Indonesia Economic Quarterly, July 2014

Hard choices

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The new administration will face major near-term challenges

Ending extreme poverty and achieving shared prosperity?

OR

Persistent pockets of extreme poverty and many Indonesians left behind?
International backdrop

High-income economy growth is strengthening…
(manufacturing PMI, +50=expansion)

…but most global commodity prices, except oil, continue to decline
(index, January 2012 = 100, 3mma)

Source: Markit

Source: World Bank
Economic growth - Will Indonesia return to 6% growth?

(annual growth, percent)

- East Asia Pacific (excl. China & Indonesia)
- Indonesia

Source: BPS; World Bank staff calculations

Forecast
Fiscal risks are building up steeply

Significantly weaker revenue growth has added to expenditure-side pressures…

(Contributions to overall nominal revenue growth, percentage points)

- All other revenues
- Intl. trade taxes
- Oil and gas revenues (tax and non-tax)
- Income tax (non-oil and gas)

…and contributed to a substantial rise in government financing needs

(IDR trillion)

Source: Ministry of Finance; World Bank staff calculations

Note: 2014 (1) is initial Budget (APBN), (2) is revised Budget (RAPBN-P)
Source: Ministry of Finance; World Bank staff calculations
External balance still in focus despite macro stabilizing measures

After successful macro stabilization, focus now on weak exports…
(export and import USD values, yoy growth, 3mma)

…which have been hit by ongoing commodity sector challenges
(contributions to export value growth yoy, percentage points)

Source: CEIC; World Bank staff calculations
## Moderate pace of growth expected to continue

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<tbody>
<tr>
<td><strong>Real GDP</strong> (% change)</td>
<td>6.2</td>
<td>5.8</td>
<td>5.2</td>
<td>5.6</td>
<td>5.3</td>
<td>5.6</td>
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<tr>
<td><strong>Consumer price index</strong> (% change)</td>
<td>4.3</td>
<td>6.9</td>
<td>5.8</td>
<td>4.9</td>
<td>6.2</td>
<td>5.2</td>
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<tr>
<td><strong>Current account balance</strong> (% of GDP)</td>
<td>-2.8</td>
<td>-3.3</td>
<td>-2.9</td>
<td>-2.4</td>
<td>-2.9</td>
<td>-2.1</td>
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<tr>
<td><strong>Budget balance</strong> (% of GDP)</td>
<td>-1.9</td>
<td>-2.2</td>
<td>-2.8</td>
<td>n.a.</td>
<td>-2.6</td>
<td>n.a.</td>
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Source: BI; BPS; Ministry of Finance; World Bank staff projections
Assessing the hard policy choices ahead

Addressing near-term macro challenges
Reinvigorating growth
Fiscal pressures
External pressures

...AFFECTS THE CAPACITY TO DELIVER ON KEY STRUCTURAL REFORMS:
- SUPPLY-SIDE REFORMS
  Infrastructure
  Skills
  Functioning of markets
- REFORMS TO ENSURE SHARED PROSPERITY
  Local access to services
  Social protection
  Management of disaster risks & resilience

FISCAL REFORMS
Redirecting spending
Mobilizing revenue

...and achieve key development outcomes
Faster poverty reduction
Reduced inequality
Inequality is a growing problem in Indonesia

Inequality on the rise in recent years... ...and increasing faster in Indonesia than in its neighbors

(percent, LHS; percentage points, RHS)

Source: Kanbur, Rhee and Zhuang, 2014, “Inequality in Asia and the Pacific”; World Bank staff calculations

Note: Poverty rates are March BPS estimates; 2014 GDP growth: World Bank projection
Source: BPS; World Bank staff calculations
Why does inequality matter for Indonesia?

- Inequality can slow down economic growth
  Preliminary research comparing districts in Indonesia indicates that high levels of inequality hurt growth.

- Inequality slows down poverty reduction
  If all households received growth equally, poverty would have fallen from 17.4 percent in 2003 to 0 percent by 2010.

- Inequality can trigger conflict and social tension
  Districts with Gini coefficients of 40 experienced 60 percent more conflict than districts with Gini coefficients of 20.

- The majority of Indonesians believe that the country is more unequal than they’d like it to be
What is causing the rise in inequality?

Children are born with unequal opportunities

*(lack of access, percent)*

- No proper sanitation
- No clean drinking water
- 16-18 year olds not enrolled
- Not fully immunized
- Unskilled birth attendant

Returns from jobs favor the rich and well-educated

*(wage and consumption premiums compared to workers with primary education, percent)*

Source: Susenas; DHS; World Bank staff calculations

Source: Sakernas; Susenas; World Bank staff calculations
What is causing the rise in inequality?

The rich benefit from greater returns to capital

(annual change in real terms, percent)

- Real formal wages
- Real informal wages
- Real JCI price return

The poor are more vulnerable to shocks to their income

- All households face risks, for example health, cost of living shocks, and natural disasters, that can affect their income
- The rich have access to more efficient coping mechanisms to respond to shocks (savings, insurance, good jobs, etc.); the poor often do not
- The poor are less able to take risks to increase their income

Source: Indonesia Stock Exchange; BPS; Sakernas; World Bank staff calculations
What can be done to address rising inequality?

83% of Indonesians believe it is “urgent” for the new government to tackle inequality

- **Distribution**: improve spending and taxation policies (for example, eliminate regressive fuel subsidies, enhance tax compliance)
- **Opportunities**: increase poor households’ access to high quality education and health
- **Mobility**: support labor mobility for high-quality job creation
- **Safety nets**: adequate and well-targeted, to reduce the vulnerability of the poor to shocks
Thank you

July 2014 IEQ Contents:

- Regular update on economic developments and the outlook
- New purchasing power parity-adjusted estimates of Indonesia’s economy
- Inequality is growing in Indonesia and it matters for policy
- El Niño, forest fires and haze: the imperatives for concrete action

On the web: