit conditions have continued to tighten

Partly due to the larger foreign capital inflows, Indonesian bond and equity prices have risen over 2014, recovering most of the losses incurred in the second half of last year. Bank liquidity in local currency, however, remains relatively tight and is likely to result in a further decline in credit growth. At the same time, lower growth expectations may feed through into a further weakening of credit demand.

The World Bank's 2014 growth outlook for Indonesia is revised slightly down to 5.2 percent

Looking forward, lower government consumption than previously expected (following the 2014 Budget revision), slower credit growth and continued weakness in commodity-related income growth are likely to constrain GDP growth in the second half of 2014. In the base case, the World Bank projects real GDP growth of 5.2 percent in 2014, a small downward revision of 0.1 percentage points from the March 2014 *IEQ* forecast. The changes to the short-term outlook mainly reflect weaker-than-expected Q1 trade data. While economic adjustment to weaker terms of trade and the prospect of higher global interest rates is well underway, this is by no means complete. External pressures could yet re-emerge in the absence of a pronounced improvement in export performance, or due to weaker external financing inflows, if global risk appetite reverses. Additional downside pressure on growth could come from an intensifying credit contraction, if this results in further weakness in property prices, which in turn reduces real construction activity.

Table 1: Under the baseline scenario, Indonesia's growth is projected at 5.2 percent in 2014

		2012	2013	2014p	2015p
Real GDP	(Annual percent change)	6.2	5.8	5.2	5.6
Consumer price index	(Annual percent change)	4.3	6.9	5.8	4.9
Current account balance	(Percent of GDP)	-2.8	-3.3	-2.9	-2.4
Budget balance*	(Percent of GDP)	-1.9	-2.2	-2.4	n.a.
Major trading partner real GDP	(Annual percent change)	3.4	3.5	4.0	3.9

Note: * Government figures, realized (2012-2013) and approved Revised 2014 Budget balances
Source: BI; BPS; Ministry of Finance; World Bank staff calculations

The revised 2014 Budget was approved in the context of increasing fiscal pressures, resulting in a higher fiscal deficit and gross financing needs

Responding to macroeconomic changes, subdued revenue growth, and rising energy subsidy costs, the Government proposed a substantially revised 2014 Budget. The deficit under the revised Budget approved by Parliament on June 18 was 2.4 percent of GDP, up from 1.7 percent under the original Budget. Significant budget cuts of IDR 43 trillion for line ministries were approved, along with the postponement to 2015 of the payment of rising energy subsidy arrears of around IDR 50 trillion. Although further movement on the politically-sensitive issue of fuel subsidy reform is still awaited, the Government has announced important electricity tariff adjustments. However, even with the announced cost-saving measures, World Bank macroeconomic projections suggest a larger fiscal deficit of 2.8 percent of GDP. This would be close to the legal 3 percent of GDP limit, and remains vulnerable to any further rise in oil prices or weakening in the Rupiah. The need to improve further the quality of spending and enhance revenue mobilization is therefore becoming critical if Indonesia is to achieve its development priorities. Progress in this area will be important to sustain investor confidence, helping to ensure that the Government's additional financing needs are adequately met over the second half of 2014.

One of the important priorities for fiscal policy reform is to support the inclusiveness of future growth, mitigating the trend of rising inequality seen in Indonesia in recent years

Indonesia has made significant progress in reducing poverty over the past decade. However, with a slow-down in the pace of poverty reduction, alongside a rapid rise in wealth, the gap between the rich and the poor has grown. In 2002, the average consumption per person of the richest 10 percent of households was 6.6 times that of the poorest 10 percent; by 2013, this had risen to 10.3 times. This is a concern, first, because the rise in inequality reflects limited access to good job opportunities, and hence limits current growth and poverty reduction. Second, it raises equity concerns, since all Indonesians should have access to the same opportunities. Third, rising inequality may also carry risks for future economic growth and social cohesion. With concerted action, Indonesia can arrest the rise in inequality, including through "win-win" policies, which not only combat inequality, but also support poverty reduction, such as upgrading rural infrastructure, expanding access to quality education and improving labor market mobility.

El Niño conditions could worsen the forthcoming forest fire "season", posing an early challenge for the new Administration, calling for appropriate contingency planning

Safeguarding hard-fought poverty reduction and social protection progress in Indonesia calls for continuously enhancing the management of disaster risks and further building resilience. This edition of the *IEQ* examines one such disaster risk: forest and land fires. Although Indonesia has long experienced such fires, they have become increasingly regular and large-scale in recent decades, reflecting a complex interplay of natural and man-made factors. For example, the severe fires in February-March 2014 resulted in significant environmental and economic damage and losses, estimated at USD 935 million for Riau province alone. The significant chance of El Niño conditions setting in towards the end of 2014 raises the risk that the next fire season will be severe, which could pose an immediate major challenge for the new Administration. Measures such as implementing a systematic approach to determining the start of the fire season and timely triggering of stand-by emergency status could play an important role in mitigating this risk.

A. Economic and fiscal update

1. Global financial market conditions have improved but commodity price softness remains

Emerging markets are to benefit from a pick-up in global demand and improved financial conditions, although non-energy commodity prices remain soft

After a weaker-than-expected start to 2014, the global economy is forecast to pick up speed more or less in line with earlier expectations. Most of the acceleration will come from high-income countries, in particular the U.S. and the Euro Area, supporting demand for developing country exports. At the same time, global financial conditions have improved further, with the delay in the tightening of monetary policy in advanced countries. However, declines in commodity prices, especially metal prices, will cut into incomes and government revenues in commodity exporters like Indonesia, whose fiscal position will also be adversely impacted from recent rises in oil prices.

Despite a first-quarter setback, high-income economy growth, as well as import demand, is firming…

According to the World Bank's June projections[1], global economic activity is expected to expand by 2.8 percent this year, strengthening to 3.4 percent in 2015. In spite of the weather-related first-quarter weakness, the U.S. economy is gaining momentum and the Euro Area is strengthening as well. As a result, high-income country import demand growth is expected to more than double in 2014 to 4.2 percent from 1.9 percent in 2013, and rise further to 4.8 percent in 2015. The average GDP growth rate of Indonesia's 13 major trading partners, weighted by export share, is forecasted at 4.0 percent in 2014 and 3.9 percent in 2015. Thus, the outlook for Indonesia's exports – which are somewhat less focused on high income countries than some regional peers – remains unchanged for 2014 and is slightly down for 2015 compared with the March 2014 *IEQ*.

… but, at the same time, commodity prices, in particular metals, are falling

Although overall global demand has been improving, its positive impact on Indonesia's exports has been offset by the continued decline in many global commodity prices, with the exception of crude oil. In the second quarter of 2014, among Indonesia's main export commodities, the prices of coal, natural gas, rubber, copper and gold decreased considerably

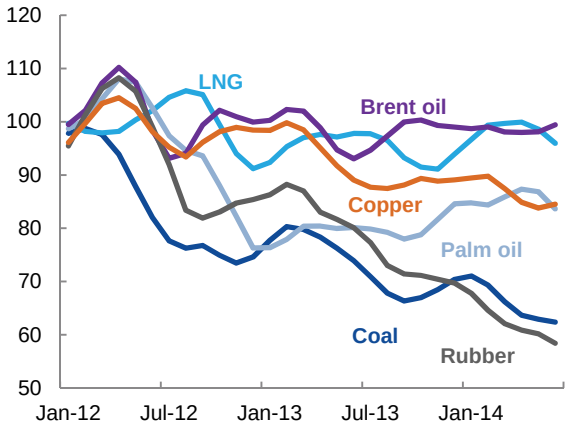
[1] World Bank, June 2014, "Global Economic Prospects – Shifting priorities; building for the future" http://www.worldbank.org/en/publication/global-economic-prospects.

compared with both the first quarter of this year and the second quarter of last year (Figure 2). Crude palm oil prices declined in Q2 2014 relative to a quarter earlier as well. Base metal prospects, in particular, are dependent on the economic outlook of China, which accounts for almost 45 percent of global metal demand. At the same time, global oil prices rose between March and June 2014, with the Indonesian crude price up by almost USD 2. As a net oil importer, Indonesia's terms of trade and fiscal position (through the large share of fuel subsidy spending) are likely to be negatively affected by the oil price increase.

Global financial conditions have improved

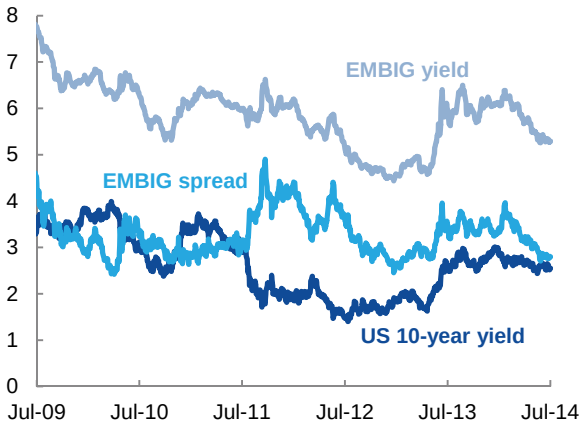
Finally, Indonesia and most other emerging market economies (EMEs) faced more benign international financing conditions in the first half of 2014 than expected earlier in the year. Investors now expect the accommodative monetary conditions in the US, Japan and Europe to remain in place for longer. Moreover, in June the European Central Bank introduced new credit easing measures to prevent deflation. In addition, the macroeconomic adjustment policies of many developing countries have reduced vulnerabilities, supporting capital inflows. Reflecting these factors, EME sovereign borrowing costs have fallen considerably since February, both because of declining high income benchmark yields and a compression in EME credit spreads (Figure 3). In the first quarter of 2014, Indonesia received the highest net portfolio inflows in a decade in USD terms (see Section 4).

Figure 2: Global commodity prices, especially metals, continue to decline
(index, January 2012 = 100, 3mma)



Note: LNG indicates liquefied natural gas (Japan import price)
Source: World Bank

Figure 3: International sovereign borrowing conditions have improved, with further liquidity tightening deferred for now
(percent)



Source: JP Morgan

2. Indonesia's recent growth moderation has been led by weak net exports

The cyclical moderation in growth has continued in 2014 Q1, as expected

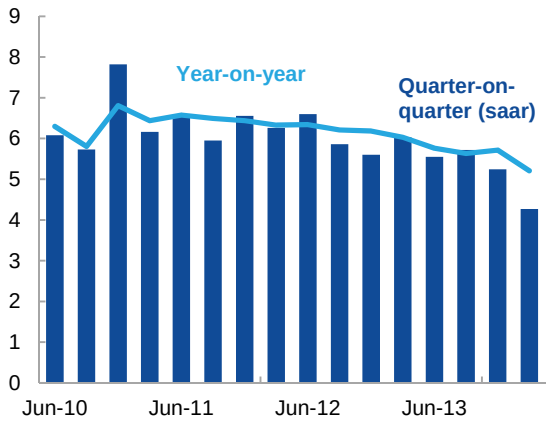
Real GDP growth in Indonesia moderated to 5.2 percent yoy and 4.3 percent qoq saar in the first quarter of 2014 (Figure 4). This slowdown was in line with the path of macroeconomic adjustment projected in the March 2014 *IEQ*. However, in contrast to 2013 Q4, when economic activity received a significant boost from net exports, in 2014 Q1 domestic demand remained robust while the net trade contribution to growth was slightly negative. Looking forward, lower-than-earlier-expected government consumption, on account of the revised Budget, slower credit growth and weaker commodity-related income growth are likely to constrain growth in the second half of 2014.

Private consumption spending, likely partly boosted by election-related spending, supported growth in 2014 Q1…

Domestic demand growth increased to 5.3 percent yoy in Q1 2014, from 5.1 percent in Q4 2013, and contributed 4.5 percentage points to overall GDP growth (Figure 5). Private consumption grew by 5.6 percent yoy and 5.8 percent qoq saar. The pick-up in growth from 5.3 percent yoy in Q4 2013 was caused by higher non-food consumption, which was likely driven in part by temporary, election-related spending. Government spending in Q1 2014 grew by 3.6 percent yoy, down from 6.4 percent in Q4. Gross fixed capital formation continued to grow at a relatively moderate pace of 5.1 percent yoy, up from the 4.4 percent

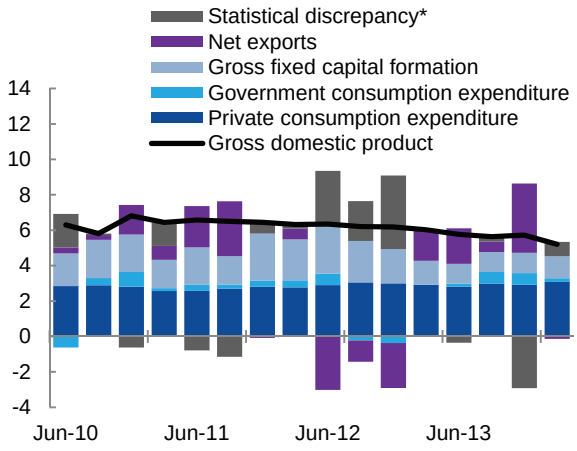
yoy in the previous quarter but still well below its 2010-2012 average of 8.8 percent yoy. Moreover, in sequential terms fixed investment growth decelerated somewhat: 3.9 percent qoq saar in Q1 2014 versus 4.4 percent in Q4 2013. Building investment growth remained robust, contributing 4.7 percentage points to year-on-year fixed investment growth. Spending on foreign transportation equipment continued to decline in year-on-year terms for a fifth consecutive quarter, while spending on foreign machinery and equipment registered positive growth for the first time in four quarters.

Figure 4: Real GDP growth moderated further in 2014 Q1…
(real growth yoy and qoq saar, percent)



Source: BPS; World Bank staff calculations

Figure 5: …driven by a small negative contribution from net trade
(expenditure components' contribution to real GDP growth yoy, percentage points)



Note: * Statistical discrepancy includes inventories
Source: BPS; World Bank staff calculations

… while net exports contributed negatively to growth in the same period

In contrast to Q4 2013 when net exports were the main driver of growth, in Q1 2014 the contribution of net exports to year-on-year growth was -0.1 percentage points (Figure 5). The growth rate of real exports of goods and services dropped markedly in the first quarter of 2014, with a contraction of 0.8 percent yoy compared with growth of 7.4 percent yoy Q4 2013. Based on trade volume data, the decline in real exports in Q1 was due to lower coal exports as well as a virtual halt in the exports of ores, slags and ashes, consistent with the reported impact of the January partial ban on unprocessed mineral exports. At the same time, import volumes decreased by 0.7 percent yoy after declining by 0.6 percent in Q4.

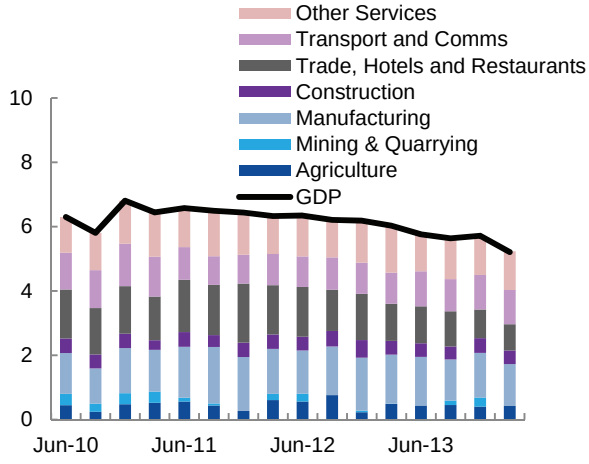
In line with the weaker mineral exports, the mining sector proved a drag on growth

From the production perspective, the mining sector contributed the most to the slowdown in year-on-year real GDP growth in Q1 2014 (Figure 6). The contribution to year-on-year growth of the other sectors of the economy remained broadly stable in Q1 2014. The weak performance of mining and quarrying was expected, as the partial ban on unprocessed mineral exports took effect in mid-January 2014. The decline in mining output, together with the continuous weakness in commodity prices, has had markedly different impacts across Indonesian provinces, with the ones relatively more dependent on mining seeing the largest slowdown in provincial GDP growth (see Box 1).

High-frequency indicators continue to provide mixed signals

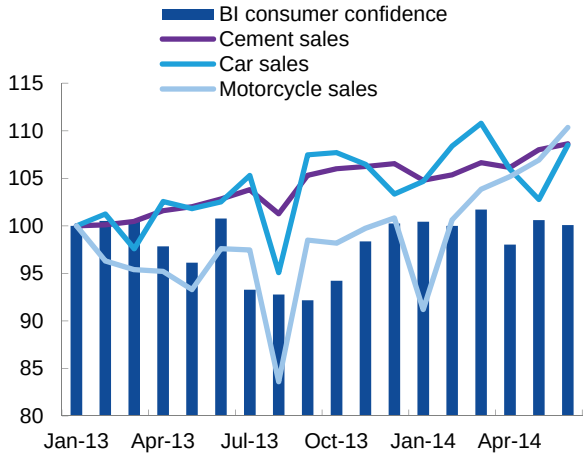
A number of monthly economic activity indicators, such as the Bank Indonesia (BI) consumer confidence survey, the HSBC Purchasing Managers Index (PMI) for Indonesia, as well as motorcycle and cement sales, point to a slight improvement in economic conditions in Q2 2014 (Figure 7). However, car sales declined significantly in April and May, likely on account of their higher sensitivity to the general economic slowdown as well as the Rupiah depreciation, compared with motorcycle sales for example. Overall, the high-frequency data do not provide a clear indication of the level of domestic demand in the second quarter of the year.

Figure 6: A decline in mining and quarrying activity contributed to the growth slowdown on the production side
(contributions to real GDP growth yoy, percent)



Source: BPS; World Bank staff calculations

Figure 7: High-frequency data provide mixed signals for Q2
(seasonally adjusted data, January 2013 = 100)



Source: CEIC; World Bank staff calculations

The World Bank's 2014 growth outlook for Indonesia is revised down slightly to 5.2 percent, with growth projected to pick up to 5.6 percent in 2015

In the base case, the World Bank projects real GDP growth for Indonesia of 5.2 percent in 2014 and 5.6 percent in 2015. From a regional perspective, Indonesia's expected 2014 performance is above the average of 4.7 percent for East Asia excluding China and Indonesia projected by the World Bank, while the 2015 figure is equal to the regional average (Global Economic Prospects, June 2014). The latest 2014 GDP growth projection includes a downward revision of 0.1 percentage points from the March 2014 *IEQ* forecast. The changes to the short-term outlook reflect the worse-than-expected 2014 Q1 trade data, which will reduce the projected contribution of net exports to growth over the year. In addition, the lower GDP forecast accounts for slower government consumption growth which reflects the IDR 43 trillion of spending cuts contained in the revised Budget (see Section 6). Following the likely pre-election increase in spending, private consumption growth is expected to moderate somewhat. Relatively tighter credit conditions and slower commodity-related income growth are the key factors behind the projected slight slowdown in consumption expenditure in the second half of 2014. The fixed investment forecast of 4.7 percent growth has been revised to reflect Q1 2014 data, with downside risks to the outlook increasing given the recent trends in credit growth (see Section 5).

Table 2: In the base case, GDP is expected to grow at 5.2 percent in 2014 and 5.6 percent in 2015
(percentage change, unless otherwise indicated)

	Annual			YoY in Fourth Quarter			Revision to Annual	
	2013	2014	2015	2013	2014	2015	2014	2015
1. Main economic indicators								
Total Consumption expenditure	5.2	4.9	4.9	5.4	4.8	5.1	0.1	0.0
Private consumption expenditure	5.3	5.0	5.1	5.3	4.7	5.4	0.1	0.0
Government consumption	4.9	4.2	3.7	6.4	5.0	3.2	-0.2	0.0
Gross fixed capital formation	4.7	4.7	6.4	4.4	5.0	6.8	0.2	-0.2
Exports of goods and services	5.3	0.3	6.5	7.4	0.2	6.7	-5.0	-0.5
Imports of goods and services	1.2	0.2	5.3	-0.6	1.4	4.9	-3.2	-0.1
Gross Domestic Product	5.8	5.2	5.6	5.7	5.1	5.7	-0.1	0.0
2. External indicators								
Balance of payments (USD bn)	-7.3	-2.0	0.9	-	-	-	0.9	-0.8
Current account balance (USD bn)	-29.1	-25.6	-23.6	-	-	-	-1.3	-3.4
As share of GDP (percent)	*-3.3*	*-2.9*	*-2.4*	-	-	-	*0.0*	*-0.3*
Trade balance (USD bn)	-6.1	-3.1	-4.3	-	-	-	-0.2	-6.9
Capital & financial acc. bal. (USD bn)	22.4	25.3	24.5	-	-	-	3.8	2.6
3. Fiscal indicators								
Central gov. revenue (% of GDP)	15.7	15.4	-	-	-	-	-0.1	-
Central gov. expenditure (% of GDP)	18.0	18.2	-	-	-	-	0.1	-
Fiscal balance (% of GDP)	-2.2	-2.8	-	-	-	-	-0.2	-
Primary balance (% of GDP)	-1.1	-1.4	-	-	-	-	0.0	-
4. Other economic measures								
Consumer price index	6.9	5.8	4.9	8.1	4.6	5.1	-0.4	-0.3
GDP Deflator	4.4	5.7	5.3	7.1	4.8	5.3	-0.9	0.0
Nominal GDP	10.4	11.2	11.2	13.2	10.1	11.3	-1.0	0.0
5. Economic assumptions								
Exchange rate (IDR/USD)	10563	11800	11800	-	-	-	-200	-200
Indonesian crude price (USD/bl)	106	106	103	-	-	-	1	1
Major trading partner growth	3.5	4.0	3.9	-	-	-	0.0	-0.2

Note: Export and import figures refer to volumes from the national accounts. Exchange rate is an assumption based on recent averages. Revisions are relative to projections in the March 2014 *IEQ*
Source: MoF; BPS; BI; CEIC; World Bank projections

3. Inflation has remained moderate, but there are upside risks

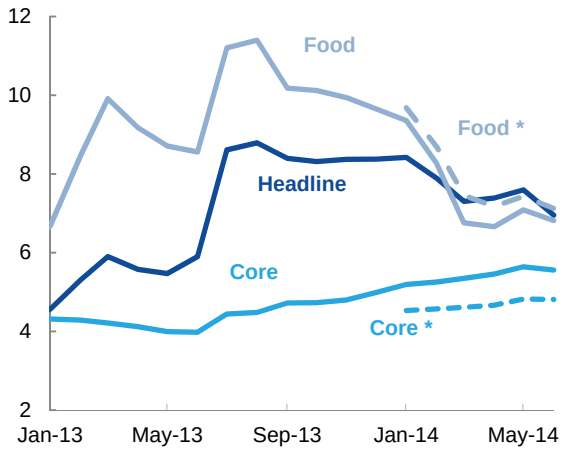
Both headline and core inflation stabilized in Q2 2014

In the second quarter of 2014, price pressures remained contained, with headline inflation gradually declining to 6.7 percent yoy in June and core inflation stabilizing at around 4.8 percent in May and June (using the new 2012-base CPI series from BPS) (Figure 8). Relatively tight credit conditions in recent months (see Section 5) have possibly offset some of the impact on inflation of the significant Rupiah depreciation of the second half of 2013 and pick up in private consumption growth in Q1 2014. The year-on-year inflation rate will decline considerably in July as the subsidized fuel price increase of 22 June 2013 drops out of the base, but upside risks to the outlook remain.

Food inflation has also remained low, with rice prices declining owing to a good harvest

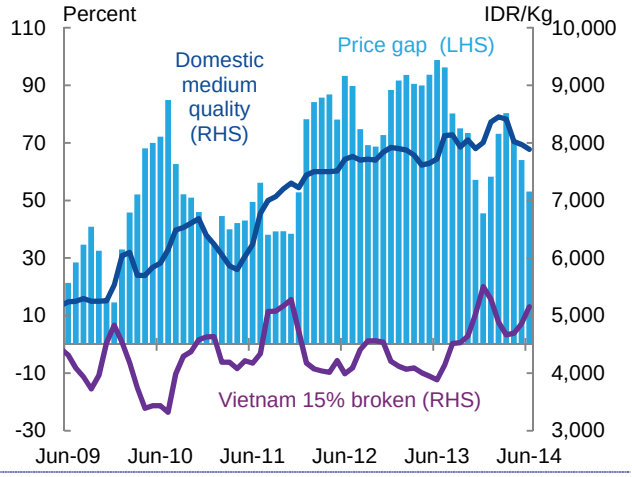
Food price inflation has remained below 7.5 percent since March 2014 (according to the 2012-base series), well below the highs observed last year. The prices of several key foods, such as rice and chilies, have declined, reflecting relatively favorable weather affecting positively both production and distribution. Declining domestic rice prices have narrowed the gap between domestic and international prices (Figure 9). However, there are upside risks to rice prices in the near term, for example, associated with possible El Niño weather conditions later this year (see Section B.1).

Figure 8: Price pressures remained contained in the second quarter of 2014
(inflation rates yoy, percentage change)



Note: * The solid lines for core and food inflation plot the 2007-base and 2012-base series spliced together; the dotted lines show yoy growth rates computed using only the available 2012-base series
Source: BPS; World Bank staff calculations

Figure 9: A favorable harvest brought down domestic rice prices
(wholesale rice prices, IDR per kg)



Note: Price gap refers to the difference between domestic and foreign rice prices
Source: BPS, Cipinang Wholesale Rice Principle Market; World Bank staff calculations

The baseline outlook for inflation is moderate, although there are upside risks

Looking ahead, strong base effects will drive headline inflation down in the second half of 2014, as the one-off rise in price levels due to the June 2013 subsidized fuel price increase drops out of year-on-year comparisons. The World Bank projects an average annual inflation rate of 5.8 percent in 2014, dropping to 4.9 percent in 2015. These forecasts account for a small increase in the CPI caused by the electricity tariff adjustment introduced by the Government this year, as well as some expected upward pressure on food prices caused by El Niño. However, the possibility of further administered price reforms remains an upside risk to inflation, given the considerable fiscal strains (see Section 6). Another risk is the scale of this year's effect of El Niño on food prices, and the Government's response, in particular to a rice supply shock.[2]

4. Current account adjustment ongoing, portfolio inflows at a decade high

Setbacks to the current account adjustment process have emerged

A stable overall current account deficit and portfolio inflows at a ten-year high characterized Indonesia's balance of payments in the first quarter of 2014. However, there are signs that the current account adjustment process is facing a number of challenges. As expected, the partial raw mineral export ban, introduced in January, caused a significant decline in overall export volumes. This, together with the ongoing moderation in global commodity prices, has resulted in weak exports being a continued drag on the overall current account so far this year. At the same time, as mentioned above, the strong recovery in capital flows to emerging markets led to a surge in portfolio flows and a decline in external financing pressures for Indonesia over the first half of 2014. However, the medium term picture outlined in previous *IEQ*s remains; international borrowing costs are expected to increase, highlighting the need to support continued external adjustment and high quality financing inflows in order to limit Indonesia's vulnerabilities to future episodes of global market volatility.

The current account deficit remained around 2 percent of GDP in Q1 2014

The current account deficit came in at 2.1 percent of GDP in both Q4 2013 and Q1 2014, totaling USD 4.2 billion in Q1 (Figure 10). Beyond the stable headline number, however, there were significant differences in the drivers of the current account in the two quarters. While in Q1 2014 the current account balance improved by 0.7 percent of GDP versus Q1

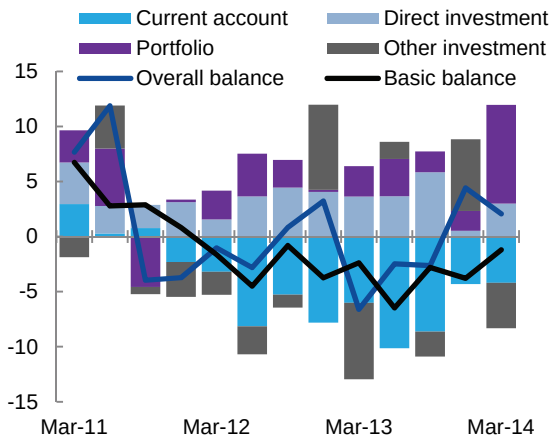
[2] The response mechanism of the Government to rice price shocks has been streamlined. A revised Ministerial Decree 06/M-DAG/PER/2/2012, issued in 2012, established clear criteria according to which the Government's Food Security Committee may authorize the National Food Agency (BULOG) to import rice.

2013, the recent adjustment was supported by the continuing weakness in imports which declined by USD 2.7 billion yoy, against a downturn in exports of USD 800 million yoy. In contrast, the 1.4 percent of GDP improvement in year-on-year terms recorded in Q4 2013 came from both import compression and an increase in exports. Smaller services and income deficits, which decreased by a cumulative USD 1.4 billion between Q4 2013 and Q1 2014, supported the stability of the current account deficit despite the smaller goods trade surplus.

The weakness in imports was led by raw materials

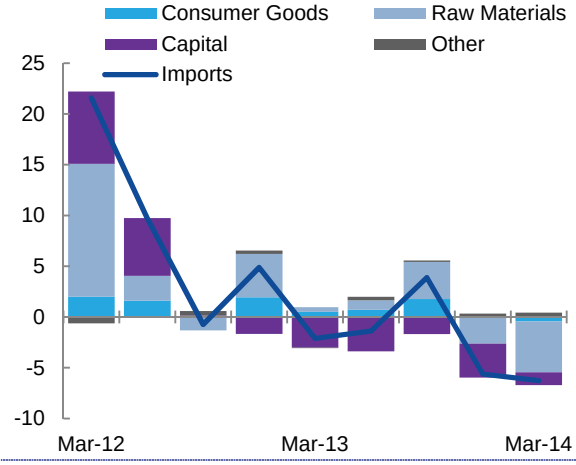
The value of imports declined by 6.3 percent yoy in the first quarter of 2014. Raw materials led the slowdown, dropping by USD 2.4 billion between Q4 2013 and Q1 2014 and contributing 5.0 percentage points to the total yoy decrease (Figure 11). Capital goods imports also continued to decline in year-on-year terms, in line with the less-than-robust fixed investment growth (see Section 2). Finally, consumer goods, which constitute approximately 14 percent of imports, decreased in year-on-year terms for the first time since Q3 2012, falling by 3.0 percent.

Figure 10: The current account remained stable, but the basic balance is still negative
(balance of payments main account balances, USD billion)



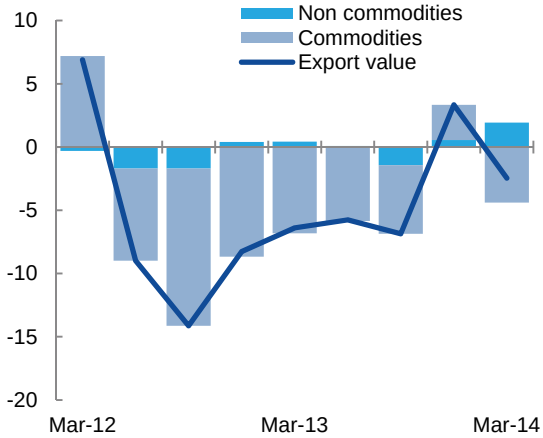
Note: Basic balance = net FDI + current account balance
Source: CEIC; World Bank staff calculations

Figure 11: Import values continued to weaken, driven by capital goods and raw material
(growth and contributions to growth, percent yoy)



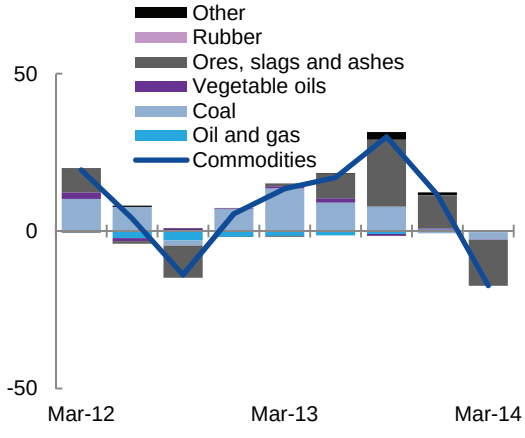
Source: CEIC; World Bank staff calculations

Figure 12: Commodities were responsible for weakening exports…
(growth and contributions to growth yoy, percentage points)



Note: Commodities exclude commodities-related manufacturing
Source: CEIC; World Bank staff calculations

Figure 13: …with commodity volumes dropping by 17.3 percent yoy, driven by minerals
(growth and contributions to growth yoy, percentage points)



Source: CEIC; World Bank staff calculations

The new regulations limiting raw mineral exports weighed heavily on commodity exports…

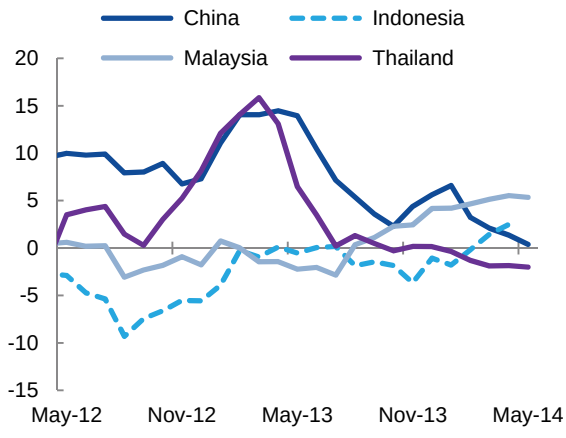
Exports of Indonesia's six main commodities declined by approximately USD 4.2 billion between Q4 2013 and Q1 2014, contributing 4.4 percentage points to the 2.5 percent yoy drop in exports (Figure 12). In year-on-year terms, commodity exports weakened by 8.3 percent, mainly driven by falling volumes (down 17.3 percent yoy). Four-fifths of the decline in commodity export volumes came from ores, slags and ashes (Figure 13), which ground to a halt with the introduction of the partial mineral export ban in January 2014.

… while there are tentative signs of the long awaited pick up in manufacturing exports

At the same time, Indonesia's manufacturing exports have gained some momentum since March 2014 (Figure 14). This compares with a general moderation in growth rates for some regional peers and a pick-up in Malaysia which started a year ago. However, if Indonesian manufacturing firms are to take greater advantage of the Rupiah depreciation since mid-2013, and from the anticipated continued pick-up in demand from high-income economies, long-standing bottlenecks, for example, relating to logistics costs and infrastructure quality, need to be addressed.

Figure 14: Manufacturing exports are staging a modest comeback

(growth of 6mma of manufacturing export values yoy, percent)



Source: CEIC; World Bank staff calculations

Monthly data indicates a likely deterioration in the goods trade balance in Q2, with income payments also likely to push the current account deficit wider

Monthly customs trade data indicated a marked deterioration in the trade balance in April 2014, when imports outweighed exports by close to USD 2 billion. The deterioration came about with an approximately equal increase in non-fuel raw material imports and decrease in non-oil and gas exports (in particular coal and vegetable oils). While May 2014 customs trade data show a small positive balance of USD 69.9 million, the second Q2-to-date customs trade balance remains in negative territory. A potential additional strain on the Q2 current account is posed by the fact that the second quarter of the year tends to see a rise in outflows on the income account associated with dividend payments. As a result of these factors, the current account deficit in the second quarter is expected to widen significantly from the levels seen in the previous two quarters, with Bank Indonesia recently signaling its expectation of a current account deficit on the order of 4 percent of GDP.[3]

Direct investment recovered somewhat in the first quarter while portfolio investment surged to a decade-high…

The capital and financial account balance remained well in surplus in Q1 2014, with a net inflow of USD 7.8 billion against USD 8.8 billion in Q4 2013. However, the composition of inflows changed substantially from Q4 2013, when portfolio and other investment inflows offset unusually weak net direct investment (due largely to an outbound transaction). In the first quarter of 2014, net direct investment recovered somewhat, to USD 3.0 billion, and portfolio investment recorded a decade-high net inflow of USD 9.0 billion. At the same time, the volatile "other investments" sub-account balance turned negative, with net outflows of USD 4.1 billion, due primarily to a shift offshore of private deposits (USD 2.4 billion) and loan repayments by the Government (USD 1.4 billion).

[3] http://www.thejakartapost.com/news/2014/07/16/bi-warns-capital-outflows.html

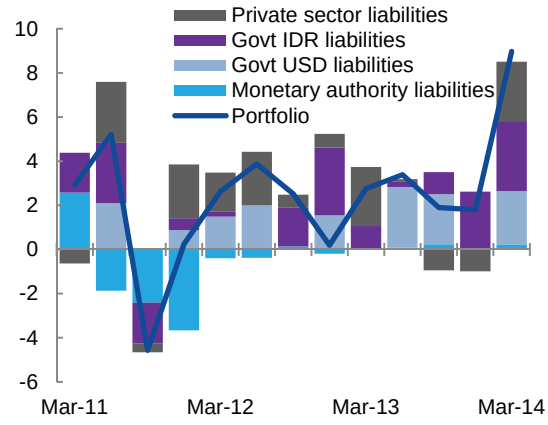
...on the back of renewed appetite for EME equities and bonds

The decade-high portfolio inflows recorded in Q1 2014 were fuelled by renewed investor appetite for emerging market assets (as discussed above), including Indonesian bonds and equities. Net government debt liabilities inflows were significant and totaled USD 5.6 billion, above the recent peaks seen in quarterly inflows in 2010 and 2011. USD 2.4 billion flowed into foreign currency bonds and USD 3.2 billion into domestic currency government bonds. Net private equity liabilities were also significant at USD 2.1 billion – the most since Q1 2013. Net offshore purchases of Rupiah-denominated government bonds, SBIs and equities remained strong into the second quarter of 2014 as well, albeit tapering off in June.

Annual gross external financing needs are above USD 80 billion

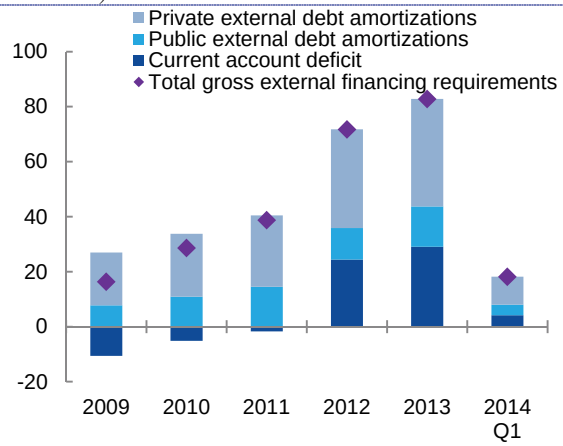
Issues of current account financing should be read in the context of overall gross financing needs. Total external debt-to-GDP remains moderate, at 32.4 percent of GDP in Q1 2014 (as measured by BI), but external debt levels and amortizations grew strongly, particularly for the private sector, from 2011-2013 (Figure 16). Consequently, gross external financing needs have risen over recent years both to finance the current account deficit and to meet external debt amortizations. Indeed, of the estimated total gross external financing needs in 2013 of USD 83 billion (based on BI data), the current account deficit generated only 35 percent, while private and public sector debt amortization generated 50 percent and 15 percent respectively. Short-term external funding pressures could therefore emerge not only as a result of current account financing becoming more challenging (whether because of a renewed widening in the current account or reduced foreign investment inflows), but also if there were to be a marked rise in private external debt rollover costs, or a decrease in the availability of external financing more broadly.

Figure 15: Decade-high portfolio inflows were driven by government borrowing and renewed appetite for EME assets
(USD billion)



Source: CEIC; World Bank staff calculations

Figure 16: Increasing private external debt has driven much of the rise in gross external financing needs in recent years
(USD billion)



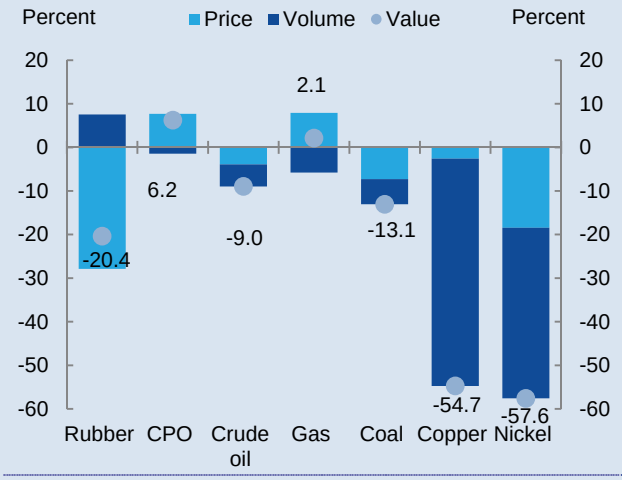
Note: External debt amortizations comprise total external debt maturing in 1 year or less as of the first month of the year
Source: BI; Ministry of Finance (DGDM); CEIC; World Bank staff calculations

Box 1: Recent challenges in Indonesia's commodity export sector

Commodities are a major constituent of Indonesia's exports, with crude oil, crude palm oil (CPO), rubber, gas, coal and other minerals accounting for more than half of Indonesia's exports by value in 2013. The raw commodity sector also accounted directly for around one-fifth of real GDP growth between 2002 and 2012. Furthermore, estimates based on the 2008 Input-Output table indicate that, through a multiplier effect, a unit increase in the output of the raw commodity sector is associated with a 1.5 unit increase in total output. The multiplier is even larger for the processed commodities sector, where a one unit increase is associated with a 2.1 unit increase in total output.

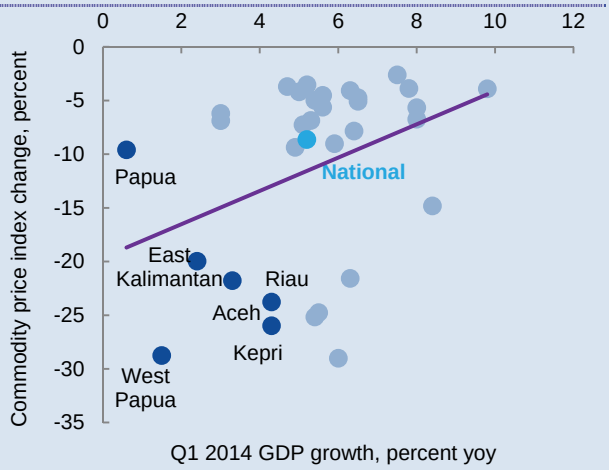
Indonesia's commodity exports are facing significant headwinds, with declining global commodity prices and the regulations issued in January 2014 imposing a ban on certain raw mineral exports and export taxes on all unprocessed mineral exports. Overall, the share of (raw) commodities in the value of total exports has declined from 60 percent in 2011 to 53.3 percent in 2013, and further down to 50 percent in the first quarter of this year. As discussed above, the observed impact of the unprocessed mineral export ban has been negative from a trade perspective.[1] Copper concentrate exports have effectively ceased since February 2014, as Freeport and Newmont, responsible for 97 percent of Indonesia's copper concentrate exports, halted exports. Similarly, trade data shows that the exports of raw nickel, bauxite, lead and zinc, the other major minerals affected by the policy, declined by a factor of five. As a result, the share of ores, slags and ashes (the statistical definition most closely accounting for raw minerals which is available on a timely basis) dropped from 2.9 percent of total exports in Q1 2013 to 0.7 percent a year later.

Figure 17: Both export volume and price declines were observed for Indonesia's major commodities in Q1 2014
(Q1 2014 to Q1 2013 export value growth decomposition by volume and price, year-on-year, percent)



Source: BPS; World Bank staff calculations

Figure 18: Provinces most exposed to the commodity sector recorded a significant slowdown in Q1 2014
(percentage changes)



Note: Commodities include oil, gas, rubber, crude palm oil, coal, copper, nickel, aluminum, lead, zinc and iron ore. The commodity price index, for each province and at the national level, is weighted by each commodity's share in provincial and national GDP
Source: BI; BPS; World Bank; World Bank staff calculations

Apart from the direct effect on export revenues, the unprocessed mineral export ban and lower global commodity prices are likely to have additional macro-economic and social consequences. For instance, according to monthly BPS trade data, the demand for imported trucks, excavators and cranes, which are used in the mining sector, declined by 60 percent between Q1 2012 and Q1 2014, resulting in lower imports of capital goods. In addition, the unprocessed mineral export ban has contributed to higher regulatory uncertainty in the sector, with potential legal challenges and reports of ongoing negotiations on some of the key regulations, especially those surrounding the export tax. The increased uncertainty may in turn reduce future investment in the commodity sector.

Finally, the decline in employment, incomes and new investment stemming from the slowdown in commodity exports, and production, is expected to affect some provinces of Indonesia disproportionately more than others. The regions subject to the greatest risk are those where commodity sectors make up a large share of output and where the main commodities have seen the largest price decline. According to Bank Indonesia estimates of Q1 2014 provincial GDP (Regional Economic Report *(Laporan Nusantara),* May 2014), Aceh, East Kalimantan, Kepri, Papua, Riau, and West Papua have seen year-on-year GDP growth rates significantly below the national average (Figure 18).

Note: [1] See the March 2014 *IEQ* for an extensive discussion of the potential impact of the partial mineral export ban.

The World Bank's projection remains for a gradual narrowing of Indonesia's current account deficit over 2014 as a whole

Looking ahead, the current account deficit is projected at 2.9 percent of GDP or USD 25.6 billion in 2014, unchanged from the March 2014 *IEQ* forecast. This is predicated on continued weakness in exports, weighed down by weaker commodity prices and the unprocessed mineral export ban. The current account deficit is projected to decrease to 2.4 percent of GDP in 2015, reflecting H1 2014 data, versus a projection of 2.1 percent of GDP in the March 2014 *IEQ*. The "basic balance", i.e. the sum of the current account balance and net direct investment, is forecasted to remain negative through the forecast horizon, albeit declining from -1.5 to -1.1 percent of GDP between 2014 and 2015.

Table 3: In the base case, a current account deficit of 2.9 percent of GDP in 2014 is projected
(USD billion unless otherwise indicated)

	2013	2014	2015
Overall Balance of Payments	-7.3	-2.0	0.9
As percent of GDP	*-0.8*	*-0.2*	*0.1*
Current Account	-29.1	-25.6	-23.6
As percent of GDP	*-3.3*	*-2.9*	*-2.4*
Goods trade balance	6.0	6.7	5.8
Services trade balance	-12.1	-9.8	-10.1
Income	-27.0	-28.1	-26.2
Transfers	4.0	5.6	6.8
Capital and Financial Accounts	22.4	25.3	24.5
As percent of GDP	*2.6*	*2.6*	*2.6*
Direct Investment	13.7	12.6	12.9
Portfolio Investment	9.8	15.1	12.4
Other Investment	-1.1	-2.5	-0.8
Memo:			
Basic Balance	-15.4	-13.0	-10.7
As percent of GDP	*-1.6*	*-1.5*	*-1.1*

Note: Basic balance = current account balance + net FDI
Source: CEIC; World Bank staff calculations

5. Indonesian asset prices strengthen but credit conditions tighten

Indonesian financial asset prices have picked up, while credit has continued to tighten

Partly as a consequence of larger foreign capital inflows, financial asset prices in Indonesia have generally risen since the beginning of this year, recovering most of the losses incurred in the second half of 2013. However, most of the improvement in 2014 so far occurred in the first quarter. At the same time, bank liquidity in domestic currency remains relatively tight, contributing to the ongoing decrease in credit growth. The credit growth slowdown and lower property prices have become a downside risk to the economic outlook. At the same time, lower growth expectations may feed through into a further weakening of credit demand.

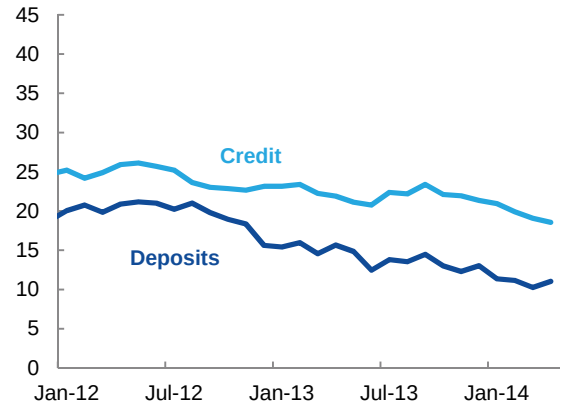
The Rupiah weakened against the US dollar in the second quarter of 2014, after strengthening in the first three months of the year

The Rupiah weakened by 2.7 percent against the US Dollar from the end of March to July 15, 2014, reversing some of the first-quarter gain of 6.8 percent. The recent depreciation reflects the above-mentioned pressures on the current account balance in the second quarter, and occurred despite strong capital inflows. Liquidity in the onshore currency market has increased with average onshore spot market volumes of USD 1 billion per day this year, versus less than USD 0.8 billion in the first half of 2013. Compared with mid-May 2013, before the capital reversal episode which followed the Federal Reserve's announcement of the possibility of reduced asset purchases, the Rupiah was 20.1 percent weaker against the US dollar on July 15, 2014. However, in real effective (trade-weighted) terms, there has been a more moderate depreciation of 10 percent through May 2014.

Equity and bond prices have risen this year

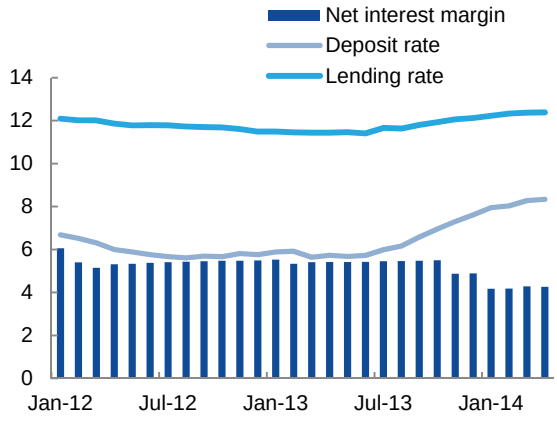
Despite a decline in June, Indonesian local equity and bond prices have risen this year, with offshore investors becoming significant net buyers of both equities and government bonds, as discussed in Section 4. As of July 14, 2014, local equities were up 5.3 percent since the end of March and up 16 percent year to date, reversing most of the loss incurred in 2013. Since the start of January, offshore investors have purchased IDR 41.4 trillion (or close to USD 3.6 billion) of local equities and IDR 87.9 trillion (or slightly more than USD 7.6 billion) of Indonesian local currency government bonds. The 10-year government bond yield decreased modestly, by 39 basis points in the first quarter of 2014 but increased by 6 basis points between end-March and mid-July. At 8.3 percent on July 15, 2014, it is still much higher than its level in mid-May last year (5.6 percent), following the subsequent abrupt rise in domestic yields.

Figure 19: A slowdown in deposit growth has contributed to the weakening in credit growth
(growth yoy, percent)



Source: CEIC; World Bank staff calculations

Figure 20: Banks have not so far fully passed on the increase in domestic currency funding costs to borrowers
(percent)



Source: CEIC; World Bank staff calculations

Credit growth continues to decelerate…

Credit growth has weakened and slow growth in loan approvals indicates that this trend will likely persist. Credit growth declined to 18.6 percent yoy in April 2014, from 21.4 percent in December 2013 (Figure 19). In the same period, *ex post* real credit growth, adjusted by realized CPI inflation, dropped by 1.8 percentage points to 10.5 percent yoy. Credit growth adjusted for the effect of changes in the exchange rate decreased from 17.3 percent yoy in December to 15.8 percent yoy in April, with dollar lending only growing by 4.9 percent yoy in March after a recent high of 10.4 percent yoy last November. New loan approvals in May declined by 12.1 percent yoy (3mma), after decreasing by 1.2 percent in March, and compared with 17.9 percent yoy growth (3mma) in May last year.

…constrained mainly by credit supply conditions…

Tighter funding conditions due to weaker deposit growth appears to be the main factor behind the slowdown in bank credit. Deposit growth has decelerated faster than loan growth since 2012 (Figure 19). This is despite a rise in the average deposit interest rate from around 5.6 percent in June last year to more than 8 percent in March 2014. The loan to deposit ratio (LDR) of the banking system was 90.8 in April, only slightly below the BI upper threshold for individual banks of 92 percent, above which banks' minimum reserve requirements are increased. As highlighted in the March 2014 *IEQ*, the LDRs of smaller banks are higher than those of larger banks, pointing to market segmentation in access to third party funding.

…with mixed signs regarding credit demand

While credit supply has clearly become more constrained, the recent evidence on credit demand conditions is mixed. Since May 2013, banks have been unable or unwilling to pass the increase in the cost of funding to borrowers, as shown by the decrease in lending spreads, amid rising deposit rates (Figure 20). This may indicate either weaker credit demand at higher lending rates, or banks' being cautious to extend credit at higher rates so as not to trigger rising non-performing loans.

Property prices continue to weaken amid signs of slower property-related bank credit

Residential property price growth rate has fallen further to 7.9 percent yoy in March 2014 compared with 11.5 percent last December, according to the 14-city BI index. Lower loan-to-value ratios for second (or more) homes, introduced in March 2013, and tighter market liquidity continue to drive the decline in property demand, particularly for middle-end residential homes. Industrial and office rental and selling price growth also both declined from around 30 percent yoy in December 2013 to 15 percent, in March 2014 (4-city BI index). Apartment selling and rental price growth are also down. One reason for the drop in property price growth is the decline in bank property financing. Overall property loans grew at 23 percent yoy in April, down from 27 percent yoy at the end of 2013. Several banks have reportedly limited their property sector credit. As discussed above, a weakening outlook for property prices represents a downside risk to the near-term growth outlook to the extent that it feeds through into softening construction investment in particular.

The corporate sector, especially manufacturing firms, is also adjusting to the sizeable depreciation of the Rupiah over the past year…

Beyond credit conditions and property sector developments, the Indonesian corporate sector is currently facing four major hurdles: rising electricity and labor costs, tightening market liquidity and the weaker Rupiah. The last factor is perhaps the most material for corporate margins and profitability. The corporate profitability of manufacturing companies, such as producers of textiles and shoes, for which most inputs are imported, are particularly impacted by the weaker Rupiah. The currency depreciation has also adversely affected consumer goods companies such as food and beverage producers. The real depreciation of the Rupiah and improved high-income country demand do, however, present upside possibilities for the export earnings of Indonesian manufacturing companies (as discussed in Section 4 above).

6. The fiscal sector continues to be under pressure

Parliament approved a revised Budget for 2014, with the deficit increased in response to continued fiscal pressures…

Responding to macroeconomic changes, subdued revenue growth, and rising energy subsidy costs, the Government proposed a substantially revised 2014 Budget. The deficit under the revised Budget approved by Parliament on June 18 is 2.4 percent of GDP. Significant budget cuts of IDR 43 trillion for line ministries were approved (down from IDR 100 trillion under the Government's original proposal) along with the postponement to 2015 of the payment of rising energy subsidy arrears of around IDR 50 trillion. The additional net financing need from the approved higher deficit of IDR 66 trillion in 2014 is expected to be financed mostly by the issuance of Government bonds. Without policy measures and including energy subsidy arrears, the Government had projected that the fiscal deficit could reach approximately 4.7 percent of GDP.[4]

…caused in part by weaker revenue collection performance

The revised 2014 Budget lowers expected revenues relative to the original Budget by IDR 31.8 trillion (or 1.9 percent). This is mostly due to a reduction in non-oil and gas tax revenues of IDR 24.3 trillion (4.8 percent less than in the original budget) and a lowering of expected value-added tax (VAT) by IDR 17.4 trillion (a downward revision of 3.5 percent). Despite significantly lower oil production of 818,000 barrels per day (bpd) compared with the original Budget (870,000 bpd), revised projected oil and gas tax and non-tax revenues are higher than in the original Budget, mostly due to the depreciation of the Rupiah. The revised 2014 Budget does not assume any significant revenue policy changes in 2014 and focuses mostly on tax administration improvements to secure the 2014 tax revenue target, for example through e-invoice VAT and income tax filing. Expected weak revenue performance continues the trend of recent years (Box 2).

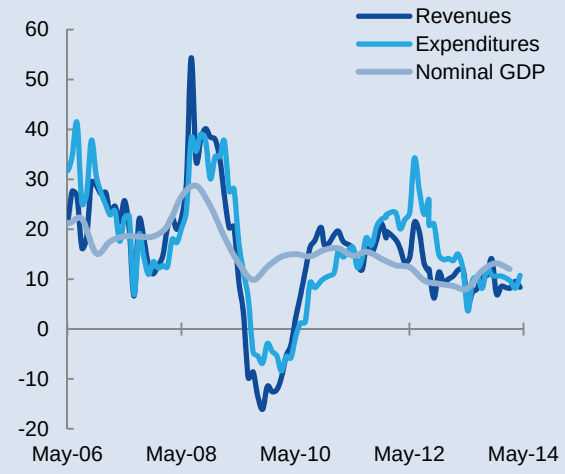
Box 2: Weak revenue performance has had a marked negative impact on the fiscal balance in recent years

While much of the recent concern regarding fiscal trends has been on the expenditure side, weakening revenue performance is also a major source of fiscal pressure. The growth of both nominal expenditures and revenues has slowed sharply since mid-2012 (Figure 21). Decomposing the change in the central government fiscal balance in recent years, in 2011 and 2012, most of the rise in the deficit-to-GDP originated from increasing expenditures, mainly through subsidies. But in 2013, weaker revenues-to-GDP accounted for most of the increase in the fiscal deficit, declining by 0.9 percentage points of GDP versus a 0.6 percentage point of GDP fall in expenditures (Figure 22).

Total nominal revenue growth has fallen significantly over the last three years, from 21.6 percent growth yoy in 2011, to 10.5 percent yoy in 2012, and 6.8 percent yoy in 2013. Nominal GDP growth has also fallen over this period, but not by as much: nominal GDP was up 15.1 percent in 2011, 10.9 percent in 2012, and 10.4 percent in 2013. As a result revenue-to-GDP has dropped down from 16.3 percent and 16.2 percent in 2011 and 2012 to 15.3 percent in 2013, the lowest level since 1998/1999. A summary measure of the performance of revenues is "buoyancy". This measures the responsiveness of total revenues to aggregate income growth, defined as the ratio of the percentage change in nominal revenues to the percentage change in nominal GDP. Total revenue buoyancy was 1.4 in 2011, declining to 0.9 and 0.5 in 2012 and 2013, respectively.

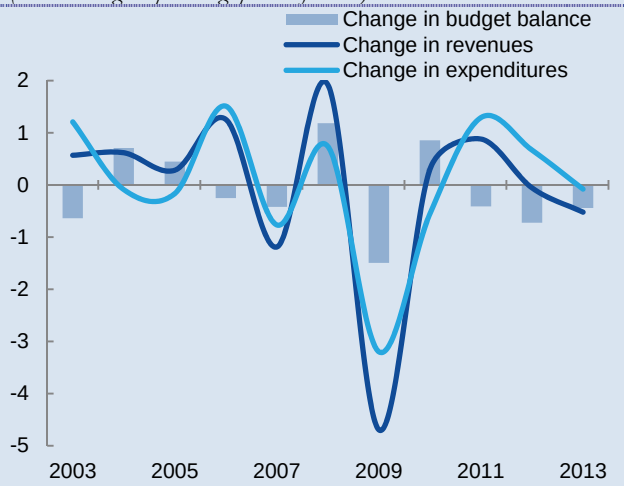
[4] http://finance.detik.com/read/2014/06/09/172547/2603338/4/kalau-apbn-tak-diubah-defisit-anggaran-2014-bisa-469-pdb.

Figure 21: Nominal revenue and expenditure growth have both slowed since mid-2012…
(12-month sum, percent yoy)



Source: Ministry of Finance; World Bank staff calculations

Figure 22: …with declining revenue/GDP being the main driver of the larger budget deficit in 2013
(annual change in percentage points of GDP)

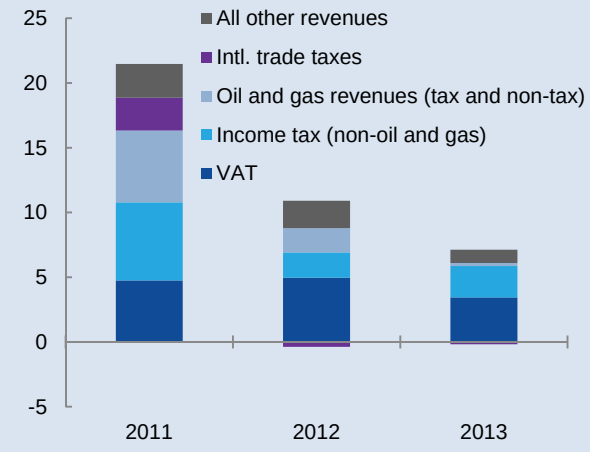


Source: Ministry of Finance; World Bank staff calculations

A major driver of weaker revenues has been oil and gas revenues (both tax and non-tax) (Figure 23). Income tax growth from oil and gas has slowed sharply, growing 6.3 percent yoy in 2013, down from 14.2 percent and 24.2 percent in 2012 and 2011, respectively. Non-tax oil and gas revenues, meanwhile, contracted outright in 2013, by 1.1 percent, having previously grown by 6.4 percent yoy (2012) and 26.7 percent yoy (2011). Revenues from the sector have been impacted by a steady downward trend in oil production during the last two decades as well as bouts of price volatility (e.g. in 2008/9), but tax and non-tax revenue collection in recent years has been mostly impacted by lower production of both oil and gas, rather than prices which have been generally favorable in Rupiah terms (Figure 24).

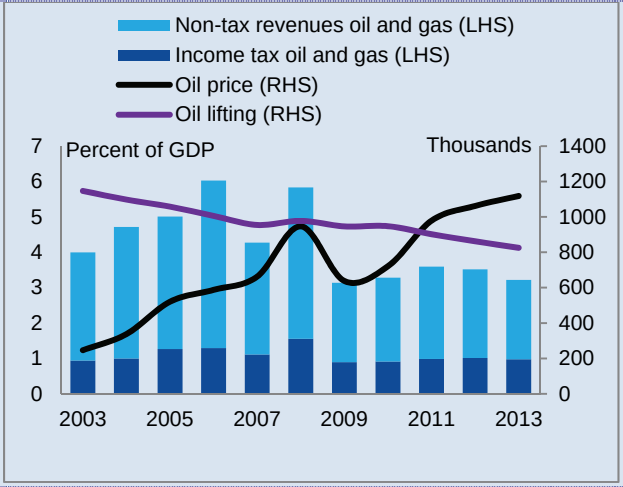
The softening of overall revenue growth has extended beyond oil and gas revenues. Non-oil and gas income tax growth was sharply weaker in 2012 (up 6.6 percent yoy) and 2013 (up 8.5 percent) compared with 2011 (up 20.1 percent), though the relative performance as measured by the tax buoyancy of non-oil and gas income tax revenues remained stable in 2012 and 2013 (at 0.6). Along with the general decline in nominal GDP growth, the significant fall in non-energy commodity prices since 2011, impacting corporate profitability and incomes, has been one driver of the falling revenue growth from this source.

Figure 23: Weaker revenue growth is broad-based but importantly includes oil and gas revenue collection…
(contribution to overall nominal revenue growth, percentage points)



Source: Ministry of Finance; World Bank staff calculations

Figure 24: … which has been impacted by the trend decline in oil production and fluctuations in the oil price
(non-tax revenues and income tax in percent of GDP; oil price in thousands of IDR/bbl; oil lifting in thousands of bbl per day)

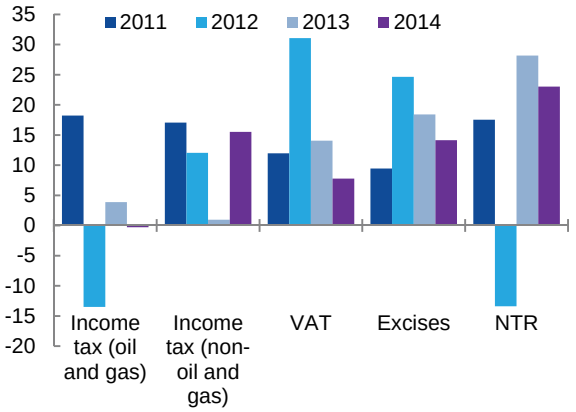


Note: The right vertical axis measures both the oil price in thousands of IDR/bbl and oil lifting in thousands of bbl per day
Source: Ministry of Finance; World Bank staff calculations

Year-to-date revenue collection in 2014 continues the declining trend of the previous year

The medium-term weakening in revenue growth discussed in Box 2 continued into the first quarter of 2014 but with a slight improvement in collection of income tax from non-oil and gas and international trade taxes in April and May. All other major components of revenues experienced a decline in year-on-year nominal growth relative to the corresponding period in previous years (Figure 25). Data for the first quarter indicate revenues-to-GDP at similar levels to the corresponding periods in the previous three years, suggesting that the collection performance was mainly driven by the growth of the tax base. VAT receipts decelerated quite markedly (up 7.8 percent yoy in Jan-May 2014), likely impacted by import compression (see Section 4).

Figure 25: January-May 2014 saw improved non-oil and gas income tax growth and a weaker VAT performance
(nominal growth in January-May over the year-ago period, percent)



Note: NTR represents non-tax revenues
Source: Ministry of Finance; World Bank staff calculations

Substantially higher energy subsidy costs also contributed to the higher fiscal deficit in the approved revised 2014 Budget…

On the expenditure side, revised expenditures are up only by IDR 34 trillion (or 2 percent more than in the initial Budget). However, this masks substantial line ministry budget cuts to offset higher energy subsidy costs which continue to put considerable pressure on the fiscal sector. Despite the average 33 percent increase in subsidized fuel prices in June 2013, energy subsidy costs have continued to increase, driven in particular by the weaker Rupiah since mid-2013, which has again widened the gap between regulated and market prices (Figure 26). According to the revised 2014 Budget, in the absence of fuel subsidy reform, energy subsidy spending will increase by IDR 68 trillion relative to the original Budget, reaching IDR 350 trillion (or 3.5 percent of GDP). Fuel subsidy spending is revised up by IDR 36 trillion to IDR 246 trillion, while the electricity subsidy increases by IDR 32 trillion to IDR 104 trillion (despite significant tariff increases, discussed below). However, these are still well below the Government's Budget revision proposals as, under the approved Budget, the payment for accumulated energy subsidy arrears of IDR 50 trillion is carried forward to 2015 (Figure 27). In addition, the approved Budget assumes a slightly stronger exchange rate (IDR 11,600 per USD versus 11,700 proposed by Government).

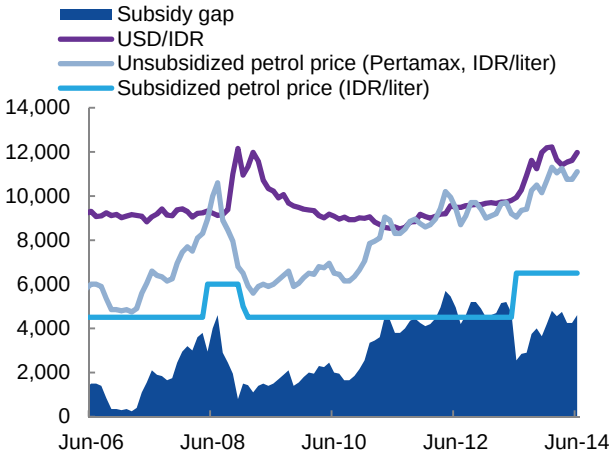
…and the extent to which the subsidized fuel quota binds will affect the fiscal outturn

The approved revised Budget lowers subsidized fuel volume to 46 million kiloliters versus 48 million kiloliters initially proposed by the Government. This assumption appears optimistic, as this is below actual subsidized fuel consumption in 2013, of 46.4 million kiloliters. For 2014, the Government intends to focus on quantitative restriction measures (controlling the volume of fuel consumption) such as stricter enforcement of the ban on subsidized fuel use for government, state and mining, non-passenger sea transportation vehicles and the conversion program from fuel to gas. Past experience suggests that these measures face implementation challenges and have limited effectiveness.[5] In contrast to previous years, however, the revised 2014 Budget includes a revision to Article 14, which narrows the Government's flexibility in managing energy subsidy spending. In the initial Budget Law, the Government was allowed, subject to Parliament's approval, to adjust energy subsidy spending according to realization and changes in macroeconomic projections and energy subsidy parameters. In the revised Budget Law, the reference to energy subsidy parameters was removed and the macroeconomic assumptions on which changes in energy subsidy spending are allowed are explicitly limited to two indicators: the oil price (ICP) and exchange rate. This means that the Government no longer has the flexibility to adjust energy subsidy

[5] http://www.antaranews.com/berita/438835/pemerintah-optimistis-kuota-bbm-46-juta-kiloliter.

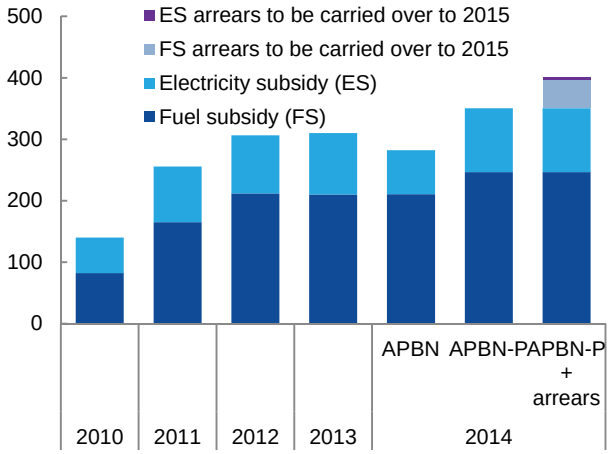
spending due to changes in energy subsidy parameters, including the quota. By adding to pressure to control the volume of consumption, this change may make the quota more binding than has previously been the case. If it were to bind, this would shave approximately 0.1 percentage points off the World Bank's baseline projection of a 2.8 percent of GDP budget deficit in 2014 (discussed below).

Figure 26: The price gap between subsidized and market petrol prices remains elevated…
(Rupiah)



Note: Subsidized petrol (Premium, RON 88) is lower octane than unsubsidized petrol (Pertamax, RON 92)
Source: Ministry of Finance; World Bank staff calculations

Figure 27: …which will significantly increase fuel subsidy spending in 2014
(trillion Rupiah)



Note: APBN represents original Budget, APBN-P represents revised Budget
Source: Ministry of Finance; World Bank staff calculations

Progress on electricity tariff adjustment continues

Following tariff adjustment for large industrial and business groups in May, the Government introduced further tariff adjustment for six additional customer groups as part of the 2014 Budget revision, effective on July 1, 2014. The adjustments will be phased in over July, September, and November, and, together with the increases announced in May, result in a significant rise in electricity tariffs for most large user categories (Table 4). Through this additional tariff adjustment, the Government projects a saving of IDR 8.5 trillion for the state budget in 2014, but electricity subsidy spending remains significant, as discussed above, at a projected IDR 103.8 trillion in 2014 under the revised Budget, up 45.5 percent from the original Budget (APBN), and up 3.8 percent from realized spending in 2013 (Figure 28), due to higher input costs.[6] Full-year subsidy cost savings can be illustrated by hypothetically applying the tariff adjustments announced in both May and July to the full-year (2014), which suggests annual savings relative to a no-change scenario on the order of IDR 37.2 trillion. However, with automatic price adjustment mechanisms having been introduced for only some users as part of the new regulations in May (but not July), these savings remain vulnerable to renewed upward pressure on electricity supply costs, notably from any further Rupiah depreciation or higher international energy costs. The impacts of the tariff increases on costs, firms' responses, and prices, will vary according to firm and industry structures but given the sizable quantum of the increases over the year these merit further examination.

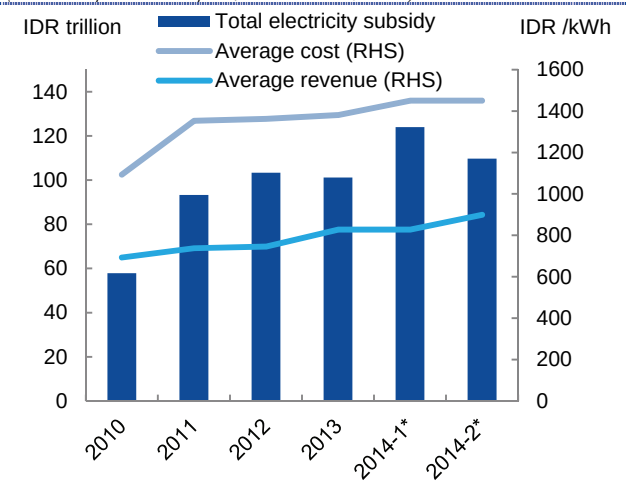
[6] http://nasional.kontan.co.id/news/banggar-sepakati-subsidi-listrik-ap billion-p-2014.

Table 4: Electricity tariffs are rising significantly for most large user categories, bar low-consumption households…
(base and new final tariffs once phased-in, as announced in May and July)

	Base tariff (IDR/ kWh)	Final tariffs as announced in: (IDR/kWh) May regn.	July regn.	Tariff change (%)
HH R-1 (1300 VA)	979	--	1,352	38.1
HH R-1 (2200 VA)	1,004	--	1,352	34.7
HH R-2 (3500-5500 VA)	1,145	--	1,352	18.1
HH R-3 (>6600 VA)*	1,352	1,530	--	13.1
Industry I-3 (>200 kVA; unlisted)	864	--	1,200	38.9
Industry I-3 (>200 kVA; listed)	864	1,200	--	38.9
Industry I-4 (>30000 kVA)	732	1,191	--	62.7
Business B-2 (6600 VA-200 kVA)*	1,352	1,530	--	13.1
Business-B-3 (>200 kVA)*	1,117	1,264	--	13.1
Government P-1 (6600 VA-20 kVA)*	1352	1530	--	13.1
Government P-2 (>200 kVA)	1026	--	1200	17.0
Government P-3 (street lighting)	997	--	1352	35.6

Note: Figures are new final tariffs (following phasing-in), as announced in the May and July regulations (regn.), respectively; "HH": households; listed status refers to stock exchange listing; * denotes automatic tariff adjustment, where new tariffs will no longer be subsidized and instead determined from inflation, exchange rates, and oil prices every month by PLN
Source: Ministry of Energy and Mineral Resource Regulation No. 9/2013; World Bank staff calculations

Figure 28: …reducing the current subsidy price gap and yielding sizable savings relative to a no-change scenario
(trillion Rupiah and Rupiah/kilowatt hour, kWh)

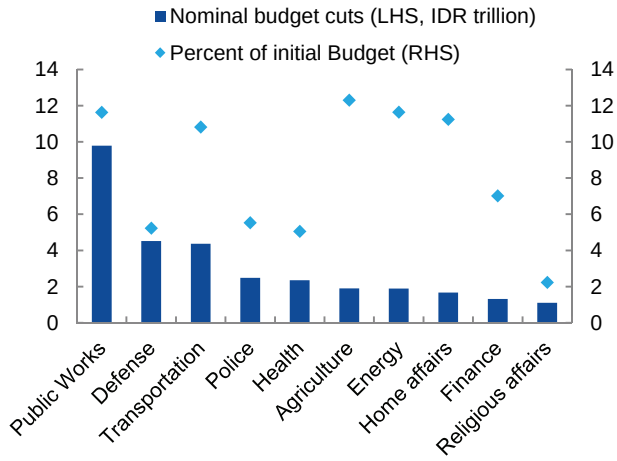


Note: *2014-1: No tariff change case; 2014-2: following regulated increases
Source: World Bank staff calculations

The revised Budget included IDR 43 trillion in line ministry budget cuts to restrain the budget deficit, in the absence of fuel subsidy reform

In the absence of sufficient policy-based cuts, the revised Budget includes IDR 43 trillion in across the board line ministry budget cuts, accounting for 7 percent of line ministries' total original Budget allocations. The approved cuts are less than half of the proposed cuts of IDR 100 trillion in the Government's draft revised Budget and are targeted to cut spending on areas such as travel, meetings, and seminars as guided by a Presidential Regulation.[7] However, the cuts also affect some key capital spending line ministries such as the Ministry of Public Works and Ministry of Transport (Figure 29). The Ministry of Public Works experienced the largest budget cuts, of close to IDR 10 trillion (nearly 12 percent of its initial Budget) and representing 23 percent of the total budget cuts, followed by the Ministries of Defense and of Transport. It is not clear that these cuts can realistically be sustained in future budgets, adding to future fiscal risks.

Figure 29: Key line ministries face significant budget cuts
(budget cut in IDR trillion; budget cut as share of original budget, percent)



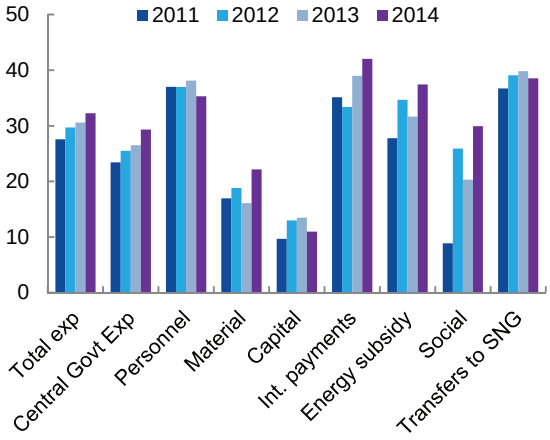
Source: Ministry of Finance; World Bank staff calculations

[7] Presidential Instruction No. 4/2014.

Five months into 2014, nearly one third of the revised Budget has been disbursed with energy subsidy, social and interest payment disbursement rates moving above recent levels

By the end of May 2014, IDR 605 trillion or 32 percent of the revised Budget allocation had been spent, a slightly higher disbursement rate than in previous years. This is partly driven by higher energy subsidy and interest payments due to the weaker Rupiah, and higher social spending due to timely disbursement of health social security premiums to the social security agency (*Badan Penyelenggara Jaminan Sosial*, BPJS). However, the execution of capital spending continues to be challenging. By May, disbursement of capital expenditure remained at 11 percent of the revised Budget, lower than previous years (Figure 30).

Figure 30: For 2014 through May, disbursement of core government spending remains low
(share of revised Budget, percent)



Source: Ministry of Finance; World Bank staff calculations

A recent Constitutional Court ruling limits Parliament's role in the discussion of State Budget at the technical level

On May 22, 2014, the Constitutional Court issued a ruling on how the Parliament (DPR) works with the Government in preparing the Budget. The court granted two out of four petitions made by several civil society groups and its ruling limits DPR's role in engaging at the technical level of the budget, and also abolishes DPR's authority in attaching disbursement conditions to budget line items (known as *bintang*). These decisions are seen as a positive development, with the vice-minister of the National Development Planning Agency stating, for example, that the revocation of parliamentary authority in State Budget implementation and warrant blocking (*bintang*) will support budget disbursement acceleration efforts. It is also expected that this ruling can help to elevate the involvement of the DPR in the budget preparation to a policy and program level. The ruling was made effective immediately, beginning with the 2014 revised Budget preparation.

The World Bank has revised upward its projection of the fiscal deficit in 2014 to 2.8 percent of GDP

Taking into account recent macroeconomic developments, and the recently approved revised Budget, the World Bank has revised up its fiscal deficit projections for 2014 to 2.8 percent of GDP in the baseline scenario (Table 5), from 2.6 percent at the time of the March 2014 *IEQ*. However, this projection does not include energy subsidy arrears of IDR 50 trillion and also assumes incomplete budget execution by line ministries (with capital expenditure in 2014 now projected to decline from preliminary 2013 levels). Including energy subsidy arrears and assuming full line ministry budget execution would lift the projected fiscal deficit to as high as 4.0 percent of GDP. The World Bank expects revenue collection in 2014 to continue moderating and has revised down its revenue projection by 2.6 percent, due mainly to lower expected tax revenues, through lower oil and gas production, a slowdown in VAT collection (due to expected moderation of private consumption and imports) and reduction of the corporate income tax collection due to the unprocessed mineral exports ban.

The revised Budget substantially increases gross financing needs but securities financing through mid-July had reached just over 60 percent of the revised full-year target

The larger planned fiscal deficit results in a substantial increase, of IDR 66.1 trillion, in the net financing need for the remainder of 2014. Amortizations of official foreign loans have also risen by IDR 5.4 trillion, reflecting the weakening of the Rupiah. The Government plans to meet the overall rise in gross financing needs primarily through higher securities issuance, along with higher official program loan disbursements. The gross securities financing target for 2014 is increased by IDR 60.7 trillion to IDR 430.2 trillion. Prior to the increase in the financing target, securities issuance had been well ahead of target, with IDR 231.9 trillion worth of bonds issued in the first half of the year. Second half issuance also got off to a strong start, with a maiden Euro-denominated issue of EUR 1 billion worth of 7-year bonds,

which was nearly seven times over-subscribed, and priced to yield under 3 percent. As of July 11, the Government had issued IDR 280.9 trillion of bonds in 2014, representing 65 percent of the revised full-year issuance target. Securities financing thus remains on track for 2014, but the increased supply does raise financing risks, and the continued resilience of domestic yields will depend in part on continued strong offshore investor purchases of domestic bonds. Foreign investors have overtaken banks as the largest institutional ownership category of domestic currency, tradable government bonds, with a 34.3 percent share of the total; offshore investors have taken up 54 percent of the IDR 85.6 trillion increase in domestic government bonds outstanding in 2014 through 11 July.[8]

Table 5: The World Bank has revised up its projection of the Budget deficit to 2.8 percent of GDP
(IDR trillion, unless otherwise indicated)

	2013	2014		2014	
	Prelim. Actual	Budget	Revised Budget	*IEQ* Mar 2014	*IEQ* Jul 2014
A. Revenue	**1,430**	**1,667**	**1,635**	**1,581**	**1,540**
1. Tax revenues	1,072	1,280	1246	1,216	1,188
Income Tax	503	586	570	561	543
Oil and gas	89	76	84	95	87
Non-oil and gas	414	510	486	466	456
VAT	383	493	476	448	440
2. Non tax revenues	353	385	387	362	351
B. Expenditures	**1,639**	**1,842**	**1,877**	**1,845**	**1,821**
1. Central government, o/w	1,126	1,250	1,280	1,259	1,229
Personnel	221	263	259	261	244
Material	168	216	178	184	169
Capital	172	184	186	185	165
Interest payments	113	121	135	126	136
Subsidies, o/w	355	334	403	416	410
Energy subsidies	310	282	350	370	363
Fuel subsidies	210	211	246	267	259
Electricity subsidies	100	71	104	103	104
Non Energy	45	52	53	46	47
Grants	1	4	3	4	3
Social	92	92	88	55	85
Other	4	37	28	29	17
2. Transfers to the regions	513	593	597	586	593
C. Primary balance	**-97**	**-54**	**-106**	**-138**	**-145**
D. Overall balance	**-210**	**-175**	**-241**	**-264**	**-281**
as percent of GDP	-2.3	-1.7	-2.4	-2.6	-2.8
Key economic assumptions					
Economic growth (percent)	5.7	6.0	5.5	5.3	5.3
CPI (yoy, percent)	8.4	5.5	5.3	6.2	5.8
Exchange rate (IDR/USD)	10,542	10,500	11,600	12,000	11,800
Crude oil price (USD/barrel)	106	105	105	105	106
Oil production ('000 barrels/day)	825	870	818	n.a	n.a
Subsidized fuel consumption (mil. KL)	46.4	48.0	46.0	47.9	47.8

Source: Ministry of Finance; World Bank staff calculations

[8] All figures in this paragraph are from the Directorate General of Debt Management, Ministry of Finance.

7. The pace of poverty reduction has slowed

The Government's poverty target for 2014 is likely to be missed, due to a slowing rate of poverty reduction

The official poverty rate, as measured by the national statistics agency (*Badan Pusat Statistik*, BPS) for March 2014 was 11.3 percent, representing a marginal 0.1 percentage point decline from 11.4 percent in March 2013. This continues the slowing trend in poverty reduction over the last five years, where annual poverty reduction has been below 1 percentage point each year, with only modest poverty reduction recorded especially for the last three years. The near-zero decline in 2014 is the smallest in over a decade, with the exception of the nearly 2 percentage point increase in 2006 due mainly to food price shocks (Figure 31). With poverty currently at 11.3 percent, the Government's 2014 target of 8-10 percent under the current medium-term development plan (*Rencana Pembangunan Jangka Menengah*, RPJM, 2009-14) is unlikely to be met when the September 2014 poverty rate is announced (expected in January 2015).

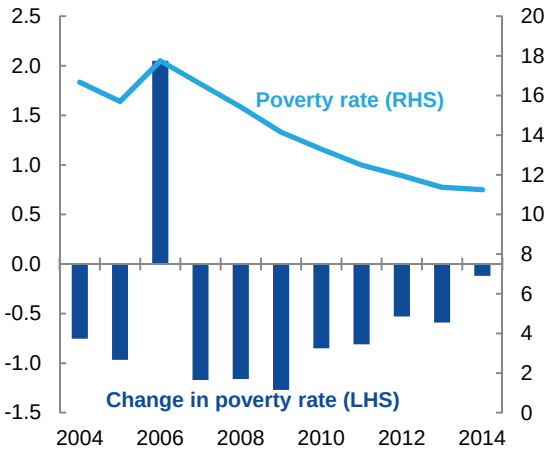
Contributing factors are that the remaining poor are increasingly hard to reach, and that economic growth continues to be unequally shared…

There are a number of reasons for slowing poverty reduction.[9] One important factor is that as poverty approaches 10 percent, the remaining poor are further and further below the poverty line, meaning that higher consumption growth at the bottom of the income distribution is required to maintain previous rates of poverty reduction. Moreover, not only is economic growth slowing, but the poor and vulnerable have participated less in this growth than wealthier Indonesians, contributing to the widening in inequality discussed in Section C.

…amid signs from the most recent labor data of slowing employment creation

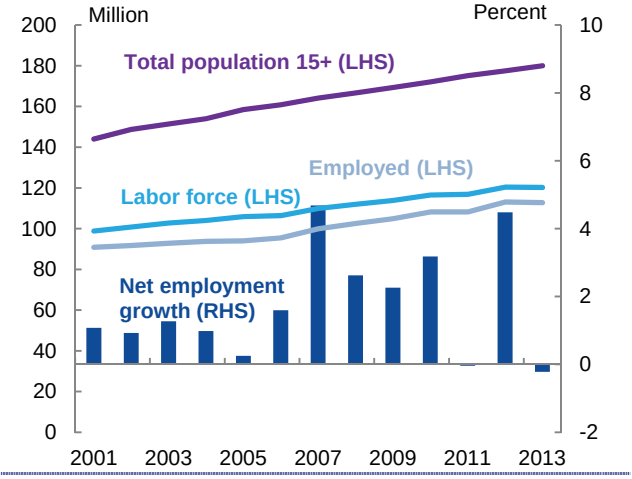
Another factor that may be weighing on poverty reduction is slowing employment growth. New labor market data released by BPS in May 2014 shows that total employment stood at 112.8 million in August 2013, down by 0.2 percent from the year previously (Figure 32). The drop is attributable to stagnant formal employment growth in 2012-2013, following strong growth from 2010-2012. Consequently, the unemployment rate edged higher to 6.2 percent in August 2013, up from 6.1 percent in 2012, while the share of the working age population in employment fell by a full percentage point, to 62.7 percent.

Figure 31: The pace of poverty reduction in the last three years has been the slowest in over a decade…
(percent)



Source: BPS; World Bank staff calculations

Figure 32: …and the latest August labor market data, for 2013, point to slowing employment growth
(millions of people, and net employment growth, percent)



Note: calculations based on backcasted weights from 2010 population census, as applied by BPS beginning in February 2014, which implied a revision of the 2011, 2012 and 2013 series
Source: BPS; World Bank staff calculations

[9] See the December 2013 *IEQ* for a detailed discussion of Indonesia's slowing poverty reduction.

8. Fiscal risks have shifted into focus

International risks to Indonesia's outlook have become more balanced in the short term

The World Bank's baseline scenario for Indonesia's outlook is one of a slight moderation in GDP growth and a continuing improvement of the current account balance. There are several international and domestic risks to the base case. Although short-term risks in international financial markets, stemming from the normalization of monetary policy in advanced countries, have become less pressing, they have not been eliminated. Over the medium-term, further episodes of volatility can be anticipated, as markets approach high-income monetary policy decision points. In contrast, the conflict in Iraq and its potential to affect global oil prices poses an immediate downside risk. A net oil importer, Indonesia stands to lose from rising oil prices as higher oil prices would add to the fiscal deficit through the dominant direct impact on higher fuel subsidy spending. Finally, as a major commodity exporter, Indonesia continues to be sensitive to developments in China, that is the country's ongoing process of economic rebalancing while aiming to minimize financial stability risks.

The transition to a new Government, and its near-term policy priorities, particularly in relation to the fiscal position, will frame the near-term domestic risks

While the growth outlook has not changed significantly from the March 2014 *IEQ*, some near-term risks, especially those related to Indonesia's fiscal position, have risen. Private consumption spending and fixed investment, in particular buildings, may decelerate more than projected in the base case, if credit conditions and property prices deteriorate more than currently expected. Once the official Presidential election result is confirmed, investor attention will shift to the policy priorities of the new Government, particularly in relation to energy subsidies given the weakening fiscal balance. Any new reform in fuel subsidies, along with a larger-than-projected impact of the increase in electricity tariffs, constitutes an upside risk to consumer price inflation. The effect of El Niño on food prices, which comprise 35 percent of the CPI basket, is another upward risk to inflation and a potentially significant negative risk to the consumption of the poor.

As in many other EMEs, sizeable concerns regarding the trajectory for future potential output remain

Looking beyond the more benign near-term global outlook, and the domestic political transition, the medium- to long-term economic outlook is also subject to considerable uncertainty. After three strong post-crisis years, real fixed capital formation growth has weakened markedly since 2012. Amidst softer commodity prices, investment is likely to ease further as capital costs rise and international liquidity tightens. As in many other EMEs, despite the potential "demographic bonus" of the next two decades, working age population growth is also slowing. All of these factors represent significant risks to potential output growth. They also place a great premium on policy reforms targeting faster productivity growth as the foundation of higher income growth to enable Indonesia to continue to move up through middle-income status.[10]

[10] For further discussion see World Bank (2014), Indonesia Development Policy Review 2014: "Avoiding the Trap", http://www.worldbank.org/en/news/feature/2014/06/23/indonesia-2014-development-policy-review.

B. Some recent developments in Indonesia's economy

1. El Niño, forest fires and haze: the imperatives for concrete action

Forest and land fires, while not new to Indonesia, have been occurring with increasing frequency and on a larger scale

Indonesia has experienced annual large-scale forest and land fires since 1982,[11] together with significant environmental damage and economic impacts. In fact, forest fires are not a new phenomenon in Indonesia - historical records compiled by the Ministry of Forestry[1] indicate that the occurrence of forest fires, albeit on a smaller scale, and the notion of an annual fire-prone dry season between May and November, existed at least as far back as the Dutch colonial period. But while fires may be nothing new, the occurrence of very large-scale fires with annual regularity is a more recent trend. This section provides a brief overview of this complex issue, drawing on the major fires in Riau province (east Sumatra) in early 2014 as a case study, particularly in light of the heightened near-term forest fire risks due to possible El Niño conditions later this year.

a. Underlying causes of recurring forest and land fires

The causes of forest fires in Indonesia are well understood…

Several studies have documented the underlying causes of forest fires in Indonesia. For example, the Center for International Forestry Research (CIFOR) conducted a study into the underlying causes and impacts of fires across Southeast Asia, including examining traditional land development practices in both the highlands and lowlands of Sumatra. The study identified several underlying causes, including land preparation for agriculture, illegal logging, insecure land tenure of the community, and land speculation.[12]

… and include degraded peatland

Peat fires are also a major trigger for new forest fires, in addition to having their own economic, social and environmental effects (see Box 3). On the island of Sumatra, most peat is found along the eastern coast, where six large remaining forest areas can be identified.

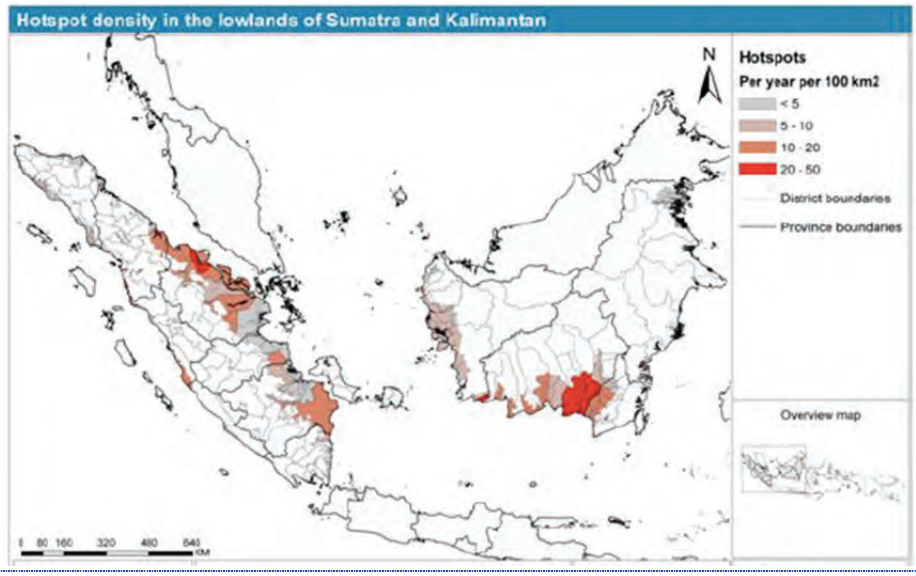
[11] Ministry of Forestry, 25 September 2013, "History of Forest Fires in Indonesia".
[12] CIFOR, March 2001, "The underlying causes and impacts of fires in Southeast Asia".

Five of these are in the province of Riau. Overall, 72 percent of former closed-canopy peat forest, once covering 6.5 million hectares (ha.) of Sumatran lowlands, was assessed to have been lost by 2010. Today, degraded forest covers 2.4 million ha., with around 1.5 million ha. converted into agricultural and plantation land.

Satellite data indicates that peatland areas have a higher prevalence of hotspots, which are associated with fires

The occurrence of fires in peatland areas can be depicted using frequency maps of hotspots, i.e. points that have significantly warmer temperatures than their surroundings. Using satellite data over 2001 to 2010, it is evident that areas along the eastern coast of Sumatra in the provinces of Jambi, Riau and North Sumatra, as well as in the southern part of Central Kalimantan, have the highest frequency of hotspots, which are associated with fires (Figure 33). Overlaying hotspot maps with land cover maps highlights that areas with higher hotspot density coincide with peatland.

Figure 33: Satellite hotspot densities indicate the frequency of fires over 2001-10, by district



Note: Satellite data from MODIS (Moderate-resolution Imaging Spectroradiometer)
Source: World Bank, February 2012, "Thematic Paper 4: Patterns In Drought and Peatland Fire in the Lowlands of Sumatra and Kalimantan".

Box 3: Peat, peatland and peat fires

Peat is an accumulation of partially decayed vegetation or organic matter. Peat forms when plant material, usually in wetland areas, is inhibited from decaying fully where flooding obstructs the flow of oxygen from the atmosphere, slowing the rate of decomposition. Peat is characterized by its wet environment. Drought will, however, increase evaporation and lower the groundwater table and soil moisture content. Consequently, drought increases the vulnerability of peatland to fire risks, exacerbated if the soils are drained.

Drainage of peatland can enhance agricultural productivity and improve the accessibility of the terrain. However, drainage enhances soil exposure to oxygen, which consequently oxidizes, resulting in accelerated subsidence of peat soils. Draining peatland also increases its vulnerability to fire, as it reduces the moisture content and stimulates oxygen supply.

Peat has a high carbon content and once ignited it smolders and can even burn underground, provided there is a source of oxygen. Peat fires can burn almost indefinitely or at least until the fuel is exhausted or the oxygen supply is interrupted. These smoldering fires can burn undetected for very long periods (months, years, and even centuries) propagating through the underground peat layer.

Peat fires are emerging as a global threat with significant economic, social, and ecological impacts, not only because of the haze they create, but also because of major resulting CO_2 emissions. Over 100 peat fires in Kalimantan and East Sumatra have continued to burn since 1997. Each year, the peat fires in Kalimantan and East Sumatra ignite new forest fires above the ground. Water management in developed peatland is essential not only to find a balance between drainage levels and cultivation practices but also to reduce fire risks, and to protect peat soils for future generations.

Source: International Peat Society (2014), see http://www.peatsociety.org

While infrequent forest and peatland fires occur naturally, it is now recognized that the problem of frequent, large scale fires in Indonesia is due to human intervention

Increasing demand for plantation land for pulp wood and cash crops, especially oil palm, has led to the opening of more forest areas covering peatland, coupled with the drying of peatland by the building of canals to make the land cultivable. At the same time, fires have also been used as a method of land clearing by both small-holders and large corporations. Patterns of fire occurrence over the past ten years clearly show that most of the burning is deliberate at the margins of the forest, taking advantage of wind direction to burn areas still covered by forest or shrubs, and burning in a direction away from already cultivated areas. More than half of the forest and peatland fires that occurred in Riau in 2013 were located within concession areas, i.e., land already licensed to large companies. Sixty percent of those burns, however, originated from company areas occupied by small-holders.

Clearing land using fires is the cheapest method, with costs averaging only about twenty percent of non-burning methods

The law prohibits the use of fires as a land clearing method and treats this as a criminal act.[13] Research shows, however, that some large corporations prefer to risk penalties rather than using alternative, more costly methods of land clearing.[14] By law, concession-holders are responsible for fires that occur within their concession area, no matter who starts the fires. Enforcement of these laws and regulations is extremely challenging, and while small-holders tend to be blamed whenever fires occur, the situation is far from clear.

Forest and peat land fires can also be linked with organized appropriation of land

Some medium-size investors use contract 'farmers' in large groups—between 100 and 200 workers/families per group—to occupy forested land areas of about 2 ha. per worker or family, cut the trees and burn them on the spot, while heavy equipment is employed for landscaping and preparing the land for oil palm plantation. Deterring this type of practice has proven to be difficult in the face of strong economic incentives. Within one to two months, occupied areas typically become small plantations claimed by small-holding settlers who live in enclaves inside the forest area. As time progresses, most of these small-holdings change hands and become owned by medium-size companies. In the case of independent small-holdings, it is estimated that a hectare of oil palm plantation that costs less than IDR 2 million in investment may change ownership after 4 to 5 years (after the first fruit is proven) for a value in the range of IDR 30-35 million. High expected financial gains, coupled with weak law enforcement capacity, have thus become the main cause of forest and land fires. It is also important to recognize, however, that another driver behind forest and land fires is conflict over land. Albeit on a far smaller scale, these are cases where fire is used as weapon in disputes or as a way to seize disputed land.[15]

b. What the 2014 El Niño may bring

2014 is predicted to be an El Niño year with potentially severe droughts

The International Research Institute for Climate and Society foresees a 70 percent chance of El Niño (see Box 4) occurring this year from July to August onwards, increasing to 80 percent by September. Historically, El Niño brings significant climate-related problems to southeast Asian countries, with India, Indonesia, the Philippines and Australia often experiencing deficient rainfall or drought. Given the region's large population, its dependence on agriculture and its reliance on small-scale subsistence farms, any climatic anomaly affecting agricultural yields has potentially serious implications for food security.[16]

[13] See Law No. 32/2007 on the Protection and Management of Environment, and Government Regulation No. 4/2001 on the Management of Environmental Degradation and/or Pollution Linked to Forest or Land Fires.
[14] CIFOR, 2014, "Fact File on Fire and haze in Southeast Asia".
[15] This paragraph draws upon CIFOR, 2 July 2014, Presentation at the Jakarta Foreign Correspondents Club Seminar on Forest Fires.
[16] USDA Foreign Agricultural Service, June 2014, "Southeast Asia: Historical El Niño-related Crop Yield Impact".

Box 4: El Niño and ENSO

El Niño is a natural phenomenon in the equatorial Pacific Ocean caused by a prolonged increase in the sea's surface temperature. In the tropical Pacific Ocean, the trade winds usually blow from east to west, gathering warm water as they go and depositing it in the west in the form of typhoons and thunderstorms. This process creates a temperature imbalance with cold water in the east and warm water in the west (around Indonesia). As a consequence, warm water flows to the South American coast and trade winds start to weaken and sometimes reverse direction completely. This phenomenon is also often referred to as the ENSO (El Niño Southern Oscillation). El Niño occurs when the surface water temperature in the central and eastern parts of the ocean rises and the temperature in the western part falls, causing a decrease in evaporation and a reduced moisture supply from the east, with consequently less cloud formation and less rain.

Typically, this anomaly happens at irregular intervals of 2 to 7 years, and lasts 9 months to 2 years. Primary effects of El Niño are alterations in weather patterns, such as changes in temperature, rainfall, storm tracks and currents. For example, during El Niño the temperatures will generally be higher, and from June to August eastern Indonesia will often suffer droughts as the rain zone moves eastwards to the islands along the equator in the Pacific Ocean. The effects on rainfall of El Niño are strongest in the period from September to November when almost all of Indonesia is drier than usual. In December-February, East Indonesia stays drier.

Source: International Research Institute for Climate and Society (IRI); Indonesian Meteorology Climatology and Geophysics Agency (*Badan Meterologi Klimatologi dan Geofisika*, BMKG); Royal Netherlands Meteorological Institute(*Koninklijk Nederlands Meteorologisch Instituut,* KNMI)

Historically, El Niño is associated with rainfall deficits in Indonesia, triggering large-scale forest fires

There have been 20 El Niño Southern Oscillations (ENSOs) in the 120 years since 1877. The most recent ENSOs are closely associated with forest fires in Indonesia. The massive fires of 1982-83 coincided with ENSO, and were the starting point of large regularly recurring forest fires in Indonesia. The 1991 ENSO fires helped to generate new interest in trying to understand the role of human activity in causing and contributing to the fires, while the 1994 ENSO forest fires triggered an ASEAN regional response with the establishment of a special committee and a legally binding trans-boundary haze pollution agreement. The 1997 ENSO forest fires have thus far been the most significant in terms of size and impact. For the first time, the Government appealed for international assistance to combat the fires.[17]

c. The lesson from the February-March 2014 fires in Riau

Riau province, which experienced severe recent forest fires in February to March 2014 is one of Indonesia's two most fire-prone, along with Central Kalimantan

When considering the risks of forest fires associated with any future El Niño conditions, the recent economic costs and lessons from the February and March 2014 fires in Riau are instructive. In Riau and Central Kalimantan, the two provinces with the highest potential for peatland fires, major peatland fires are reported in dry periods nearly every year. In Kalimantan these fires are concentrated in only a few very dry months. In Riau, however, this is not as regular, as dry months are less predictable and less severe. This leads to the practice of taking maximum advantage of even a brief rainless period to clear land with fire (as in February and March 2014).

Regardless of public debate over who started the fires, the distribution of burned areas and boundary overlaps can be easily mapped

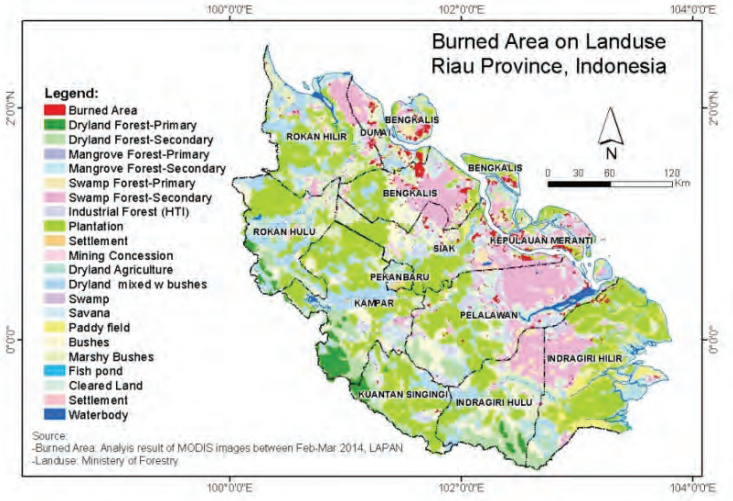
There are sufficient datasets and expertise in Indonesia to analyze the spread and impact of forest fires and rapidly map them against land-use designation and concession boundaries. A rapid analysis carried out by scientists from the Indonesian Space Agency (*Lembaga Penerbangan dan Antariksa Nasional*, LAPAN) and the Agency for the Assessment and Application of Technology (*Badan Pengkajian Dan Penerapan Teknologi*, BPPT) using a practical and widely-used technique called Normalized Burned-area Ratio (NBR) can reveal critical information that is useful to determine the typology of the fires and their impact on the landscape.

[17] Neil Byron and Gill Shepherd, April 1998, "Indonesia and the 1997-98 El-Niño: Fire Problems and Long Term Solutions" (Natural Resources Perspective. Overseas Development Institute).

The fires in Riau in February-March 2014 burned more than 176,000 ha.

The fires in Riau over January to March 2014, which burned more than 176,000 ha., occurred predominantly in lowland coastal areas and at the margins of peat-swamp forest (Figure 34). Around 24 percent of the burned area was swampy bushes (logged-over forest), while around 22 percent was on secondary swamp forest. Overlaying this with a land-system map reveals that 143,000 ha. of the burned areas fall in land classified as peatland. Further overlays with forest utilization license maps reveal that 1,300 ha. of the burned areas were in natural forest designated for utilization, and 68,500 ha. in areas designated as industrial forest, and another 30,000 ha. in areas with palm oil plantation licenses. This analysis is consistent with previously documented patterns of fires where these start from lowland forest and plantation margins where plantation expansion may be ongoing.

Figure 34: Burned areas by land-use category in Riau
(burned-area mapping and anatomy of the fire-affected areas)



Source: LAPAN and BPPT (2014)

The total damage and losses caused by the forest fires in Riau in February-March 2014 alone is estimated at USD 935 million

According to World Bank estimates, the total damage and loss from the February-March 2014 Riau fires is estimated at USD 935 million, or 2.8 percent of Riau province GDP (as projected by the regional government). Total damage is estimated to be USD 73 million (7.8 percent of the total damage and loss), and total losses are estimated at USD 862 million (92.2 percent of the total). Damage is a proxy for the amount of financing needed for reconstruction and rehabilitation, while the losses represent the reduction in economic activities and income that arise in the following months or years as a result of the disaster (Table 6). Over 73 percent of all damage and losses are of a private nature, primarily occurring in forest concession areas and palm oil crops owned by private firms.[18]

Forestry and agricultural crops suffered most, followed by manufacturing and then the trade sector

Forestry and agricultural crops suffered most during the fire with damage and losses estimated at USD 301 million and USD 260 million, respectively. This impact was associated with the burning of 34,300 ha. of forestry land and 25,400 ha. of agricultural land, with palm oil plantation and dry-land agriculture comprising 75 percent and 25 percent of total agricultural land, respectively. The direct damage to forestry was relatively limited, as calculated from replanting costs. However, the losses were significant based on the number of destroyed trees and their sales value. Manufacturing losses were also significant, at USD 219 million. The loss of industrial forest in Riau results in a major loss for the surrounding sawn-timber, plywood, and pulp and paper manufacturers. Some manufacturers have limited if any alternative sources for their main raw materials, in this case timber. The trade sector is estimated to have suffered losses of 10 percent of total provincial trade sector annual output,

[18] The assessment was conducted in early April 2014 using the methodology designed by the UN Economic Commission for Latin America and the Caribbean (ECLAC) to determine the value of lost assets, and assess the impact on each sector.

oil and gas and mining sector activities halted their activities for more than a week, and local and international travelers cancelled or postponed their visits to Riau. Furthermore, because of the thick smoke haze, airports and seaports were closed for several days, and land transportation was reduced for days.

Table 6: The estimated damage and losses of the forest fires in Riau, February-March 2014, reach USD 935 million
(estimated damage and losses, USD million)

	Disaster effects			Ownership	
	Damage	Losses	Total	Public	Private
Forestry	9	292	301	133	168
Agricultural crops	64	196	260	91	169
Mining	0	12	12	0	12
Trade	0	76	76	0	76
Manufacturing	0	219	219	0	219
Tourism	0	20	20	0	20
Transportation, communication	0	22	22	6	16
Health	0	11	11	8	4
Environment*	0	0.1	0.1	0.0	0.1
Humanitarian and fire-fighting costs	0	14	14	13	1
Total	73	862	935	251	684

Note: *Environment loss estimates capture direct biodiversity losses only, and exclude emissions
Source: World Bank staff calculations

Overall, the Riau fires are estimated to have caused a material decline in provincial GDP growth

The Riau fires are estimated to have caused a decline in provincial GDP growth for several years. For 2014, the regional government of Riau had expected to post regional GDP growth of 3.0 percent, with 6.0 percent growth of non-oil-and-gas GDP and a 0.7 percent contraction of oil-related GDP. However, based on the impact assessment summarized above, Riau's 2014 regional GDP growth may be lowered by 0.4 to 0.6 percentage points, to approximately 2.5 percent yoy, all else equal. Non-oil sectors (which account for 63 percent of provincial GDP) were impacted the most, with their losses projected to reduce non-oil GDP growth from 6.0 to 4.9 percent. With Riau one of Indonesia's "big five" regions in terms of regional GDP, along with DKI Jakarta, East Java, West Java, and Central Java, such impacts are also of national economic interest.

However, the assessed losses do not cover important impacts, such as longer-term health and environmental costs…

Due to limited time and resources, the assessment did not include the education sector (e.g. disruption to schooling). It also only partially captured the health effects of the disaster, focusing on public spending on medicine and health equipment, but not the longer-term human health consequences of exposure to the smoke haze arising from the fires. Studies on the health impacts of forest fires, related to the increase of fine particulate matter levels, have demonstrated that in the long run health-related economic impacts appear to be substantial, second only to timber losses.[19] In addition, due to forests having multiple functions it is difficult to state the true economic value of all goods and services provided from forest resources. Notably, for example, the economic impact of the environmental losses in this assessment only includes the value of the loss of biodiversity related income, and does not capture the release of emissions from the fires.

…and recurrent fires pose longer-term risks to the CPO industry in Indonesia and to the country's reputation in international markets

Comprehensive forest fire impact assessment should also consider the major, longer-term risks to the crude palm oil (CPO) industry, in Riau and nationally. Indonesia is now the world's largest CPO producer and the industry generates over USD 15.8 billion[20] of annual export earnings. Many industry players have become more proactive in implementing sustainable production including adopting a no-deforestation and no-burning policy in land preparation for their plantations. However, while plantation owners undertake preventive

[19] See, for example, R. Ritmaster and W.L Adammowicz, May 2001, "Economic Analysis of health effects from forest fires in Chisholm, Canada".
[20] Indonesia's CPO export revenues in 2013 were USD 15.8 billion (BPS).

measures to protect their productive crops, the pattern of fires also remains consistent with the pattern of plantation expansion, typically using the local community to carry out burning for land preparation (as discussed above). This practice of using local communities as a proxy makes it difficult to establish that companies certified as applying sustainable production are not involved in driving the land burning, a situation which may jeopardize the overall global reputation of the industry.

d. The imperative for more, concrete action

Forest fires are a major, costly risk with significant economic, social and environmental impacts…

Economic impact assessments, such as that for Riau above, show clearly that the potential costs of forest fires are large. Though less easily quantified, they also bring long-term risks to business and Indonesia's international reputation. Other, major long-term risks, though not the focus of the brief discussion of this section, include the threat to climate change goals, environmental sustainability, and (through economic, social and environmental impacts), poverty reduction. The risks and costs of large-scale, regular forest fires, therefore, are significant, and consequently should be considered as part of Indonesia's wider disaster risk prevention and mitigation strategy.

…and are largely preventable, unlike many other disasters that continue to occur in Indonesia

When it comes to natural disasters, Indonesia tops the list of the world's most vulnerable countries to multiple hazards, such as earthquakes and tsunamis, volcanic eruptions, floods, droughts and landslides. Annual disaster-related national fiscal spending, mainly for post-disaster reconstruction to rebuild damaged public assets and provide financial assistance to disaster-affected populations, reaches an average of USD 500 million per year.[21] Most of this spending is used to respond to natural disasters that cannot be prevented. But, unlike earthquake and volcano occurrences, the number of land and forest fires in Indonesia can be significantly reduced. In the Riau fires of early 2014, the Government had to spend USD 13 million on fire-fighting during the two months immediately after the fires got out of control. The communities involved in land clearing by burning typically receive about USD 5 per person per day, similar to the rate for typical post-disaster cash-for-work programs. Using this level of payment as an example, when planned properly through a community empowerment approach—which has worked well in disaster prevention, response and recovery in other areas in Indonesia—the USD 13 million spending for two months could have been used to employ more than 30,000 community members for three months to undertake fire prevention and land preparation, all without the use of fires for land clearing.

The need to tackle forest fires is urgent; El Niño and the fire season will likely coincide with the early weeks of the new administration

El Niño this year could be of the severity of El Niño in 1997, when massive forest fires occurred. A likely peak of the dry period is predicted in October to December 2014, at the time when the newly-elected president will take office. As the transition between administrations can be a time when policy-making slows down, it is imperative that the outgoing and incoming administrations work closely together to ensure that massive fires are prevented. For example, systematic steps to determine the start of the fire season using parameters such as a drought index, the occurrence of hot spots (with higher thresholds), and a decrease in the air quality index, need to be defined. The Government at both the national and subnational levels could trigger a stand-by emergency status much earlier using well-established practices in disaster management under Law No. 24/2007 on Disaster Management that have been applied by the National Agency for Disaster Management (*Badan Nasional Penanggulangan Bencana*, BNPB). Triggering stand-by emergency status early would enable the Government to mobilize stand-by (on-call) funds quickly from the state budget without the need for specific parliamentary approval, enabling preventive measures through intensified law enforcement, and the involvement of local communities. Progress on such measures over the next few months can help to ensure that fires and haze do not impose major environmental and economic losses, and burden the fresh start of the new administration.

[21] World Bank/GFDRR, October 2011, "Indonesia: Advancing a National Disaster Risk Financing Strategy – Options for Consideration".

2. New purchasing power parity-adjusted estimates of Indonesia's economy

Comparing the size of economies and average expenditures at market exchange rates can be misleading…

How large is Indonesia's economy relative to that of other countries? To make such comparisons, it is necessary to convert values into common units. One option is to use market exchange rates: for example, to compare the size of Indonesia's economy to that of the US, Indonesia's GDP in Rupiah can be converted into US Dollars using the market exchange rate (about 12,000 IDR per USD, at the time of writing). However, the market exchange rate may not be a good measure of the relative purchasing power of one dollar in the US versus that of one dollar, converted into Rupiahs, in Indonesia, because it does not adjust for different price levels. If goods and services, particularly non-traded ones, are generally cheaper in Indonesia than in the US, then using market exchange rates would under-estimate the value of goods and services produced by Indonesia, and hence under-estimate of the size of its economy. The International Comparison Program (ICP), an international initiative hosted by the World Bank, tackles this problem of accurately comparing the value of the goods and services produced by different economies. In June 2014, the full results were released from the latest round of estimates, launched in 2011 ("ICP 2011" or the 2011 Round). This section examines these results for Indonesia.

…relative to using comparisons based on purchasing power parities ("PPP")…

What is needed is a measure that adjusts for differences in price levels between different countries. Purchasing power parity (PPP) estimates, i.e. the ratio of the prices in national currencies of the same good or service in different economies, can be used to provide cross-country estimates of GDP or expenditure using a common price level.[22] For example, if it turned out that, given prevailing prices in Indonesia, the volume of goods and services that could be purchased with one dollar in the US in 2011 could be purchased with only IDR 3,607 in Indonesia (not IDR 8,770, the market exchange rate value of one US Dollar in 2011), then the estimated goods and services produced by the Indonesian economy, adjusted for differences in purchasing power, would be almost three times larger than when using the market exchange rate. There are theoretical reasons to expect PPP conversion rates to be an important determinant of market currency exchange rates, especially over longer periods, but at any one time there is little reason to expect them to capture PPP, making international economic comparisons on a market exchange rate basis potentially misleading.

...as comprehensively estimated by ICP 2011

ICP 2011 provides new estimates of PPP conversion factors across most of the world's economies. This is the first comprehensive update since the 2005 Round, and involved major improvements in methodology, as well as the addition of new countries to the study (199 countries were included in 2011, compared with 146 in 2005). The methodological differences between the ICP 2005 and 2011 estimates, and shifts in economies over time, make it very difficult to compare the data across years. Rather, the 2011 ICP results should be seen as the new best estimate of the differences in purchasing power across economies.

a. The results for Indonesia: a "Top 10" economy

The global context: developing economies account for a greater share of the world economy

The results of ICP 2011 for Indonesia (summarized in Table 7) should be placed in the global context.[23] Developing countries' share of the global economy is much bigger than previously estimated. Middle income economies' share of global GDP is 48 percent when using PPPs and 32 percent when using exchange rates. Six of the world's twelve largest economies were in the middle income category (based on the World Bank's definition). When combined, the twelve largest economies account for two-thirds of the world economy, and 59 percent of the world population. Roughly twenty-eight percent of the world's population lives in economies with GDP per capita expenditures above the PPP$ 13,460 world average and 72 percent are below that average. The median yearly per capita expenditures for the world is PPP$ 10,057.

[22] For a complete overview of PPP concepts, and of ICP 2011 methodology, see http://icp.worldbank.org.

[23] This paragraph is drawn from the ICP 2011 press release, available at http://www.worldbank.org/en/news/press-release/2014/04/29/2011-international-comparison-program-results-compare-real-size-world-economies.

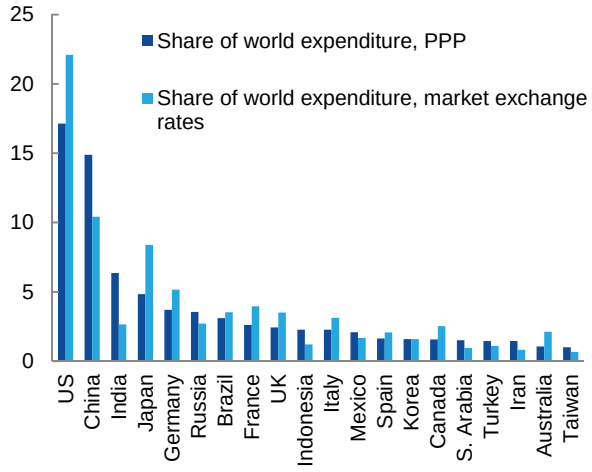
On a PPP basis Indonesia's economy is estimated to be the 10th largest in the world– the largest developing economy after the BRICs…

The ICP 2011 estimate of Indonesia's PPP exchange rate to the US Dollar in 2011 was 3,607, resulting in an estimated PPP-based GDP of PPP$ 2.06 trillion. On this basis, Indonesia was the tenth largest economy in the world (Figure 35), and the largest developing country economy behind only the "BRICs" (Brazil, Russia India and China). Indonesia accounted for 2.3 percent of total global expenditure (versus 3.6 percent of the global population). By contrast, using market exchange rates, Indonesia was the nineteenth largest economy in the world in 2011, accounting for only 1.2 percent of total global expenditure. The difference is driven by cheaper prices in Indonesia, with the index of prices used for the computation standing at only 53 percent of the global price index.

…and consumption per person is 13 percent that of the US, versus under 6 percent when comparing using market exchange rates

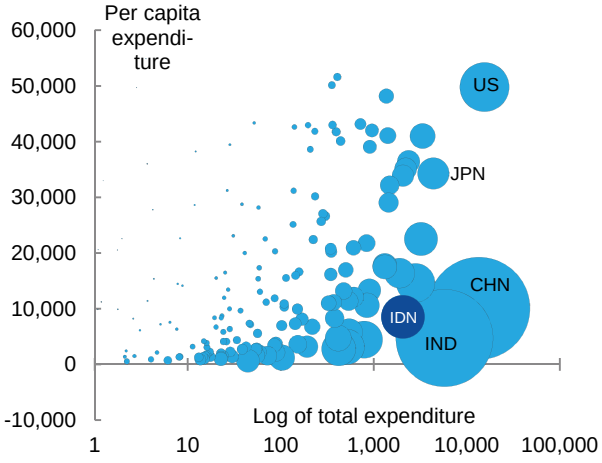
On average, Indonesians are relatively better off, when compared with average consumption in the US, for example, than would appear based on commonly-used, market exchange-rate based comparisons. At market exchange rates, consumption expenditure per capita in Indonesia in 2011 was just 5.5 percent of that in the US, but this rises to 12.9 percent on a PPP basis. However, even adjusting for relative prices, per capita consumption in Indonesia remains comparatively low (Figure 36), ranking 127th on a PPP basis out of 187 countries for which data are available (and 126th at market exchange rates).

Figure 35: Indonesia's economy is the tenth largest, measured on a PPP basis…
(largest twenty economies by PPP expenditure, share of world expenditure, percent, 2011)



Source: ICP

Figure 36: …but per capita expenditure at PPP remains comparatively low
(total and per capita PPP expenditure, 2011)



Note: Full ICP sample excluding three outliers; bubbles indicate population size
Source: ICP; World Bank staff calculations

On a PPP basis, Indonesia's economy remains the giant of ASEAN, and expenditure per person is closer to the regional average

In the regional context, ICP 2011 estimates support the contention that Indonesia is the giant of south east Asian economies, but unlike its global economic size ranking, there is little difference between estimates based on market exchange rates and those on PPP, with Indonesia's economy estimated to contribute just under 40 percent of total ASEAN GDP. This is because PPP-estimates increase the estimated GDPs of Indonesia's ASEAN peers by generally similar margins. Expenditure per person in PPP terms in Indonesia is approximately equal to the population-weighted ASEAN average (of PPP$ 8,549 in 2011).

Table 7: ICP 2011 key results for Indonesia

	Expenditure per capita				Relative size of economy		Domestic economic structure		Memo:
	Value		Comparison with US (=100)		Share (world = 100)				PPP (US$ = 1.000)
	Based on PPPs	Based on XRs	Based on PPPs	Based on XRs	Based on PPPs	Based on XRs	Based on PPPs	Based on XRs	
Overall GDP	8,539	3,511	17.2	7.1	2.3	1.2	100%	100%	3,607
Actual Individual Consumption	4,805	2,044	12.9	5.5	2.0	1.1	56%	58%	3,731
Individual Consumption by Households	4,110	1,917	12.0	5.6	2.1	1.1	48%	55%	4,092
Individual Consumption by Government	637	127	20.8	4.1	1.3	0.5	7%	4%	1,745
Collective Consumption by Government	564	189	11.2	3.8	1.6	0.8	7%	5%	2,947
Gross Fixed Capital Formation	2,701	1,122	29.8	12.4	3.1	1.7	32%	32%	3,645

Source: ICP

b. Limitations and what the new data do not tell us

The results are statistical estimates only, subject to uncertainty…

The ICP 2011 results have some important limitations, which this section briefly reviews. First, the PPP adjustment factors are statistical estimates. They represent the best effort to pinpoint the true figure, within an error band. The resultant adjustments are then applied to data, such as domestic currency-denominated output and population, that are also estimates subject to measurement errors. Given this imprecision, as well as the dynamic nature of economies, it is best to focus on the qualitative implications of the estimates (e.g. adjusting for relative price levels shows that Indonesia's economy is very much bigger than the estimate obtained using market exchange rates), rather than on the quantum of the estimates (e.g. Indonesia has a PPP$ 2.06 trillion economy and is certainly larger than Mexico's).

…they should not be used to infer relative economic performance since the 2005 ICP Round…

Second, because of methodological differences between the surveys, and because of shifts in relative prices across time, differences between the results of the 2005 and 2011 ICP rounds cannot be used to infer Indonesia's economic performance over time. For example, the fact that Indonesia's PPP-adjusted GDP was estimated at $707.9 billion in 2005, compared with $2.06 trillion in 2011, does not mean that the economy grew by $1.4 trillion (191 percent) in the intervening years. For such comparisons across time, the best estimate is the official statistical (BPS) estimate of real GDP growth, which shows that Indonesia's economy expanded by a total of 41 percent in real terms from 2005-2011.

…and they generate expenditure information only, not a complete picture of welfare

A third limitation is more general. ICP 2011 provides a more accurate way of comparing price levels, and the relative expenditure on goods and services, across economies. The resultant data are thus subject to the usual limitations of GDP for making welfare comparisons, for example, in terms of ignoring both distributional issues—inequality (as discussed in Section C)—and other determinants of welfare, such as environmental quality.

c. Implications for policymakers

ICP 2011 confirms the global relevance of Indonesia's economy…

The ICP 2011 results are clearly relevant for Indonesia's policymakers, in at least four key ways. First, they confirm that Indonesia's economy is globally significant. Indonesia is the world's 10th largest producer of goods and services, making its ongoing economic development directly relevant to the global economy, with clear potential to act as a regional, and global, "growth pole" (in line with the findings of the World Bank's 2011 *Global Development Horizons* report).

…points to solid progress made in lifting living standards relative to the US…

Second, they suggest that Indonesia may have made more progress in catching up to living standards in advanced economies than suggested by previous estimates of PPP per capita expenditure. While this is clearly positive, it does not change the need to make more progress in raising average living standards, and in addressing vulnerability and inequality. The emphasis now should be on supporting the continued progress, that can help Indonesia decisively avoid falling into a "middle income trap" (as discussed in the World Bank's recent Indonesia 2014 Development Policy Review, summarized in the March 2014 IEQ).

…and will inform updated estimates of poverty in Indonesia…

Third, the ICP 2011 results will be considered in future global, PPP-based, estimates of poverty in Indonesia, which should adjust for the relative purchasing power of the poor along conceptually similar lines to the international dollar adjustments for expenditures described in this note. However, the new ICP 2011 PPPs cannot be automatically mapped into new poverty estimates, because they do not necessarily capture the prices faced by the poor (price adjustments to make international poverty rate comparisons should specifically reflect the relative costs of poor households' consumption baskets across countries). The PPPs based on the 2005 ICP Round will thus continue to be used for the World Bank's global poverty statistics, but the 2011 Results will eventually inform future updates. PPP estimates can also play an important role in identifying and understanding the consumption of the emerging middle classes in countries like Indonesia.[24]

…as well as being a useful input for long-term macroeconomic management

Fourth, ICP 2011 shows that price levels in Indonesia are well below the global average. Following the recent release of the detailed ICP data, it will be important to examine the key sources of these price differences. This may also shed insights on how relative price differences across sectors, for example, between investment and consumption, are influencing economic structure and may be reflective of deeper policy issues. As Indonesia's economy continues grow and develop, it is reasonable to expect prices generally to converge with higher world prices. This, in turn, would feed into trend real currency appreciation (by reducing foreign currencies' purchasing power in Indonesia). Thus, it will be important to consider the broader implications of these new estimates for expectations of future price growth and the impact on the exchange rate.

[24] See, for example, Homi Kharas, 2010, "The Emerging Middle Class in Developing Countries", OECD Working Paper 285.

C. Indonesia 2015 and beyond: A selective look

1. Inequality and opportunity in Indonesia

a. Overview: rising inequality matters to the people of Indonesia

Inequality was a major media issue in the lead up to the Indonesian presidential election

Inequality was a key issue in the run-up to the recent Indonesian presidential election. Major national and international media outlets reported on rising inequality in Indonesia. Both presidential candidates made public statements about their concerns about this trend and stated their strategies to combat it during the first televised presidential debate on economic development and national welfare.

The majority of survey respondents think that Indonesia has become too unequal

A survey conducted by Lembaga Survei Indonesia in 2014 found that, while most respondents are prepared to tolerate some degree of inequality, the majority feels that Indonesia is significantly more unequal than it should be and that the country has become more unequal in recent years.[25] Those surveyed had a strong preference for greater equality of incomes and were willing to accept slower overall economic growth to achieve it. The survey found that people greatly underestimate how much of total national income goes to the rich.

Little is known about inequality in Indonesia and its underlying drivers; further analysis is key for the design of appropriate policies

Past academic and policy research has tended to focus more on poverty than inequality. Alongside other research institutions paying greater attention to inequality, the World Bank has launched a research project on inequality in Indonesia. The research is still underway and will be published in 2015. This section presents some of the initial findings on why inequality is growing in Indonesia and why it matters for policy. Further work will explore the causes of inequality in order to identify how government policy can be shaped to mitigate or reverse this trend.

Inequality in Indonesia has been steadily rising since 2000

Inequality, as measured by the Gini coefficient, increased by 11 percentage points between 2000 and 2013. The true level of economic inequality in Indonesia is likely to be even higher because the data used to measure it do not adequately represent rich households. Even so,

[25] Lembaga Survei Indonesia, 2014, *Inequality Perceptions Survey.*

the measured level of inequality is much higher than most people think, and strikingly higher than they would like it to be according to the above-cited survey.

Unequal access to assets and good job opportunities is driving inequality, undermining *current* growth and poverty reduction

Members of rich Indonesian households have access to assets, such as real estate and stocks, which have allowed their wealth to grow quickly. At the same time, with better education, they are able to find better jobs to boost their incomes. Those from poorer households, however, lack financial assets and can only improve their income through work. Most of the jobs created in Indonesia since 2001, and indeed most current jobs, are in low productivity sectors, resulting in low real labor incomes, particularly for the poor and the vulnerable. In addition, these workers have restricted access to formal worker protection. Limited access to good job opportunities also undermines current economic growth, since Indonesia is not maximizing the productive potential of its current labor force, exactly at the time when the demographic dividend is peaking. As they struggle to move upwards, many households are vulnerable to shocks and unexpected events and, without coping mechanisms, are at risk of falling back into poverty.

Unequal opportunities during childhood also compromise future growth and poverty reduction

According to World Bank estimates, one-third of inequality is due to circumstances that are beyond the control of individuals, such as their birth place and the education of their parents—that is, due to inequality of opportunities. Many of these differences originate during childhood, for example, if children grow up without proper housing, water and sanitation, or quality health and education services. Failing to realize the full potential of all Indonesian children today compromises future economic growth, as well as further poverty reduction.

Inequality is not a necessary part of the development process…

Other countries have achieved economic growth without significantly increasing their inequality levels. Historically, Japan, South Korea and Taiwan all saw strong growth over a number of decades with low inequality. Indonesia, on the other hand, experienced the largest increase in inequality in the region between the 1990s and the 2000s, after China. During the same period, countries like Thailand, Vietnam and the Philippines have all enjoyed periods of strong growth with stable or declining inequality.

…and the vast majority of Indonesians want the new government to tackle the problem of inequality

About 83 percent of surveyed Indonesians believe that it is 'urgent' (39 percent) or 'very urgent' (44 percent) that the Government tackles inequality.[26] The forthcoming World Bank report on inequality will provide policy options based on the analysis of the drivers of inequality and lessons learned from other countries, building on current policies and programs. In general terms, key policy priorities include increasing access to productive livelihoods, ensuring access to quality basic education, health, water and sanitation for all, and expanding social protection.

b. Inequality in Indonesia is high and the gap between rich and poor is widening

Inequality in Indonesia has been steadily increasing since 2000

Inequality in Indonesia as measured by the Gini coefficient (see Box 5) changed little between 1980 and 1996. It fluctuated between 32 and 34 points, rising only to 36 in 1996 (Figure 37).[27] This changed in the wake of the 1997/1998 Asian financial crisis. Urban and wealthier Indonesians were not only the hardest hit by the crisis but also the slowest to recover. Consequently, inequality fell from 36 percentage points in 1996 to 30 by 1999. Following the recovery from the crisis, Indonesia experienced a period of strong economic growth, driven in part by a commodity boom and strong domestic consumption. During this period the Gini coefficient climbed from 30 percentage points in 2000 to 42 by 2013. Comparing consumption levels across households, in 2002 the average consumption per person of the richest 10 percent of households was 6.6 times that of the poorest 10 percent; by 2013, this had risen to 10.3 times. As a consequence, the richest 10 percent now account for nearly a third of all household consumption in Indonesia, and the richest 20 percent for nearly half (Table 8). The poorest 40 percent, on the other hand, account for only a fifth of consumption and their share has been declining over time.

[26] See previous footnote.
[27] Changes in survey methodology mean the data are not necessarily consistent over time.

Box 5: The challenge of measuring inequality and comparing across countries

The Gini coefficient is the most commonly used measure of inequality. It lies between 0 (perfect equality) and 1 (complete inequality), with a typical range of 0.3 to 0.5. Often this is expressed in percentage points between 0 and 100. Gini coefficients are conventionally calculated from either income or consumption distributions. For more information on the Gini coefficient and Theil measures (used for some of the following analysis), see Haughton and Khandker, 2009, "Handbook on Poverty and Inequality" and the March 2011 *IEQ*.

Comparing the Gini coefficients or any inequality measure across countries is very difficult. First, different countries use different welfare measures. Some, such as Malaysia and many Latin American countries, use household income, while others, such as Indonesia and most of Asia, use household consumption. Since richer households do not spend all of their income, but instead save a portion, income Gini coefficients are usually higher than consumption Gini coefficients in any given country. The average difference is 7.5 points; in Indonesia it is around 6 points (based on the average difference between the income and consumption Gini coefficients from 1984 to 1993, the last time income data were available), suggesting the current consumption Gini coefficients of 41 could represent an income Gini coefficients of around 47. Consequently, Indonesian inequality often seems lower than that of other countries which use income Gini coefficients, when it is actually comparable, or perhaps even higher.

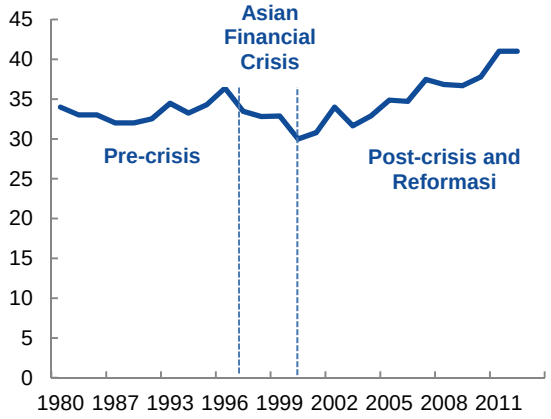
Even when countries use the same welfare measure, they often define and measure it differently. For example, Indonesia includes imputed housing expenditures for homeowners, one-off durable good purchases, and own-production food consumption. Vietnam does the same but uses annual durable depreciation instead, while India omits imputed rents and own-production consumption altogether. Moreover, the way in which consumption is asked about in a household survey also affects the result. Consequently, comparing inequality over time within the same country is more useful than comparing levels across countries.

Most people accurately perceive that inequality is rising, but levels of inequality are higher than they imagine…

Over 90 percent of respondents from the above-mentioned *Inequality Perceptions Survey* said that Indonesia was 'unequal', 40 percent of whom thought that it was 'very unequal'. These people estimated that the richest 20 percent receive 38 percent of total national income, almost four times what they thought was received by the bottom 20 percent (7 percent of national income). While the poor do in fact have about the same share of consumption as the survey respondents believed, the richest 20 percent of Indonesians in national surveys consume almost 48 percent of the total. This is 10 percentage points more than suggested by those surveyed.

Figure 37: Inequality in Indonesia has been steadily rising since 2000

(household per capita consumption Gini coefficient, percentage points)



Source: Susenas; World Bank staff calculations

Table 8: The richest 20 percent of households now account for nearly half of all consumption in household surveys

(share of total household consumption, percent)

	2002	2006	2010	2013
Poorest quintile	10.8	10.2	9.3	8.9
Quintile 2	13.7	13.2	12.5	11.8
Quintile 3	16.5	16.0	16.1	15
Quintile 4	20.4	21.4	21.6	20.6
Richest quintile	38.5	39.1	40.6	43.7
Richest decile	25.2	24.6	26.0	28.7

Source: Susenas; World Bank staff calculations

…and the measured level likely understates the true level

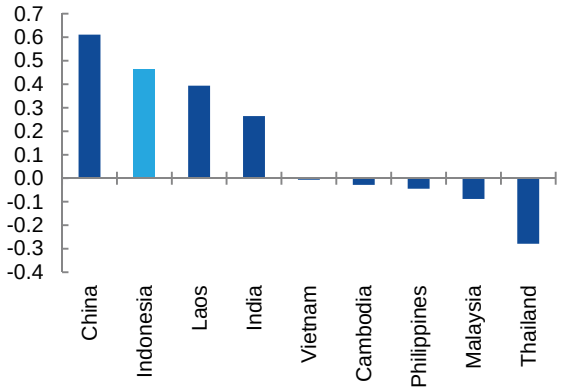
Indonesia's actual level of inequality is most likely even higher than the measured level. Accurately measuring inequality requires collecting data from a representative sample of all households, from the poorest to the richest. In Indonesia, however, it appears that the richest households are under-reporting consumption or missing from the data altogether. According to the National Socio-economic Survey (Susenas), which is used to estimate inequality, only 5 million people (or 2 percent of the population) consumed more than IDR 2 million per month during 2012, and only 1.3 million (0.5 percent) more than IDR 4 million

per month. Meanwhile, only around half of the owners of private passenger cars registered with the police are found in Susenas. If half are missing, then the true Gini coefficient is likely to be significantly higher. The World Bank's forthcoming inequality report will attempt to correct this problem by using non-survey methods to estimate how many Indonesians are at the upper end of the income distribution.

Inequality in Indonesia is rising more quickly than in regional neighbors, many of which have stable or falling inequality

Although comparing levels of inequality across countries is difficult, due to differences in definitions and measurement (see Box 5), Indonesia stands apart from many of its neighbors. The country experienced the second-fastest (and largest) rise in the Gini coefficient in the region over the past two decades, increasing by around 0.5 percentage points per year between 1990 and 2011, almost all of which occurred since 2000. Only China, with an annual rise 0.6 percentage points per year, saw a faster increase (Figure 38). Moreover, other countries in the region that also enjoyed strong economic growth over the same period, such as Vietnam, Malaysia and Thailand, experienced flat or even declining inequality.

Figure 38: Indonesia has experienced the second-fastest increase in inequality in the region after China
(annual average change in Gini over 1990- 2011 period, points)



Note: Consumption Ginis for all countries except Malaysia, which uses income. The periods for each country are: Indonesia 1990-2011; Malaysia 1992-2009; Lao PDR 1992-2008; China 1990-2008; Vietnam 1992-2008; Thailand 1990-2009; the Philippines 1991-2009; and Cambodia 1994-2008
Source: Kanbur, Rhee and Zhuang, 2014, "Inequality in Asia and the Pacific", from PovCalNet (available at http://iresearch.worldbank.org/PovcalNet); World Bank staff calculations

c. Increasing inequality is being driven partly by higher wage and non-wage inequality

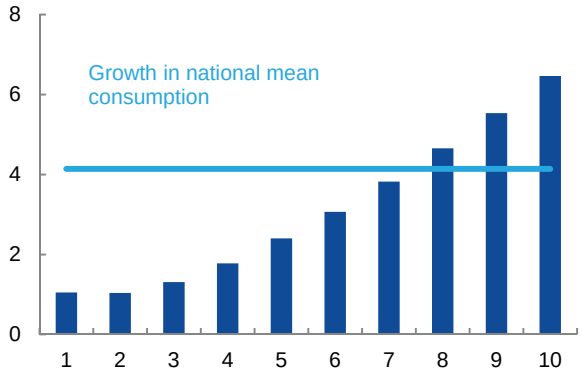
The rich have benefited far more from economic growth than the rest of the population of Indonesia

In Indonesia, all households have seen rising real consumption over the past decade, but it has been highest for the wealthier, who are pulling away from the rest of the country. Between 2003 and 2010, consumption for the poorest 40 percent grew at only 1-2 percent per year, while the richest 10 percent, as measured by the household survey, enjoyed consumption growth of 6.5 percent and the second richest 5.5 percent (Figure 39). Growth for the bottom seven deciles was below the growth in the national mean.

The rich tend to stay rich over time, the mobility of the poor has been improving

Richer households also were much less likely to change their relative position than other quintiles in the distribution. Of the individuals with total personal income in the top 20 percent of Indonesians aged between 25 and 34 years in 1993, nearly two-thirds remained in the top quintile 14 years later. Conversely, individuals in all of the other quintiles experienced much greater relative movement over the period, both upwards and downwards (Table 9). The poor, however, had a reasonable chance of moving into higher income levels within their lifetime. Of those in the poorest income quintile in 1993, 65 percent had reached a higher income quintile by 2007; 19 percent even reached the top two quintiles.

Figure 39: The richest households have seen much higher growth in consumption than poorer households
(average annual real consumption growth 2003-10, percent, by household decile)



Source: Susenas; World Bank staff calculations

Table 9: The composition of the richest quintile of income earners is relatively sticky; more mobility in other quintiles
(transition matrix of percent of 1993 income quintiles in 2007 quintiles)

	07 Q1	07 Q2	07 Q3	07 Q4	07 Q5
93 Q1	35	32	15	15	4
93 Q2	34	25	27	9	4
93 Q3	23	25	34	14	3
93 Q4	14	15	24	26	21
93 Q5	6	4	8	19	64

Note: Total income quintiles for individuals aged 25-34 in 1993, excluding those with zero income
Source: IFLS; World Bank staff calculations

Richer households have benefited through their access to assets…

Based on 2007 data, on average labor income accounts for just over half of all household income, with around another quarter each coming from farm and non-farm businesses.[28] Reported income from capital is minimal. However, many of the rich are not included in survey data, so income in the form of capital gains from stocks and real estates is under-reported. Only wealthier Indonesians have access to these assets, and their returns have been substantial. Between the beginning of 2002 and the end of 2013, the Indonesian Stock Exchange Composite Index increased in nominal value nearly 11 times, averaging compounded increases of 22 percent per year. The corresponding property price index increased in value 12.5 times, averaging 23 percent in annual compounded returns.

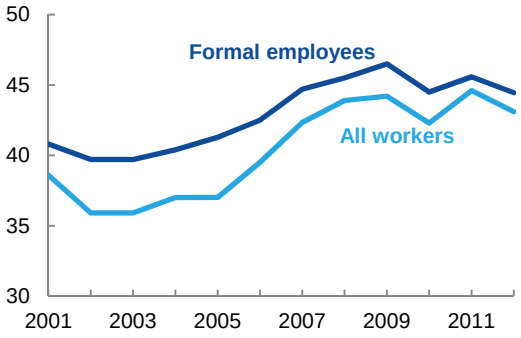
…and from an increasing capital income share while the labor income share has been falling

Not only have many Indonesians not shared the gains from rising asset markets, the wages and salaries upon which they rely have declined as a share of national income. For example, the labor share of income in manufacturing has been falling; it fell 3-4 percentage points between the early 2000s and mid-2000s, reflecting a broader Asian pattern.[29] As the poor do not own capital, an increasing capital income share benefits richer households, further exacerbating inequality.

Inequality from wages, salaries and other work income has also been increasing…

The labor income Gini coefficient rose from 41 to 45 percentage points for formal sector employees between 2001 and 2012, and from 39 to 43 among all workers (Figure 40). An increasing trend is observed if only full-time workers are considered. With much of household income dependent on income from working, significant increases in labor income inequality have a large impact on total household income inequality.

Figure 40: Increasing consumption inequality is being driven partly by increasing inequality in labor incomes
(labor income Gini coefficient, percentage points)



Source: Sakernas; World Bank staff calculations

[28] 2007 Indonesian Family Life Survey.
[29] Zhuang, Kanbur and Maligalig, 2014, "Asia's income inequalities: recent trends", in Kanbur, Rhee and Zhuang (eds.), "Inequality in Asia and the Pacific".

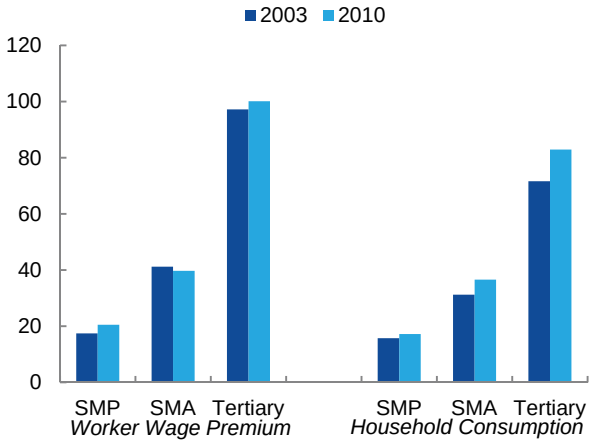
…driven by a widening gap in returns to education

The stakes of finding a good job have been rising, which has increased the gap between workers from richer households and those from poorer households. Compared with workers with a primary education or less, those with junior secondary now enjoy a 20 percent premium, those with senior secondary a 40 percent premium, and those with tertiary earn double (Figure 41). Moreover, the junior secondary and tertiary premium has increased. The gap in wages between the more and less educated then influences consumption inequality. Households whose head has better education have higher consumption, and this gap with poorly educated households has also been increasing over time (Figure 41).

Three quarters of all new jobs since 2001 have required senior secondary education or higher

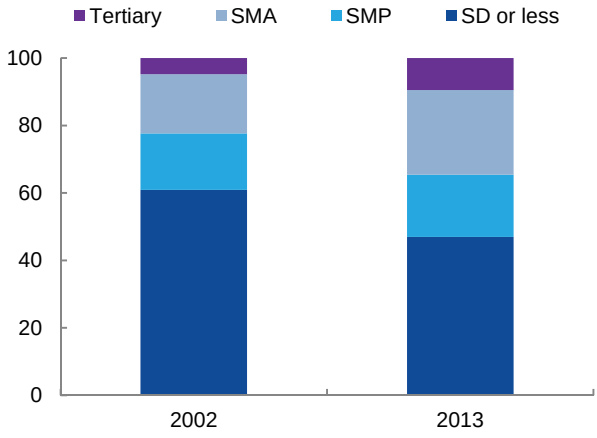
About 19 million net new jobs have been created in Indonesia since 2002. Of these 5.1 million have gone to junior secondary graduates, 11.7 million to senior secondary graduates, and 6.1 million to tertiary graduates. Jobs held by those with primary education or less have actually fallen by 3.8 million in net terms. By 2013, workers with primary education, once a majority, became a minority (Figure 42). Declining demand for less educated workers puts downward pressure on their wages relative to those of more educated workers.

Figure 41: Wage and consumption premiums have been rising for highly educated workers
(wage and consumption premiums to higher than primary education, incremental percent over primary education)



Note: Worker wage premium represents how much higher wages workers at each level of education receive compared with workers with primary education or less, controlling for experience, gender, work status, location and other factors. Household consumption premium represents the same for per capita consumption and head of household's education
Source: Sakernas; Susenas; World Bank staff calculations

Figure 42: Jobs increasingly require more education
(workers by education level, percent of total)



Source: Sakernas; World Bank staff calculations

d. Unequal opportunities during childhood also contribute to higher inequality

Adult inequality often stems from unequal opportunities during childhood; one-third of total inequality is due to circumstances that children are born into or develop soon after

Some inequality is due to circumstances that are beyond the control of an individual, such as gender, ethnicity, birthplace or family background. This type of inequality prevents individuals from achieving their potential, which is unfair to them and lowers Indonesia's overall human capital, reducing growth and productivity. Equality of opportunity, therefore, aims to level the playing field so that these circumstances do not unduly influence a person's chance to succeed. Just three of these factors—the gender of the head of household, his or her level of education, and where the household lives (urban or rural, which region of Indonesia)—explained 33 percent of total consumption inequality in 2012.[30] These

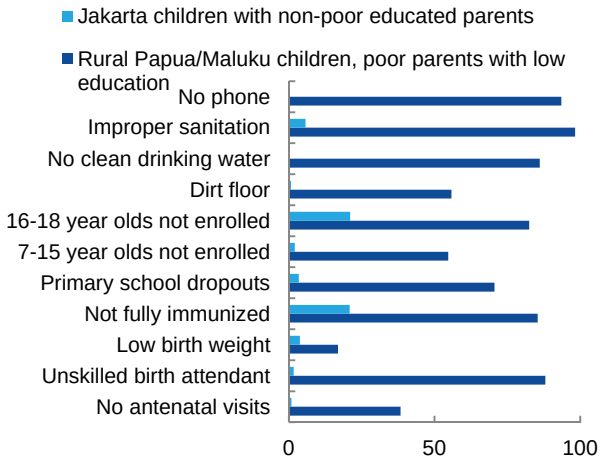
[30] This is the between-group component from decomposing the Theil Index into between- and within-group components using head of household gender and education, urban or rural location, and region of Indonesia based on island groupings. This estimate is preliminary only, and work is ongoing to better understand how birth circumstances contribute to overall inequality, and how this has evolved over time.

circumstances are measured for adults due to data limitations, but are strongly related to the opportunities the adults faced as children—namely, where they were born and what educational opportunities they had. The forthcoming World Bank inequality report will more accurately quantify the degree of adult outcomes due to childhood inequality of opportunities.

Differences in the lives of children with different background in Indonesia can be very stark

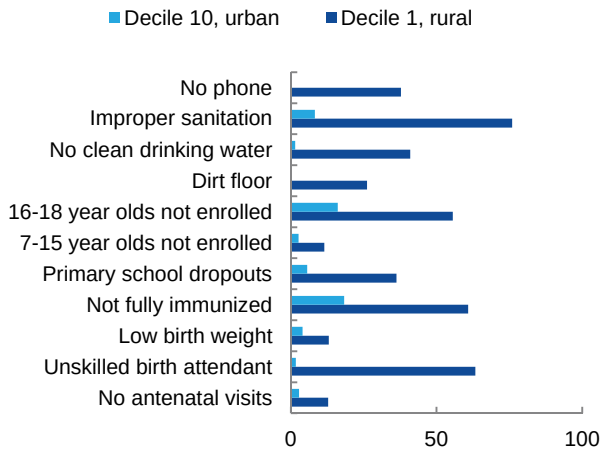
Significant inequality of opportunities can be seen by comparing a child born in Jakarta to non-poor parents who have at least high school education with a child born in a rural area of Papua or Maluku to a poor family with little education. The former has only a 6 percent chance of lacking proper sanitation, compared with 98 percent for the latter child (Figure 43). These differences extend across all other indicators of opportunity, such as access to clean water, having non-dirt floors in the house, primary school enrolment, birth by skilled attendant and immunization coverage. This is true not only when comparing Jakarta and Papua. Generally, children from poor households in rural areas consistently lag behind children from rich households in urban areas on almost every indicator (Figure 44).

Figure 43: There are stark differences in opportunities in life for children in Indonesia…
(lack of access, percent)



Source: Susenas 2012; DHS 2007; World Bank staff calculations

Figure 44: …and major gaps in opportunity exist between rural children born into the poorest decile and urban children born into the richest decile
(lack of access, percent)

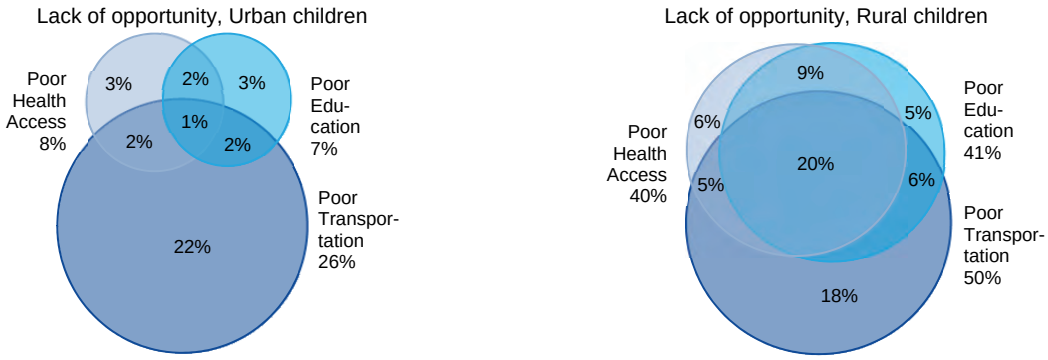


Note: Deciles are national spatially-adjusted real per capita household consumption deciles
Source: Susenas 2012; DHS 2007; World Bank staff calculations

Children in remote and rural areas tend to experience inequality of opportunities on multiple dimensions

Moreover, inequality of opportunities are often experienced on multiple dimensions by the same children. Children in rural areas are more likely to lack proper access to education, health and transportation services than urban children. However, children in rural areas are also more likely to experience a lack of all these opportunities at the same time. Of the 35 percent of all urban children who lack access on at least one of these dimensions, 20 percent lack access on two (Figure 45, where this is represented by areas within two overlapping circles) and only around 3 percent lack access on all three (the area within three overlapping circles). In contrast, 58 percent of children in rural areas lack access on at least one dimension, but furthermore, a third of them lack access on two dimensions and another third lack access on all three dimensions. The situation is even worse in some areas, for example in Papua, where almost all children who lack clean drinking water, proper sanitation or electricity, are deprived on at least two of these dimensions, and the vast majority on all three.

Figure 45: Most rural children without access to health, education and transportation services are deprived on more than one dimension to a greater extent than urban children
(overlapping circles indicate lack of access on two or three dimensions)

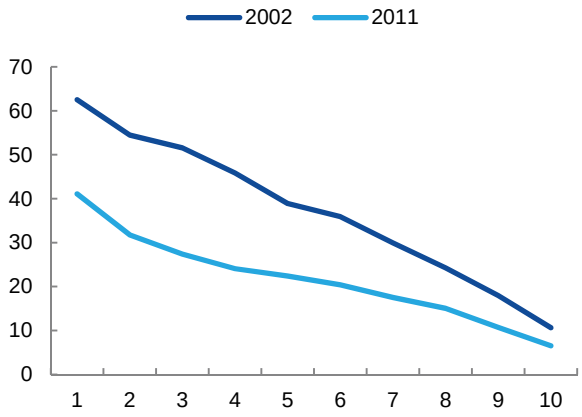


Note: The size of the circle in the Venn diagrams are proportional to the extent of the lack of opportunity
Source: Hadiwidjaja, Paladines and Wai-Poi (2013); Podes; Susenas

Some gaps in access to opportunities have improved over the past decade, leading to children having better outcomes than their parents

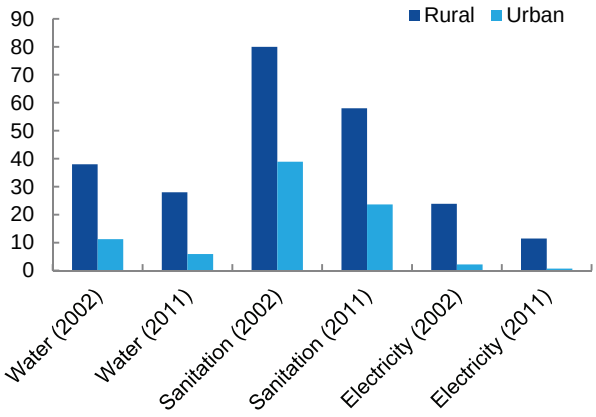
On some dimensions the gap between children from rich and poor families fell between 2002 and 2011,[31] including for most health, education and housing outcomes and opportunities. For example, in 2002 63 percent of children in the poorest consumption decile were delivered by an unskilled attendant, compared with just 11 percent for the richest decile, a 52 percentage-point gap. By 2011, this gap closed to 34 percentage points (Figure 46). Like the gap for rich and poor children, the rural-urban gap has also been closing on many dimensions, such as access to clean drinking water, proper sanitation and electrification (Figure 47). However, the rural-urban gap is closing at a slower rate.

Figure 46: Children from poorer households start further behind in life, but the gap is closing
(share of children not delivered by a skilled birth attendant by household per capita consumption decile, percent)



Source: Hadiwidjaja, Paladines and Wai-Poi (2013); Susenas

Figure 47: Opportunity gaps between urban and rural households are closing, but at a slower pace
(lack of access, percent)



Source: Hadiwidjaja, Paladines and Wai-Poi (2013); Susenas

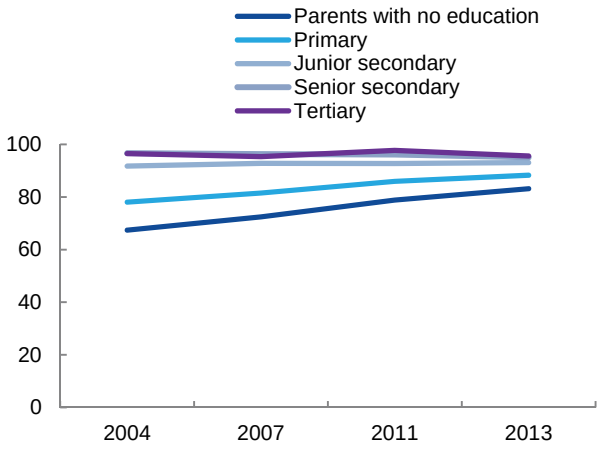
Gaps in access to education have also been closing, but inequality in the quality of services persists

Substantial and sustained government efforts to expand educational access over the past 40 years have given children from poorer or less educated families a greater chance of achieving higher education levels. Enrolment rates among 13-15 year olds (Figure 48) whose parents had a primary school level of education or less have increased in the past decade. They are converging with the already high enrolment rates of children of parents who have a junior secondary level of education or higher. Closing school enrolment gaps has provided poor children with opportunities to improve their education outcomes for many years now.

[31] Hadiwidjaja, Paladines and Wai-Poi, 2013, "Child Multidimensional Poverty in Indonesia".

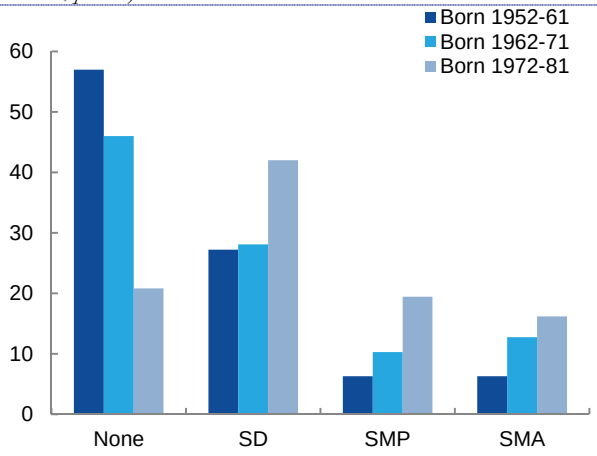
Adults whose parents had little education have been increasingly likely to achieve a higher level of schooling themselves. For example, nearly 60 percent of people born between 1952 and 1961 into a household where the parents had no education, also received no education themselves. For those born during 1962-71, this rate dropped to 45 percent, and to just 21 percent for those born 1972-81 (Figure 49). However, measures of access and opportunity, especially in health and education, do not reflect the quality of services received. Children in poorer or more remote areas not only participate less in these services, but when they do, the quality is often lower.

Figure 48: Enrolment rates of children with less educated parents are converging…
(enrolment rate of children aged 13-15, by parents' final education , percent)



Source: Susenas; World Bank staff calculations

Figure 49: …and children born to parents with no education are achieving greater educational attainment
(2007 final educational attainment for children whose parents have no education, percent)



Source: IFLS; World Bank staff calculations

e. Lack of proper protection from shocks also makes it harder for households at the lower end of the distribution to climb up

Households face a number of risks at the individual, household, local and national levels

Indonesian households have faced a number of negative economic shocks and natural disasters in the last 15 years. The country was the worst affected by the Asian financial crisis in 1997-98. During the 2008-09 global financial crisis, it saw growth slow but it fared better than most. Indonesians have also faced periods of high food prices, such as in 2005-06, 2008 and 2010. Major recent natural disasters include the 2004 tsunami which devastated Aceh, earthquakes in a number of locations, and the 2010 eruption of Mount Merapi. These economic shocks and disasters highlight the substantial risks that households face on an ongoing basis. Risks specific to particular individuals or households are just as important. These include loss of employment, illness and accidents, death of a spouse, or divorce. For many households, such a shock is sufficient to push them back into poverty.

Many households lack the access to proper coping mechanisms that richer ones have

When households experience a shock, they need to find a way to respond. However, many households lack access to some of the better coping mechanisms that richer households can use. For example, buying health insurance to cover medical costs during a serious illness or accident means a household is not faced with large financial costs when the event occurs. Those households without insurance face the choice of not treating the individual, using what little savings they have, selling their assets (which their livelihood often depends upon), or reducing spending in a way that negatively affects future generations, such as on education. They can also borrow from friends and family, but in Indonesia this can be inadequate to deal with severe shocks (Box 6), especially if the shock is being experienced simultaneously by many people in the community, as in the case of a natural disaster.

As a consequence, individuals can struggle to move economically upwards because new shocks send them back down

Even when individuals get a good education and find a good job, the presence of shocks and the lack of mechanisms to properly cope mean that they can find it difficult to rise up the income distribution. This is particularly so for the poor, who have the weakest coping mechanisms. Of the poor in 2008, 75 percent failed to exit poverty or vulnerability by 2010 (Figure 50). While this was often due to lack of productive employment, some of it was due to shocks. 15 percent of the poor actually left poverty in 2009, but were poor again in 2010. Without effective means to deal with shocks, the ability to earn more over a sustained period and to climb the distribution remains limited. This applies not just to the poor but to the majority of Indonesians.

Figure 50: 75 percent of poor households do not move out of poverty or vulnerability over a three year period
(2010 status of households who were poor in 2008, percent)

Note: Poor are those beneath the official poverty line; vulnerable are those between the poverty line and 1.5 times the line
Source: Susenas; World Bank staff calculations

Risk can also lead households to make safe but low-income choices

Not only can shocks prevent those who find productive livelihoods from rising, but fear of risk—and a lack of mechanisms to effectively deal with it—can mean that people avoid risky but potentially rewarding activities in the first place. This is emphasized in the World Bank's 2014 World Development Report *Risk and Opportunity: Managing Risk for Development.*[32] It observes that "realizing that a negative shock can push them into destitution, bankruptcy, or crisis, poor people may stick with technologies and livelihoods that appear relatively safe but are also stagnant," pointing out that not only does this prevent people in the bottom half of the distribution from rising upwards, it also adversely affects national development through underinvestment in productive work.

Box 6: Main findings from new research on risk and risk management in Indonesia

Drawing primarily on original qualitative evidence from four rural and peri-urban sites, a forthcoming World Bank study explores in-depth the risks faced and risk management practices adopted at the household and community level in Indonesia. Three interrelated research questions are studied: which risks and shocks do households and communities face most frequently and severely? Who or what do households rely upon to address these risks and shocks? Which specific household or community-level factors lead to greater exposure to risks and/or use of specific risk management methods?

Five key messages emerge from this work. First, the rural poor and near-poor face a wide variety of risks and shocks. Among these, economic and health shocks are the most important. In addition, the study examines a less commonly discussed risk, which arises from the high cost of participating in customary lifecycle rituals. Second, despite the expansion of formal social assistance, informal coping mechanisms, such as borrowing from friends and family, are by far the most common way in which households and communities manage the risks and shocks they face. Third, informal resources shared between households or within communities are often inadequate to manage the most devastating individual and households shocks, or shocks that affect entire communities at once, such as natural disasters. Informal resources are also inadequate when households confront multiple shocks at the same time or in quick succession. Fourth, social assistance, especially in the form of programs that address health and environmental shocks, plays an important role– but coverage and benefit levels remain insufficient. Fifth, building adequate systems that provide protections against risks and shocks is a central concern of policymakers – these findings suggest that there are important uncovered risks in the lifecycle that may be better addressed by formal assistance.

Source: World Bank (forthcoming), Informal Risk Management and Vulnerability among the Poor in Indonesia: A Study of Four Villages

[32] The report is available at http://www.worldbank.org/wdr2014/.

f. Inequality can also lead to lower growth, slower poverty reduction, and more conflict

Rising inequality can slow down poverty reduction

In addition to considerations of fairness and equity, inequality also matters for other reasons, including social, political and economic stability. While the poor cannot get good jobs because they lack sufficient education, many non-poor with better education also still cannot find productive work. As mentioned above, most current jobs, and most job creation over the past decade, has been in low productivity sectors and most workers have limited access to formal worker protection. Consequently, people from poorer households struggle to earn their way out of poverty.

Higher inequality can also lead to slower economic growth…

Insufficient productive jobs also undermine Indonesia's current growth by not maximizing the productive contribution of the labor force at the time when the demographic dividend is peaking. High inequality can also affect economic growth in other ways. The extent to which households in the bottom 40 percent are unable to move into the middle class could weaken expected future middle class-driven consumption growth. This may also reduce economic growth through a number of other channels, such as low investments in human capital and decreased entrepreneurial activity. Also, inequality of opportunities can impact on the ability of children today to realize their full potential, affecting growth in the future. Some inequality is needed for growth, as differential rewards provide the incentives for hard work and innovation. In Indonesia, preliminary findings suggest that higher levels of inequality at the district level are related to higher growth, but after a certain point, higher inequality may hurt growth.[33]

…and slower growth can further hamper poverty reduction efforts

Poverty generally falls with economic growth, but the speed of poverty reduction depends on how equally growth is shared. If the pattern of growth benefits the rich more than the poor, the pace of poverty reduction slows. Estimates suggest that Indonesia's strong growth over the last decade could have been sufficient to eradicate poverty. The average growth effect—assuming all households receive the average growth equally—would have reduced poverty from 17.4 percent in 2003 to 0 percent by 2010.[34] This would have almost eliminated poverty in Indonesia if all households received average growth equally.[35] However, the unequal distribution of this growth meant that poverty fell only 5.4 percentage points instead, to 12.0 percent. The degree of inequality, therefore, affects the extent to which Indonesia can realize its poverty reduction targets.

Inequality also contributes to conflict and social tensions

When inequality increases, the differences between household standards of living becomes more noticeable. This may lead to jealousy and conflict. New research on the effects of inequality in Indonesia shows that as districts become more unequal they are more likely to experience conflict. On average, a district with a Gini coefficient of 30 experiences around 30 percent more violent incidents than one with a Gini coefficient of 20. For a district with a Gini coefficient of 40, violence increases by 60 percent.[36] More conflict is detrimental socially and politically, but can also create another channel by which economic growth and poverty reduction are slowed down.

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[33] Yumna, Rakhmadi, Hidayat, Gultom, Suryadi, 2014 (forthcoming),"Estimating the Impact of Inequality on Growth and Unemployment in Indonesia".

[34] Based on World Bank research that decomposed historical poverty reduction into contributions from average household consumption growth (the effect if all households received the average growth equally) and from the distribution of that growth (the effect if there was no growth and only the observed change in inequality). Applying this to Indonesia provides both growth and distribution effects, but also a large (negative) residual. However, the most conservative case for the growth effect can be determined by adding all of this residual to distribution, leaving the *minimum* growth effect on poverty reduction, which is presented here.

[35] In reality, poverty would have been low but non-zero, as some non-poor would fall into poverty after suffering shocks.

[36] Peirskalla and Sacks (2014), "Research Note: Using NVMS Data to Identify Determinants of Political Violence and Social Conflict".

g. There is wide demand for action and a number of key policy messages are emerging

Surveys suggest that most Indonesians want greater equality and are willing to accept slower overall economic growth to achieve it

When asked to choose between two distributions of income—one less equal and one more equal—the majority of surveyed Indonesians chose a more equal distribution.[37] On average, they said that they would prefer the top 20 percent of Indonesians to have around 29 percent of total national income, and they would like the bottom 20 percent to have 13 percent of total national income. Their ideal distribution is not perfectly equal: it still has those at the top with more than twice as much income as those at the bottom. When given the choice, survey respondents said that they would prefer slower growth and falling inequality to faster growth and widening inequality. Respondents also had specific ideas on how to reduce inequality. Some 42 percent said providing work opportunities is the most important way to tackle inequality, while 24 percent favored social protection strategies. Other respondents chose education as the best response (18 percent) or overcoming corruption (18 percent).

Knowing how to respond requires a better understanding of inequality...

The World Bank's ongoing research project on inequality, on which this section draws, aims to provide a better understanding of the causes of inequality in Indonesia. With such diagnostics, Indonesia's new government and policymakers will be in a better position to know the range of policy options available to them and the extent to which they will address the main drivers of inequality in Indonesia.

… and learning from other countries that have reduced inequality while continuing to grow

International experience suggests that rising inequality is neither a necessary outcome of development, nor is it a common trend across the region over the past decade. Thailand, Vietnam and the Philippines have all enjoyed broadly similar levels of growth as Indonesia over a similar period, while seeing stable or falling inequality. Furthermore, the Latin America region—the most unequal in the world—has seen declines in inequality since the late 1990s. Different countries in this region have achieved this in different ways, but there are common lessons and a range of possible policy options.[38]

Government spending and taxation policies have an important role to play in addressing concerns over the distribution of income

The structure of fiscal policy can be an important determinant of inequality trends within an economy. Some forms of expenditure may primarily benefit the rich, such as fuel subsidies, while others may benefit all Indonesians. Examples of the latter include investments in primary health care and education, and in infrastructure to better connect villages to cities, outlying regions to the center, and Indonesia to international markets. The structure of taxation also matters. For example, governments can ask all citizens to pay their fair share. Broadening the tax base to cover more people not only increases the range of growth-promoting and inequality-reducing policies the government can adopt, but it can also lead to a fairer income distribution.

Building the foundation for inclusive growth starts with investing in quality basic education and health for all children…

As highlighted in the World Bank's recently released Indonesia 2014 Development Policy Review, improving local access to services is one of the central priorities for ensuring shared prosperity going forward.[39] Investments in health and education are not only needed to close the remaining disparities in access to these services but, going forward, to address the substantial disparities in the quality of these services between richer and poorer areas. Moreover, greater access to clean water, proper sanitation, and quality housing is vital to support efforts in health and education. Only when all children receive the best start in life can they maximize their potential, which in turn will allow Indonesia to reap greater economic benefits and, at the same time, reduce inequality.

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[37] Lembaga Survei Indonesia (2014), *Inequality Perceptions Survey*.

[38] See, for example, World Bank, April 2012, "Inequality in Focus".

[39] World Bank (2014), "Indonesia Development Policy Review 2014: Avoiding the Trap". The report is available at http://www.worldbank.org/en/news/feature/2014/06/23/indonesia-2014-development-policy-review and is summarized in the March 2014 *IEQ*.

…ensuring all people have access to productive livelihoods…

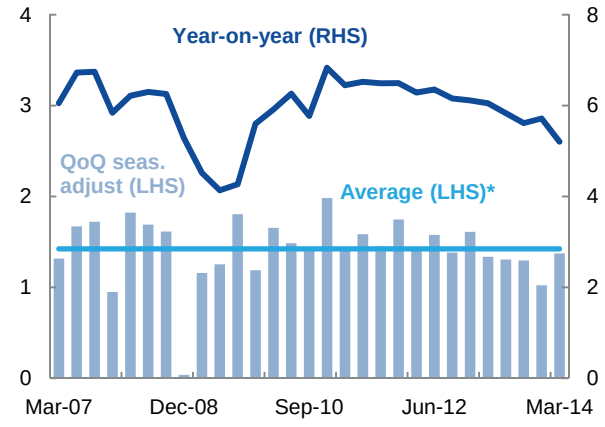
Next, educated and healthy Indonesians need productive livelihoods. This means the creation of more skill-based jobs, and ensuring that school graduates have the right skills to fill them. This, in turn, requires investments to close Indonesia's long-standing infrastructure and skills gaps. It also means an open economic environment that promotes the continued rise of Indonesia up the value ladder, including labor regulations that benefit both workers and businesses, a positive investment climate, efficient and transparent rules and regulations for business, and a bureaucracy free from corruption and inefficiency. As set out in the Development Policy Review, the implementation of such a productivity-driven growth strategy is required to unleash the potential of the economy, to boost growth and share prosperity more widely.

…and are protected from shocks

Many Indonesians work hard at school, stay healthy, and get good jobs. But they still face many risks in life, and shocks can take away their hard-won gains. The Government can help protect households from such shocks, whether to health, employment, or the cost of living. First, this means promoting greater access to insurance to allow those who can afford it to protect themselves, while extending insurance to those who cannot afford it. Getting the new social security programs right will be essential. Second, it is necessary to expand and improve the current social safety net to effectively provide all the poor and vulnerable with the support they need to cope with the many serious risks they face in life. Third, continuously enhancing the management of disaster risks and further building resilience is needed so as to safeguard hard-fought poverty reduction and income gains.

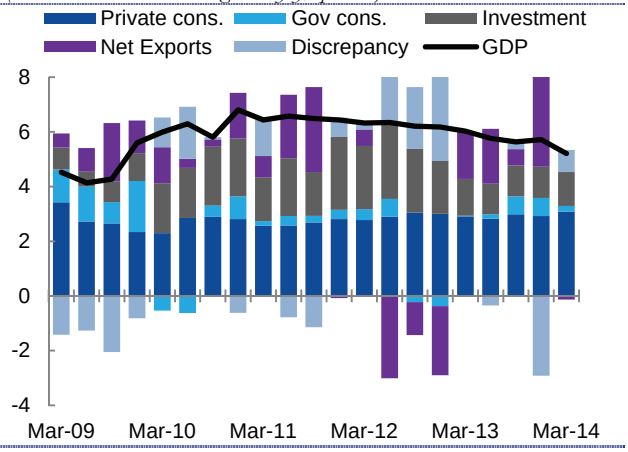
APPENDIX: A SNAPSHOT OF INDONESIAN ECONOMIC INDICATORS

Appendix Figure 1: Quarterly and annual GDP growth
(real GDP growth, percent)



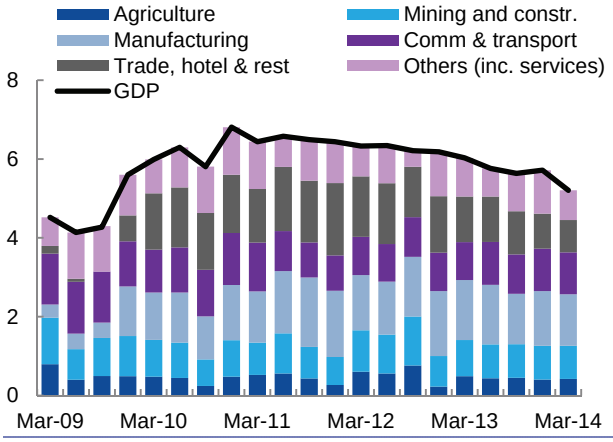
Note: *Average QoQ growth, Q1 2007–Q1 2014
Source: BPS; World Bank staff calculations

Appendix Figure 2: Contributions to GDP expenditures
(contribution to real GDP growth yoy, percent)



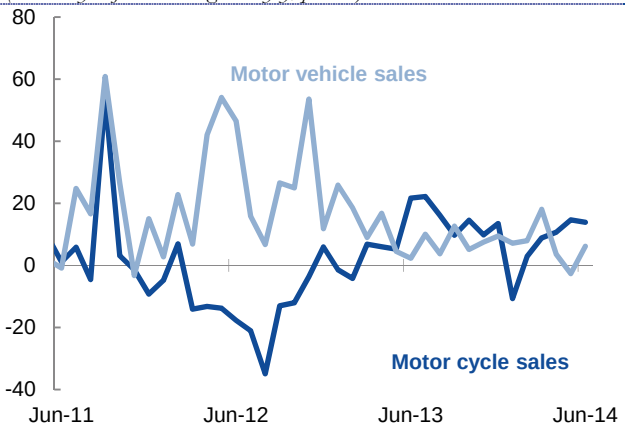
Source: BPS; World Bank staff calculations

Appendix Figure 3: Contributions to GDP production
(contribution to real GDP growth yoy, percent)



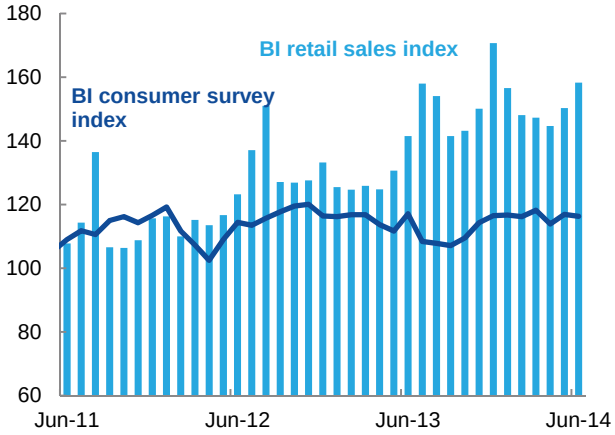
Source: BPS; World Bank staff calculations

Appendix Figure 4: Motor cycle and motor vehicle sales
(seasonally-adjusted sales growth yoy, percent)



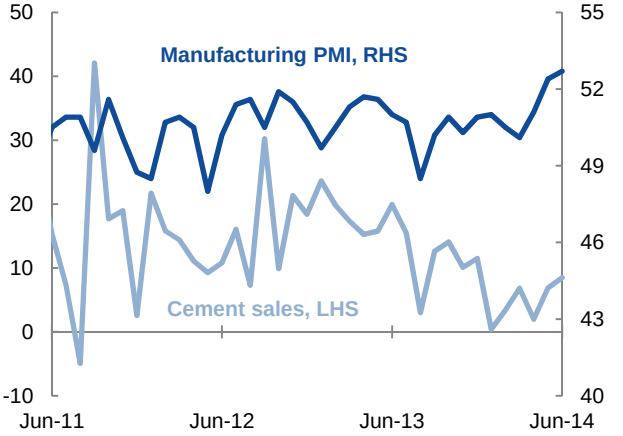
Source: CEIC; World Bank staff calculations

Appendix Figure 5: Consumer indicators
(retail sales index 2010=100)



Source: BI

Appendix Figure 6: Industrial production indicators
(PMI diffusion index and cement sales seasonal-adjusted growth yoy, percent

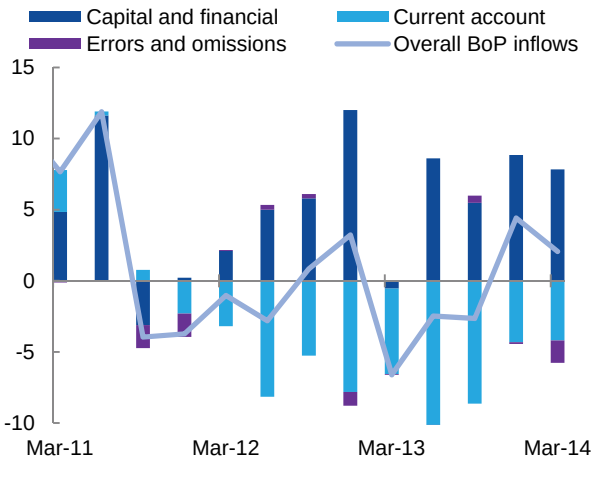


Source: BPS; Markit HSBC Purchasing Managers Index

Appendix Figure 7: Trade volumes
(growth yoy, percent)

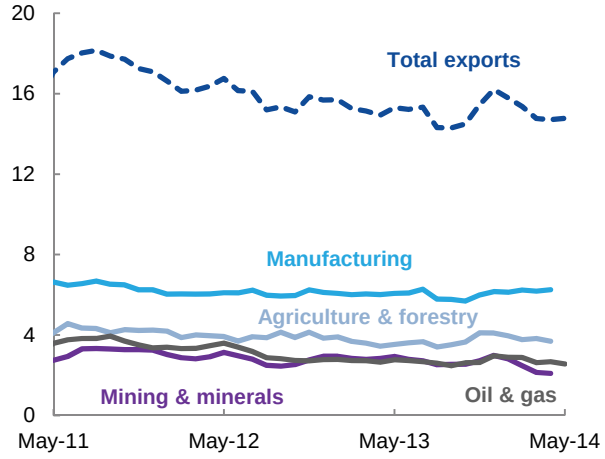
Source: BPS

Appendix Figure 8: Balance of payments
(USD billion)



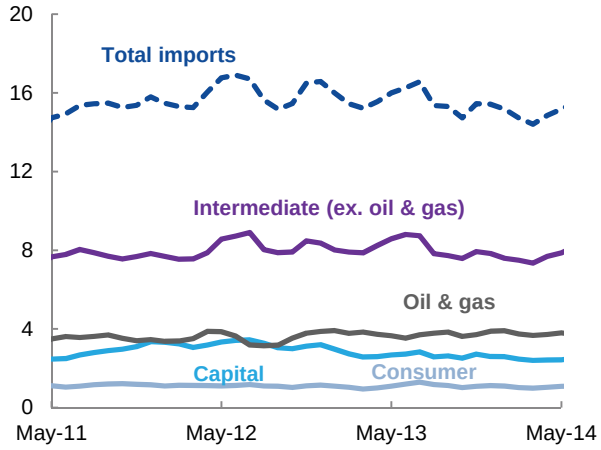
Source: BI

Appendix Figure 9: Exports of goods
(3-month moving average, USD billion)



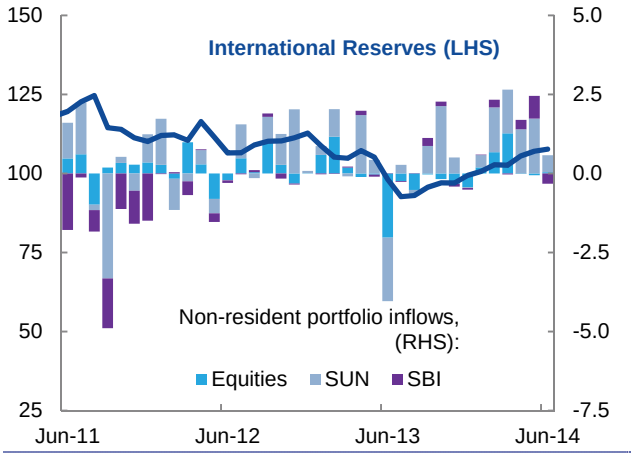
Source: BPS

Appendix Figure 10: Imports of goods
(3-month moving average, USD billion)



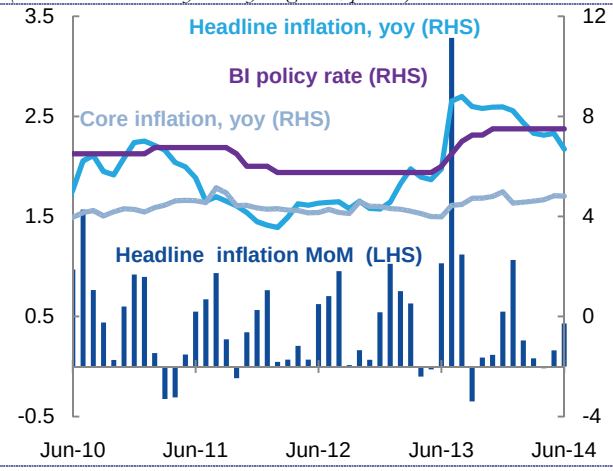
Source: BPS

Appendix Figure 11: Reserves and capital inflows
(USD billion)



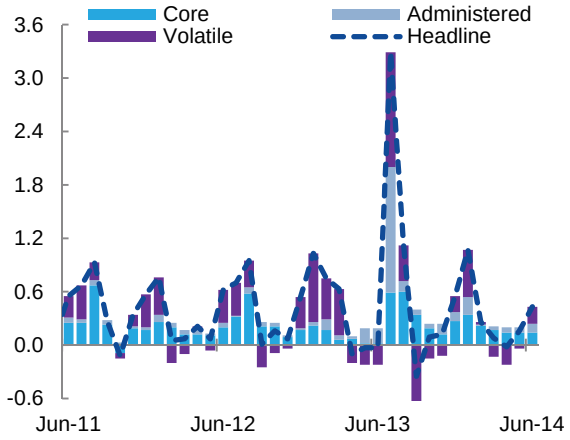
Source: BI; CEIC; World Bank staff calculations

Appendix Figure 12: Inflation and monetary policy
(month-on-month and year-on-year growth, percent)



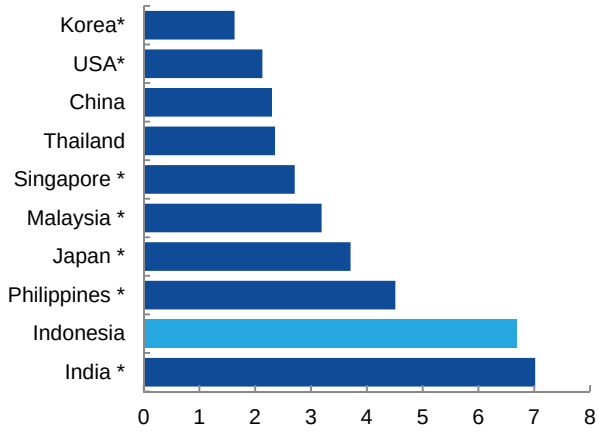
Source: BPS; World Bank staff calculations

Appendix Figure 13: Monthly breakdown of CPI
(percentage point contributions to monthly growth)



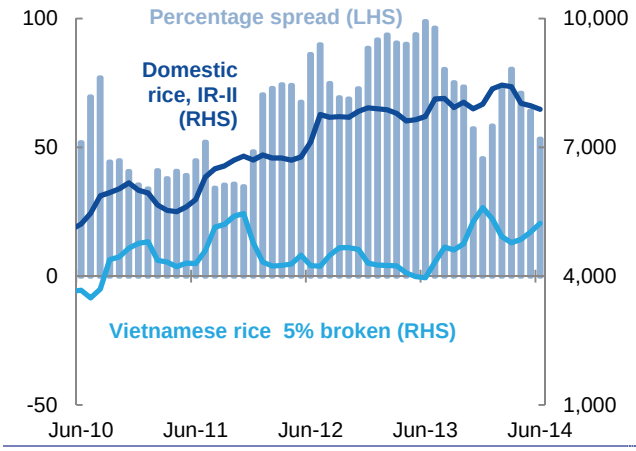
Source: BPS; World Bank staff calculations

Appendix Figure 14: Inflation comparison across countries
(year-on-year, June2014)



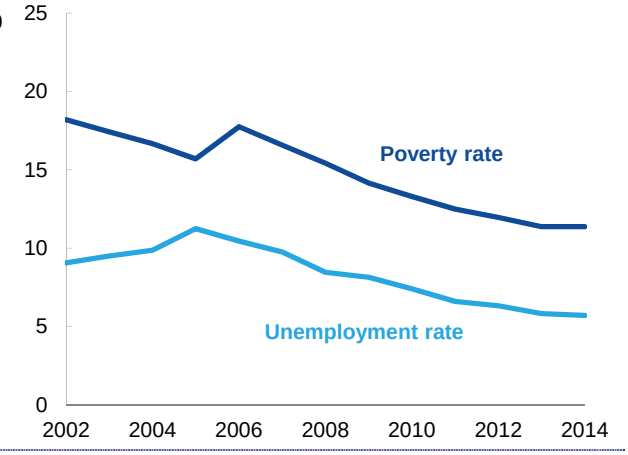
*May is the latest available month
Source: National statistical agencies via CEIC; BPS

Appendix Figure 15: Domestic and international rice prices
(percent LHS, wholesale price, in IDR per kg RHS)



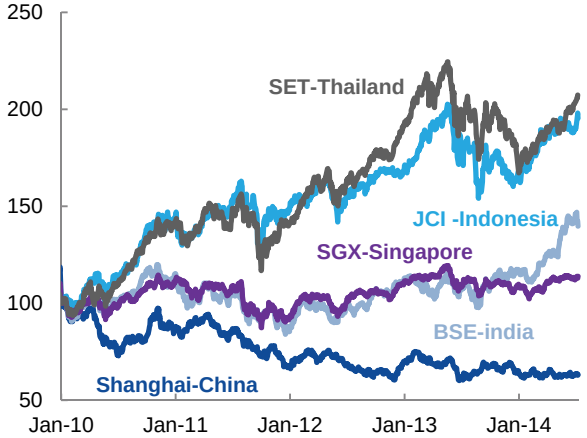
Source: Cipinang wholesale rice market; FAO; World Bank

Appendix Figure 16: Poverty and unemployment rate
(percent)



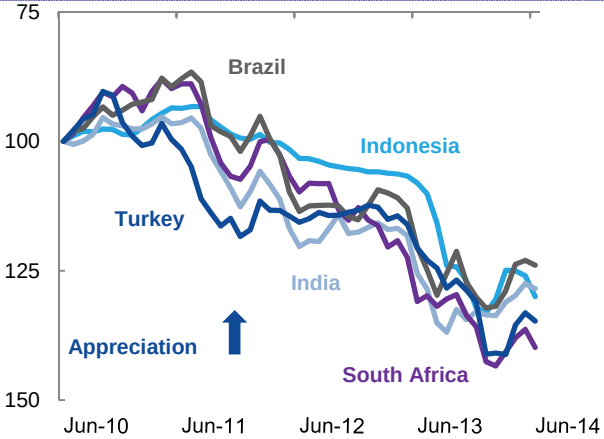
Source: BPS

Appendix Figure 17: Regional equity indices
(daily index January 4 2010=100)



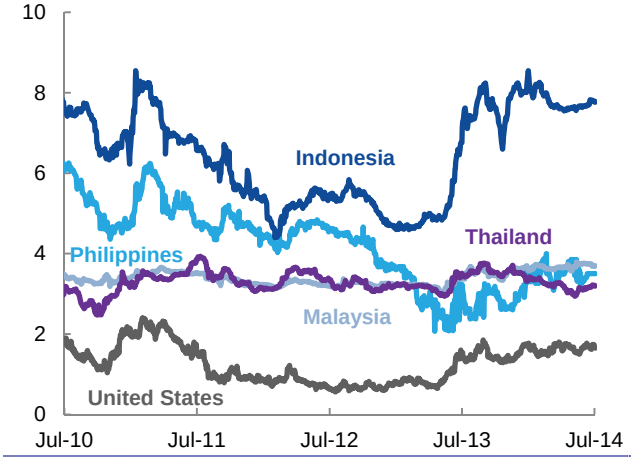
Source: CEIC; World Bank staff calculations

Appendix Figure 18: Selected currencies against USD
(monthly index June 2010=100)



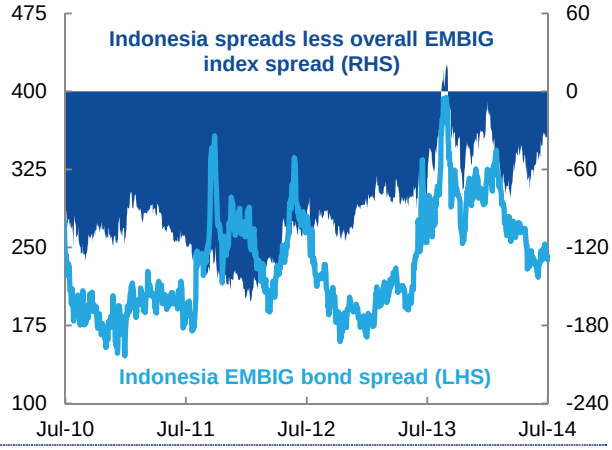
Source: CEIC; World Bank staff calculations

Appendix Figure 19: 5-year local currency govt. bond yields
(daily, percent)



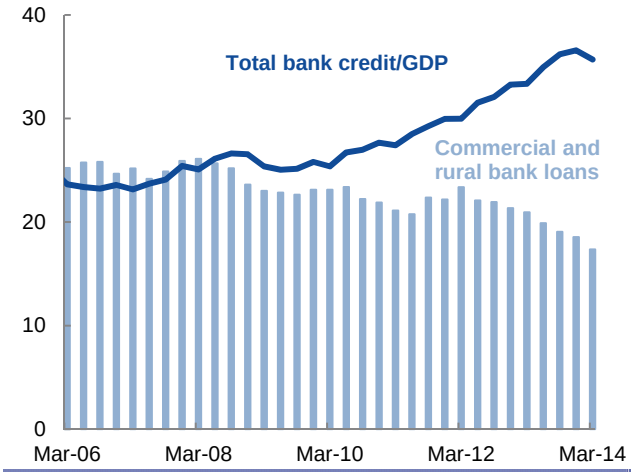
Source: CEIC

Appendix Figure 20: Sovereign USD bond EMBIG spread
(daily, basis points)



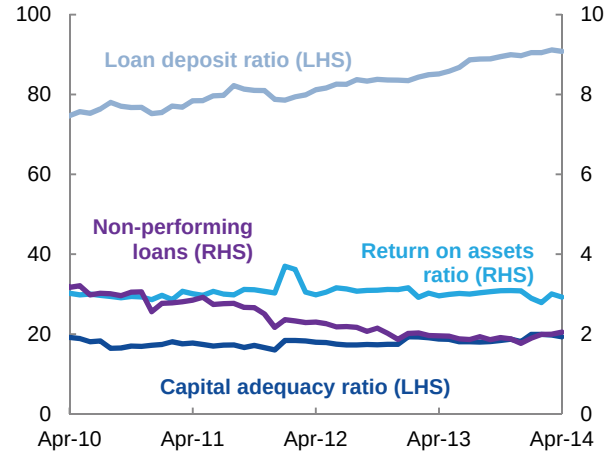
Source: JP Morgan; World Bank staff calculations

Appendix Figure 21: Commercial and rural credit bank credit growth
(growth year-on-year, percent)



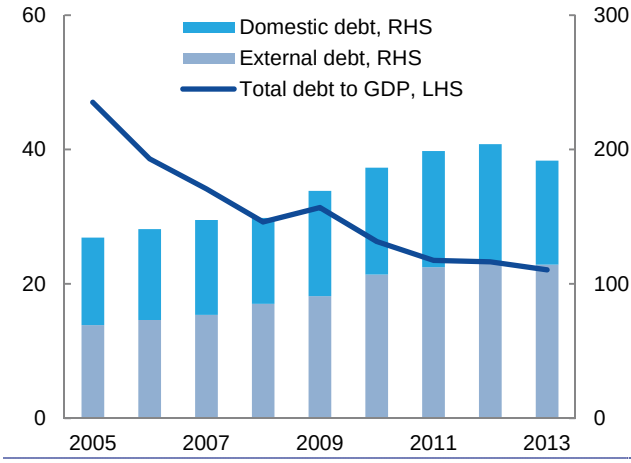
Source: CEIC; World Bank staff calculations

Appendix Figure 22: Banking sector indicators
(monthly, percent)



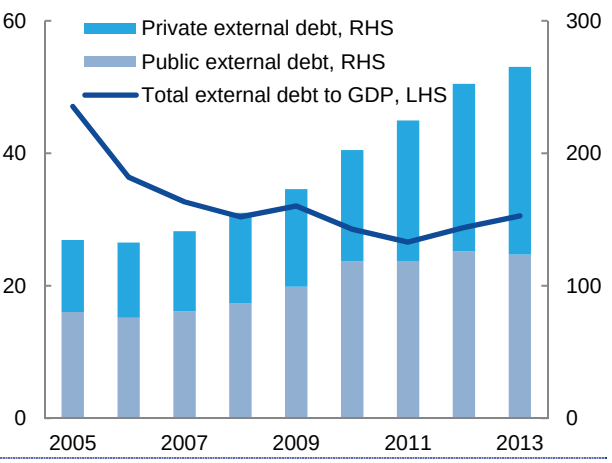
Source: BI

Appendix Figure 23: Government debt
(percent of GDP; USD billion)



Source: MoF; BI; World Bank staff calculations

Appendix Figure 24: External debt
(percent of GDP; USD billion)



Source: BI; World Bank staff calculations

Appendix Table 1: Budget outcomes and projections

(IDR trillion)

	2009	2010	2011	2012	2013	2014	2014
	Outcome	Outcome	Outcome	Outcome	Preliminary outcome	Budget	Revised budget
A. State revenue and grants	**849**	**995**	**1,211**	**1,338**	**1,430**	**1,667**	**1,635**
1. Tax revenue	620	723	874	981	1,072	1,280	1,246
2. Non-tax revenue	227	269	331	352	353	385	387
B. Expenditure	**937**	**1,042**	**1,295**	**1,491**	**1,639**	**1,842**	**1,877**
1. Central government	629	697	884	1,011	1,126	1,250	1,280
2. Transfers to the regions	309	345	411	481	513	593	597
C. Primary balance	**5**	**42**	**9**	**-53**	**-97**	**-54**	**-106**
D. SURPLUS / DEFICIT	-89	-47	-84	-153	-210	-175	-241
(percent of GDP)	-1.6	-0.7	-1.1	-1.9	-2.2	-1.7	-2.4

Source: MoF

Appendix Table 2: Balance of payments

(USD billion)

	2011	2012	2013	2012		2013				2014
				Q3	Q4	Q1	Q2	Q3	Q4	Q1
Balance of payments	**11.9**	**0.2**	**-7.3**	**0.8**	**3.2**	**-6.6**	**-2.5**	**-2.6**	**4.4**	**2.1**
Percent of GDP	1.4	0.0	-0.8	0.4	1.5	-3.0	-1.1	-1.2	2.2	1.0
Current account	**1.7**	**-24.4**	**-29.1**	**-5.3**	**-7.8**	**-6.0**	**-10.1**	**-8.6**	**-4.3**	**-4.2**
Percent of GDP	0.2	-2.8	-3.3	-2.4	-3.6	-2.7	-4.5	-4.0	-2.1	-2.1
Trade balance	24.2	-1.7	-6.1	0.8	-2.4	-1.0	-4.1	-2.7	1.6	1.3
Net income & current transfers	-22.5	-22.7	-23.0	-6.1	-5.4	-5.0	-6.1	-6.0	-6.0	-5.5
Capital & Financial Account	**13.6**	**24.9**	**22.4**	**5.8**	**12.0**	**-0.5**	**8.6**	**5.5**	**8.8**	**7.8**
Percent of GDP	1.6	2.8	2.6	2.6	5.5	-0.2	3.8	2.5	4.4	3.8
Direct investment	11.5	13.7	13.7	4.5	4.1	3.6	3.7	5.8	0.5	3.0
Portfolio investment	3.8	9.2	9.8	2.5	0.2	2.8	3.4	1.9	1.8	9.0
Other investment	-1.8	1.9	-1.1	-1.2	7.7	-6.9	1.6	-2.3	6.5	-4.1
Errors & omissions	**-3.4**	**-0.3**	**-0.6**	**0.3**	**-1.0**	**-0.1**	**-1.0**	**0.5**	**-0.1**	**-1.6**
Foreign reserves*	**110.1**	**112.8**	**99.4**	**110.2**	**112.8**	**104.8**	**98.1**	**95.7**	**99.4**	**102.6**

Note: * Reserves at end-period
Source: BI; BPS

Appendix Table 3: Indonesia's historical macroeconomic indicators at a glance

	1990	1995	2000	2005	2010	2011	2012	2013
National Accounts (% change)[1]								
Real GDP	9.0	8.4	4.9	5.7	6.2	6.5	6.3	5.8
Real investment	..	..	11.4	10.9	8.5	8.3	9.7	4.7
Real consumption	..	..	4.6	4.3	4.1	4.5	4.8	5.2
Private	..	..	3.7	4.0	4.7	4.7	5.3	5.3
Government	..	..	14.2	6.6	0.3	3.2	1.3	4.9
Real exports, GNFS	..	..	30.6	16.6	15.3	13.6	2.0	5.3
Real imports, GNFS	..	..	26.6	17.8	17.3	13.3	6.7	1.2
Investment (% GDP)	28	28	20	24	32	32	33	32
Nominal GDP (USD billion)	114	202	165	286	709	846	877	868
GDP per capita (USD)	636	1035	804	1,300	2,984	3,467	3,546	3,468
Central Government budget (% GDP)[2]								
Revenue and grant	18.8	15.2	20.8	17.8	15.5	16.3	16.2	15.3
Non-tax revenue	1.0	4.8	9.0	5.3	4.2	4.5	4.3	3.8
Tax revenue	17.8	10.3	11.7	12.5	11.3	11.8	11.9	11.5
Expenditure	11.8	13.9	22.4	18.4	16.2	17.4	18.1	17.5
Consumption	..	3.9	4.0	3.0	3.8	4.0	4.1	4.2
Capital	..	4.6	2.6	1.2	1.3	1.6	1.8	1.8
Interest	..	1.4	5.1	2.3	1.4	1.3	1.2	1.2
Subsidies	..	..	6.3	4.3	3.0	4.0	4.2	3.8
Budget balance	0.4	1.3	-1.6	-0.6	-0.7	-1.1	-1.9	-2.2
Government debt	41.9	32.3	85.9	47.0	26.3	23.5	23.3	22.1
o/w external government debt	41.9	32.3	45.1	22.0	9.6	8.0	7.2	6.7
Total external debt (including private sector)	61.0	61.5	87.1	47.1	28.5	26.6	28.8	30.5
Balance of Payments (% GDP)[3]								
Overall balance of payments	..	..	..	0.2	4.3	1.4	0.0	-0.7
Current account balance	-2.6	3.2	4.8	0.1	0.7	0.2	-2.8	-3.3
Exports GNFS	25.6	26.2	42.8	35.0	24.7	26.2	24.1	23.7
Imports GNFS	24.0	26.9	33.9	32.0	21.6	23.3	24.3	24.4
Trade balance	1.6	-0.8	8.9	2.9	3.0	2.9	-0.2	-0.7
Financial account balance	..	..	..	0.0	3.7	1.6	2.8	2.6
Net direct investment	1.0	2.2	-2.8	1.8	1.6	1.4	1.6	1.6
Gross official reserves (USD billion)	8.7	14.9	29.4	34.7	96.2	110.1	112.8	99.4
Monetary (annual average % change)[3]								
GDP deflator[1]	7.7	9.9	20.4	14.3	8.3	8.1	4.4	4.4
Bank Indonesia interest key rate (%)	..	..	..	9.1	6.5	6.6	5.8	6.5
Domestic credit	..	..	..	28.7	17.5	24.4	24.2	22.1
Nominal exchange rate (average, IDR/USD)[4]	1,843	2,249	8,422	9,705	9,090	8,770	9,387	10,461
Prices (% change)[1]								
Consumer price Index (eop)	9.9	9.0	9.4	17.1	7.0	3.8	4.3	8.4
Consumer price Index (average)	7.7	9.4	3.7	10.5	5.1	5.4	4.3	7.0
Indonesia crude oil price (USD per barrel)[5]	..	17	28	53	79	112	113	107

Source: [1] BPS and World Bank staff calculations, [2] MoF (for 1995 is FY 1995/1996, for 2000 covers 9 months), [3] Bank Indonesia, [4] IMF, [5] CEIC

Appendix Table 4: Indonesia's development indicators at a glance

	1990	1995	2000	2005	2010	2011	2012	2013
Demographics[1]								
Population (million)	184	199	213	227	241	244	247	250
Population growth rate (%)	1.7	1.5	1.3	1.2	1.3	1.3	1.2	1.2
Urban population (% of total)	31	36	42	46	50	51	51	52
Dependency ratio (% of working-age population)	67	61	55	54	53	53	52	52
Labor Force[2]								
Labor force, total (million)	75	84	98	106	117	117	120	120
Male	46	54	60	68	72	73	75	75
Female	29	31	38	38	45	44	46	45
Agriculture share of employment (%)	55	43	45	44	38	36	35	35
Industry share of employment (%)	14	19	17	19	19	21	22	20
Services share of employment (%)	31	38	37	37	42	43	43	45
Unemployment, total (% of labor force)	2.5	7.0	8.1	11.2	7.1	7.4	6.1	6.2
Poverty and Income Distribution[3]								
Median household consumption (IDR 000)	..	..	104	211	374	421	446	487
National poverty line (IDR 000)	..	..	73	129	212	234	249	272
Population below national poverty line (million)	..	..	38	35	31	30	29	28
Poverty (% of population below national poverty line)	..	..	19.1	16.0	13.3	12.5	12.0	11.4
Urban (% of population below urban poverty line)	..	..	14.6	11.7	9.9	9.2	8.8	8.4
Rural (% of population below rural poverty line)	..	..	22.4	20.0	16.6	15.7	15.1	14.3
Male-headed households	..	..	15.5	13.3	11.0	10.2	9.5	9.2
Female-headed households	..	..	12.6	12.8	9.5	9.7	8.8	8.6
Gini index	..	..	0.30	0.35	0.38	0.41	0.41	0.41
Percentage share of consumption: lowest 20%	..	..	9.6	8.7	7.9	7.4	7.5	7.4
Percentage share of consumption: highest 20%	..	..	38.6	41.4	40.6	46.5	46.7	47.3
Public expenditure on social security & welfare (% of GDP)[3]	..	..	..	0.4	0.4	0.4	0.4	0.6
Public expenditure on social security & welfare (% of Spending)[4]	..	..	..	2.4	2.4	2.3	2.3	3.3
Health and Nutrition[1]								
Physicians (per 1,000 people)	0.14	0.16	0.16	0.13	0.29	..	0.20	..
Under five mortality rate (per 1000 children under 5 year)	98	67	52	42	34	32	31	..
Neonatal mortality rate (per 1000 live births)	27	26	22	19	16	16	15	..
Infant mortality (per 1000 live births)	67	51	41	34	28	27	26	..
Maternal mortality ratio (estimate, per 100,000 live births)	600	420	340	270	210	..	..	190
Measles vaccination (% of children under 2 year)	..	63	74	77	75	74	80	..
Total health expenditure (% of GDP)	..	1.8	2.0	2.8	2.9	2.9	3.0	..
Public health expenditure (% of GDP)	..	0.7	0.7	0.9	1.1	1.1	1.2	..
Education[3]								
Primary net enrollment rate, (%)	..	..	..	92	92	92	93	92
Female (% of total net enrolment)	..	..	..	48	48	49	49	50
Secondary net enrollment rate, (%)	..	..	..	52	61	60	60	61
Female (% of total net enrolment)	..	..	..	50	50	50	49	50
Tertiary net enrollment rate, (%)	..	..	..	9	16	14	15	16
Female (% of total net enrolment)	..	..	..	55	53	50	54	54
Adult literacy rate (%)	..	..	..	91	91	91	92	93
Public spending on education (% of GDP)[4]	..	..	..	2.7	3.2	3.4	3.4	3.6
Public spending on education (% of spending)[4]	..	..	..	14.5	20.0	19.7	18.8	19.0
Water and Sanitation[1]								
Access to an improved water source (% of population)	70	74	78	81	84	84	84.9	..
Urban (% of urban population)	91	91	91	92	93	93	93.0	..
Rural (% of rural population)	61	65	68	71	75	76	76.4	..
Access to improved sanitation facilities (% of population)	32	38	44	53	57	59	58.8	..
Urban (% of urban population)	56	60	64	70	70	73	71.4	..
Rural (% of rural population)	21	26	30	38	44	44	45.5	..
Others[1]								
Disaster risk reduction progress score (1-5 scale; 5=best)	..	..	..	..	..	3.3	..	..
Proportion of seats held by women in national parliament (%)[5]	..	..	8	11	18	18.2	18.6	..

Source: [1] World Development Indicators; [2] BPS (Sakernas); [3] BPS (Susenas) and World Bank; [4] MoF and World Bank staff calculations, only includes spending on Raskin, Jamkesmas, BLT, BSM, PKH and actuals; [5] Inter-Parliamentary Union

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