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INDONESIA ECONOMIC PROSPECTS
IEP

THE LONG ROAD TO RECOVERY

THE WORLD BANK
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July 2020

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Preface

The Indonesia Economic Prospects (IEP) is a six-monthly World Bank report that aims to provide an impartial and up-to-date assessment of recent global and domestic macroeconomic developments, outlook and risks, as well as specific development challenges for the Indonesian economy. In doing so, the IEP informs public policy debate, not only for the government but also for the private sector, civil society organizations, and other domestic and international stakeholders.

The IEP has two main objectives. First, it highlights key developments in the Indonesian economy over recent months, and places these in a longer-term context. Based on these developments, and on policy changes over the period, the IEP regularly updates the outlook for Indonesia's economy. The ongoing COVID-19 pandemic highlights the continued need for sound macroeconomic monitoring to help the economy weather the impact of the crisis. Second, the report provides an in-depth examination of selected economic and policy issues, and an analysis of the country's medium-term development challenges. It is intended for a wide audience, including policy makers, business leaders, financial market participants, and the community of analysts and professionals engaged in Indonesia's evolving economy.

The IEP is a product of the World Bank's Jakarta office and receives editorial and strategic guidance from an editorial board chaired by Satu Kahkonen, Country Director for Indonesia and Timor-Leste. The report is prepared by the Macroeconomics, Trade and Investment (MTI) Global Practice team, under the guidance of Ndiame Diop (Practice Manager) and Frederico Gil Sander (Lead Economist). Led by Derek H. C. Chen (Senior Economist and lead author), the core project team comprises Dwi Endah Abriningrum, Arsianti, Hilda Choirunnisah, Indira Maulani Hapsari, Ahya Ihsan, Assyifa Szami Ilman, Angella Faith Lapukeni, Yus Medina, Juul Pinxten, Anthony Obeyesekere, Ratih Dwi Rahmadanti, and Virgi Agita Sari. Administrative support is provided by Deviana Djalil. Dissemination is organized by Jerry Kurniawan and GB Surya Ningnagara under the guidance of Lestari Boediono Qureshi.

Part A of this edition of the IEP was coordinated by Indira Maulani Hapsari, with contributions from Anthony Obeyesekere (Part A.1), Angella Faith Lapukeni and Ratih Dwi Rahmadanti (Part A.2), Dwi Endah Abriningrum (Part A.3), Ratih Dwi Rahmadanti (Part A.4), Yus Medina (Part A.5), Juul Pinxten (Part A.6), Virgi Agita Sari (Part A.7), Indira Maulani Hapsari (Part A.8), Dwi Endah Abriningrum (Box A.1), Ririn Salwa Purnamasari (Box A.2), Hilda Choirunnisah and Indira Hapsari (Box A.3), Juul Pinxten (Box A.4), and Muhammad Fajar Nugraha (Box A.5) with inputs for Part A from Ririn Salwa Purnamasari, Rabia Ali, Sailesh Tiwari, Changqing Sun, Anna C. O'Donnell, and Gillian Brown. Part B was coordinated by Anthony Obeyesekere, with contributions from Anthony Obeyesekere (Part B.1), Pandu Harimurti and Somil Nagpal (Part B.2), Aufa Doarest, Bertine Kamphuis, and Massimiliano Cali (Part B.3), Francesco Strobbe, Ketut Kusuma and Neni Lestari (Part B.4), Anthony Obeyesekere, Josefina Posadas, Juul Pinxten, and Sara Giannozzi (Part B.5 and Part B.6), Anthony Obeyesekere (Part B.7 and Part B.8), Andhyta Firselly Utami and Massimiliano Cali (Box B.1). Excellent research assistance was provided by Hilda Choirunnisah. The Appendix was provided by Assyifa Szami Ilman. The report also benefited from discussions with, and in-depth comments from Ahya Ihsan, Jeffrey Delmon, Ralph Van Doorn, Angella Faith Lapukeni, Jaffar Al Rikabi, Ekaterina T. Vashakmadze (Senior Economist, DECPG, World Bank), Ergys Islamaj (Senior Economist, EAPCE), Hassan Zaman (Regional Director, EEADR, World Bank), and Janani Kandhadai (editorial assistant).

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The findings, interpretations, and conclusions expressed in this report do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent, or the Australian government. The World Bank does not guarantee the accuracy of the data included in this work. The data cut-off date for this report was November 21, 2019. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of the World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

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- June 2019 : Oceans of Opportunity
- December 2018: Strengthening competitiveness

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Abbreviations

APD	Alat Pelindung Diri
ASEAN	Association of Southeast Asian Nations
Askrindo	Asureansi Kredit Indonesia
BI	Bank Indonesia
BLT	Bantuan Langsung Tunai
BLU	Badan Layanan Umum
BoP	Balance of Payments
BPJS	Badan Penyelenggara Jaminan Sosial
BPK	Badan Pemeriksaan Keuangan
BPS	Biro Pusat Statistik
BPUI	Bahana Pembinaan Usaha Indonesia
BUMN	Badan Usaha Milik Negara
CAD	Current Account Defisit
CAR	Capital Adequacy Ratio
CNBC	Consumer News and Business Channel
COVID-19	Corona Virus Disease
COICOP	Classification of Individual Consumption According to Purpose
CPI	Consumer Price Index
DAK	Dana Alokasi Khusus
DAU	Dana Alokasi Umum
DBH	Dana Bagi Hasil
DGT	Directorate General of Taxation
DID	Dana Insentif Desa
DNDF	Domestic non-Deliverable Forward
DTKS	Data Terpadu Kesejahteraan Sosial
DTU	Diklat Teknis Umum
ECB	Europeans Central Bank
EMBI	Emerging Market Bond Index
EMRP	Ex-Mega Rice Project
EWARS	Early Warning Systems
FDI	Foreign Direct Investment
FHH	Female Headed Households
FLFP	Female Labor Force Participation
GDP	Gross Domestic Product
GoI	Government of Indonesia
ICT	Information & Communications Technology
IEP	Indonesia Economic Prospects
IMF	International Monetary Fund
IT	Information Technology
ITDC	Indonesia Tourism Development Corporation
Jamkrindo	Jaminan Kredit Indonesia
JKN	Jaminan Kesehatan Nasional
KBJI	Klasifikasi Baku Jenis Pekerjaan Indonesia
KEM-PPKF	Kerangka Ekonomi Makro dan Pokok-Pokok Kebijakan Fiskal
LGST	Luxury Goods Sales Tax
LHS	Left Hand Side
LNG	Liquefied natural gas
LPS	Deposit Insurance Corporations
LSSR	Large Scale Social Restrictions
MoEC	Ministry of Education and Culture
MoF	Ministry of Finance
MoH	Ministry of Health
MoPWH	Ministry of Public Works and Housing
MoSA	Ministry of Social Affairs
MSME	Micro Small Medium Enterpise
MTI	Macroeconomics, Trade and Investment
NBFIs	Non-Bank Financial Institutions
NCD	Non Communicable Disease
NPL	Non-Performing Loan
NTI	Net Trade-commodity price Index
OECD	Organisation for Economic Co-operation and Development
O&G	Oil and Gas
OJK	Otoritas Jasa Keuangan
OSC	Standard occupational classification
OTJ	On-the-job
PEN	Pemulihan Ekonomi Nasional
PKH	Program Keluarga Harapan
PERPRES	Peraturan Presiden
PERPU	Peraturan Pemerintah Pengganti Undang-Undang
PIT	Personal Income Tax
PLN	Perusahaan Listrik Nasional
POJK	Peraturan OJK
PNBP	Penerima Negara Bukan Pajak
PPI	Private Participation in Infrastucture
PPP	Private Public Partnership
PVC	Photovoltaic Panels
R&D	Research and Development
RHS	Right Hand Side
RPJM	Rencana Pembangunan Jangka Menengah
SA	Social Assistance
SAL	Saldo Anggaran Lebih
SBH	Survey Biaya Hidup
SBI	Sertifikat Bank Indonesia
Sembako	Sembilan Bahan Pokok
SEMEFPA	Support for Enhanced Macroeconomic and Fiscal Policy Analysis
SJSN	Sistem Jaminan Sosial Nasional
SNG	Sub-National Governments
SNI	Standar Nasional Indonesia
SOE	State-owned Enterprises
SOC	Standard Occupational Classification
SUN	Surat Utang Negara
SUPAS	Intercensal Population Survey
SUSENAS	Survei Sosial Ekonomi Nasional
TA	Technical Assistance
ToT	Terms of Trade
TVET	Technical and Vocational Education and Training
UHC	Universal Health Coverage
USTR	United States Trade Representative
VAT	Value Added Tax
WEF	World Economic Forum
WHO	World Health Organization

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Executive Summary: The Long Road to Recovery

The COVID-19 pandemic and associated containment measures triggered the deepest global recession in eight decades. As many countries implemented lockdowns and travel restrictions, global demand for goods and services plummeted along with tourism flows and commodity prices; supply chains were disrupted; and financial market volatility spiked. The Government of Indonesia also implemented mobility restrictions from mid-March and then a partial lockdown from April to June, preventing many firms and shops from operating, and discouraging many consumers from shopping.

Hit by severe external and domestic shocks, economic activity tumbled. Real GDP growth slumped from 5.0 percent yoy in Q4 2019 to 3.0 percent in Q1 2020, the lowest quarterly growth since 2001 (Figure ES.1). Private consumption slowed as mobility restrictions and personal avoidance behavior curbed household consumption. Investment growth also declined with heightened uncertainty and lower commodity prices. There was broad-based slowdown across sectors. Manufacturing, construction and low value-added service sectors including transport, storage, hotels and restaurants, sectors that employ a larger number of workers, all saw a near halving in their sectoral growth rates from Q4 2019. In contrast, growth of modern, knowledge-intensive services sectors, including digital, financial, education and health services accelerated.

The slowdown in domestic demand and the unexpected growth in some manufactured exports helped narrow the current account deficit (CAD) to 2.5 percent of GDP in Q1 2020 from 2.7 percent of GDP in Q4 2019 (four-quarter rolling basis; Figure ES.2). The goods trade surplus soared, as some diversion of manufacturing production from China and higher palm oil prices earlier in the year propped up export values, while imports contracted due to lower consumption and, investment and falling oil prices. With the sudden stop in global travel and transport, both services exports and imports plunged.

Amid global financial volatility, sharp and sudden portfolio outflows, larger than those during the Global Financial Crisis and the Asian Financial Crisis, brought the financial account to its first quarterly deficit since 2011 (Figure ES.3). As a result, government bond yields surged by 57 basis points and the Rupiah depreciated by 17.7 percent in Q1. Despite the smaller CAD, the larger financial account deficit led to an overall Balance of Payments deficit and international reserves fell to USD 121.0 billion at the end of March.

Following massive easing by global central banks, external liquidity conditions improved significantly in the second quarter, which led the Rupiah to appreciate and bond yields to fall. This global easing, together with the relatively benign inflation rate (Figure ES.4), allowed Bank Indonesia (BI) to cut the policy rate by a cumulative 50 bps in Q1.

To mitigate the economic impacts of COVID, the Government has announced a package of IDR 695.2 trillion, with an overall estimated impact on the budget of 4.3 percent of GDP, including new spending of 3.0 percent of GDP. Together with lower revenues, the fiscal deficit is expected to widen to 6.3 percent of GDP. The package includes larger allocations to the health sector, significant increases in social assistance, large tax incentives for corporates, bailouts of SOEs, credit programs for SMEs and equity injections for banks that restructure SME loans, and additional spending by local governments and line ministries.

The impact of COVID-19 on livelihoods has been severe, with workers in heavily affected sectors such as transport and construction reporting large declines in income. Without measures to mitigate the shock, the pandemic would lead poverty to increase by 2.0 percentage points. The substantial increase in social assistance spending as part of the Government's mitigation package is therefore critical: if appropriately targeted and fully disbursed with minimal leakage, the package would significantly mitigate the impact of the pandemic on poverty.

Table ES.1: Real GDP growth is projected to fall to zero percent in 2020 as COVID-19 impacts both domestic demand and supply, and the external sector

		2019	2020	2021	2022
Real GDP	(Annual percent change)	5.0	0.0	4.8	6.0
Consumer price index	(Annual percent change)	2.8	2.6	2.8	3.0
Current account balance	(Percent of GDP)	-2.7	-1.9	-2.0	-2.1
Government budget balance	(Percent of GDP)	-2.2	-6.3	-4.1	-3.1

Source: BI; Central Bureau of Statistics (BPS); Ministry of Finance; World Bank staff calculations
Note: 2020-2022 are estimated and forecast figures

Despite an expansionary monetary and fiscal policy, the negative domestic and external shocks will dissipate only gradually and Indonesia's real GDP in 2020 is expected to

be unchanged from 2019 (Table ES.1). Private consumption is expected to slow sharply and investment to contract. Government consumption growth will accelerate but cannot fully offset the weakness in other components of domestic demand. Export and import volumes are projected to slump on adverse external conditions, with imports projected to shrink more rapidly on sharply weaker domestic demand. Net exports are therefore expected to make a positive contribution to overall headline growth.

Predicated on a gradual but steady reopening of the economies in Indonesia and abroad, the baseline growth outlook foresees a recovery spanning the next two years, with private consumption recovering first, followed by private investment. Real GDP is projected to grow by 4.8 percent in 2021 on recovering private consumption, and by 6.0 percent in 2022 due to strong investment growth and the low base of previous years.

This baseline projection assumes that global GDP will contract by around 5.2 percent this year,[1] and that the Government will ease mobility restrictions as announced in five stages through June and July, with the economy fully open in August. Downside risks to these assumptions are significant. If flare-ups occur or subsequent waves emerge, necessitating an extension or re-imposition of partial lockdowns, private consumption and investment are likely to slow and contract further. Meanwhile, if external conditions also worsen and the global economy slips into a more severe recession where world real GDP shrinks by 7.8 percent in 2020,[2] investment and exports would be further hit. In such a scenario, the Indonesian economy would contract by 2 percent in 2020.

The twin public health and economic crises have confronted the Government with new challenges while exacerbating older ones. As Indonesia considers the road ahead, there is a need to care for the sick and contain infections while cushioning the effects of the economic downturn and repositioning the economy for a rapid and full economic recovery.

The focus of this edition of the Indonesia Economic Prospects is therefore on overcoming these challenges and setting up Indonesia for a sustainable and inclusive economic recovery.

To support a safe (and sustainable) reopening of the economy, the priority remains to have in place a robust health system. As recently seen in other countries, the risks of an acceleration in infection rates or the emergence of subsequent waves are very real, and consumer confidence may remain low even if mobility restrictions are removed. Safely and sustainably reopening thus requires continued improvements in health system capacity and readiness, including continued expansion of testing and surveillance.

Many businesses will require continued support to ride out the economic downturn. Firms will need support to gradually re-start or expand production, while conditions need to be in place to facilitate the entry of new firms; these include addressing long-standing constraints to investment. The Government has taken steps in this direction, most notably through the investment and trade reforms proposed through the Omnibus Bill on Job Creation. The Bill, however, also proposes reforms that could have adverse effects on people's health and safety, the environment and labor rights. Finally, a sound financial system is a foundation of a sustainable recovery, and ensuring adequate liquidity and oversight is a priority.

With millions of jobs destroyed during the crisis, and the possible acceleration of trends in labor demand that favor the skilled, the unemployed need to be supported in their job search and upskilling to meet employer needs. Moreover, rectifying newly identified gaps in Indonesia's social protection coverage, building on COVID-driven expansions in the system, and expediting the delivery of appropriately funded universal health care for all, will help build, employ, and protect Indonesia's human capital.

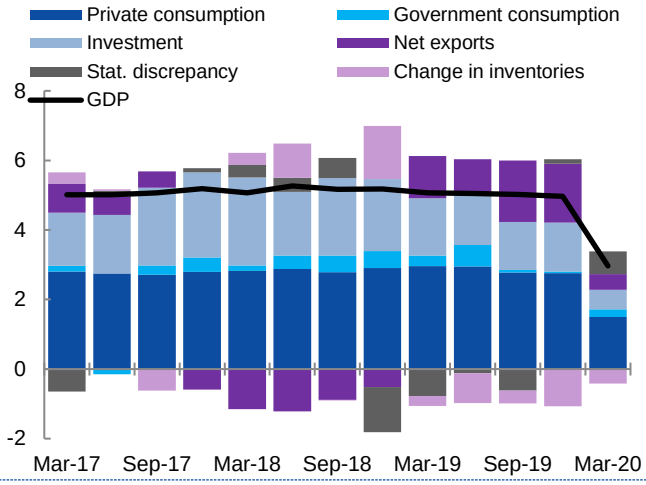
At the same time, COVID-driven cuts to public capital spending and postponements of infrastructure projects need to be reversed to avoid putting at risk the Government's growth-enabling infrastructure agenda. Efforts to catalyze private sector participation in infrastructure are paramount, but additional spending will also be necessary.

Given these expenditure needs, as well as the imperative of flattening the debt curve, temporary fiscal measures need to be gradually unwound, and revenues increased. The economic downturn's heavy fiscal burden has put public debt on an elevated trajectory entailing higher debt servicing costs that, if not reversed through revenue-enhancing reforms, will eventually crowd out priority spending or risk Indonesia's hard-earned investment-grade credit ratings.

[1] World Bank (2020a).

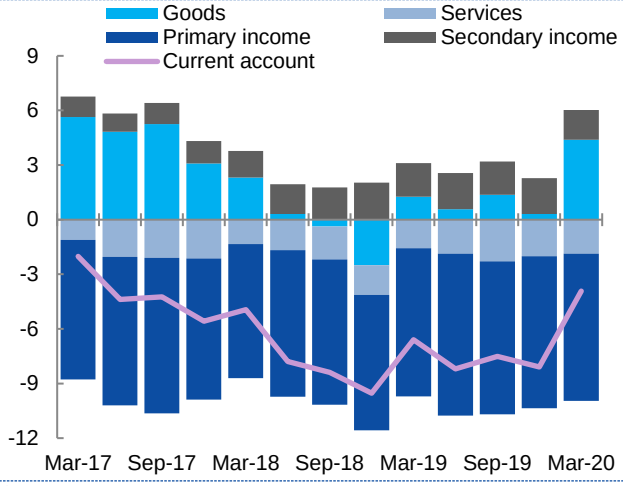
[2] Ibid.

Figure ES.1: GDP growth slowed sharply, with substantially weaker investment and private consumption
(contribution to growth yoy, percentage points)



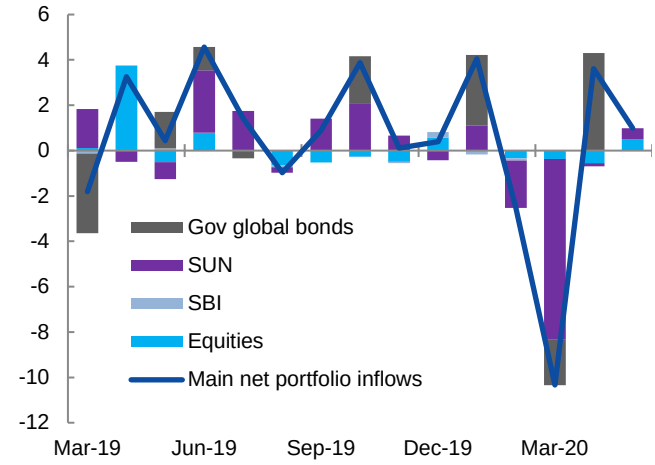
Source: Central Bureau of Statistics (BPS); World Bank staff calculations

Figure ES.2: Current account deficit narrowed in Q1 in line with the slowdown in domestic demand
(USD billions)



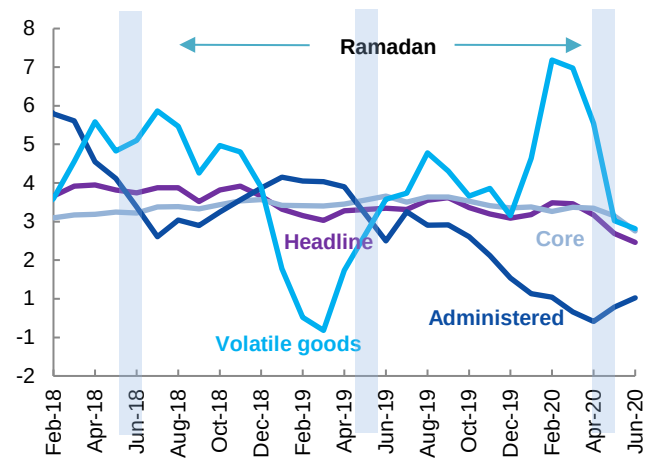
Source: BI; World Bank staff calculations

Figure ES.3: Massive portfolio flight-to-safety from emerging markets in Q1 amid global financial volatility
(USD billion)



Source: BI, World Bank staff calculations
Note: Sertifikat Bank Indonesia (SBI) and Surat Utang Negara (SUN) are local currency bonds

Figure ES.4: Supply and demand shocks affected headline inflation in Q1
(change yoy, percent)



Source: BPS; World Bank staff calculations

A. Economic and Fiscal Update

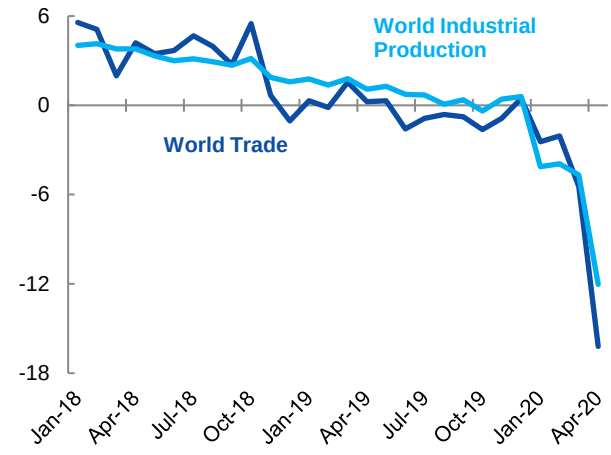
1. Economic growth fell to its slowest pace in almost two decades

COVID-19 and related policy responses led to unprecedented disruptions to world demand, international trade, investment and finance

This year has seen a deterioration in global economic conditions that is unprecedented in modern times. COVID-19 spread globally at an alarming speed and governments responded with measures to contain the virus including stringent domestic mobility and international travel restrictions. On a global level, these containment measures led to an acute contraction in global demand, a sudden stop in tourism flows, sharply falling commodity prices, supply chain disruptions, and heightened financial market volatility, which culminated in a contraction in global GDP in Q1 and likely Q2 (Figure A.1).

Figure A.1: Global production and trade fell sharply as COVID-19 spread rapidly around the globe

(yoy, percent)



Source: CPB World Trade Monitor; World Bank staff calculations

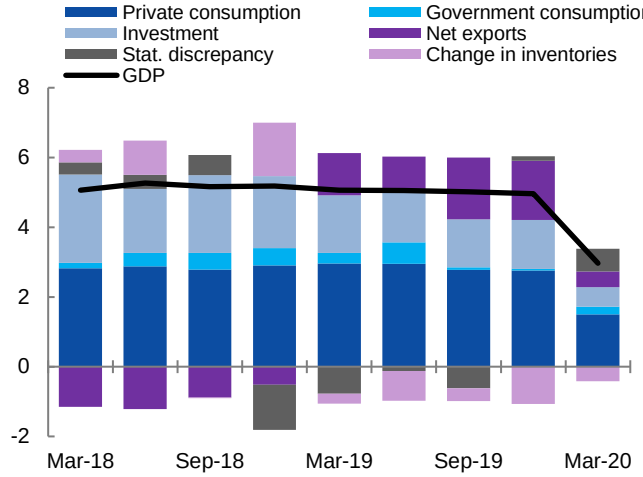
Indonesia's economy slowed in Q1 as the shutdown of tourism, weaker commodity prices and domestic

Indonesia's real GDP growth slowed from 5.0 percent year-on-year (yoy) in Q4 2019 to 3.0 percent in Q1 2020 (Q1 2019: 5.1 percent), the lowest quarterly growth since 2001 (Figure A.2), as the COVID-19 shock hit the economy through both domestic and external channels. Adverse global conditions were exacerbated by a sharp fall in domestic economic activity, as the Government of Indonesia also implemented mobility restrictions from mid-March and then a

mobility restrictions weighed on economic activity

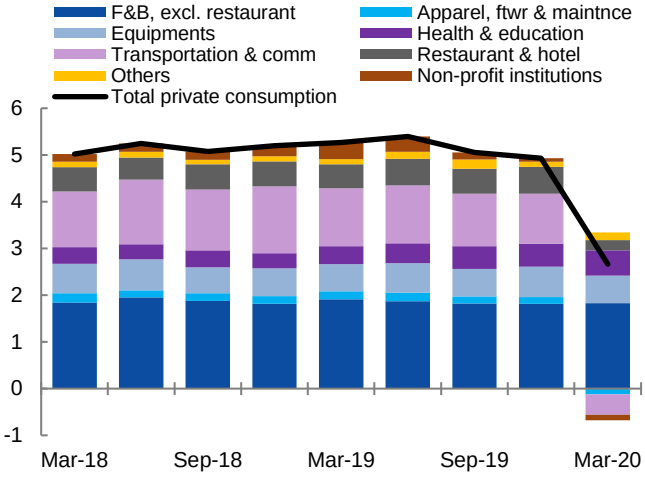
partial lockdown from April to June. Many firms and shops were prevented from operating, while many consumers were either unable or unwilling to shop given the heightened uncertainty about income prospects and infection risks.

Figure A.2: GDP growth slowed sharply, with substantially weaker investment and private consumption
(contribution to growth yoy, percentage points)



Source: BPS; World Bank staff calculations

Figure A.3: Consumption of transportation contracted as Indonesians limited their mobility
(contribution to growth yoy, percentage points)



Source: BPS; World Bank staff calculations

Mobility restrictions that began in mid-March resulted in a significant deceleration of household consumption in Q1 that is likely to have deepened in the second quarter

Consumption growth dropped from 4.2 percent yoy in Q4 to 2.8 percent in Q1, also the lowest since 2001. Private consumption growth fell from 4.9 percent yoy in Q4 to 2.7 percent in Q1. Lower consumption of transport services because of mobility restrictions was the main driver of the slowdown (Figure A.3). Restaurant and hotel consumption growth was weaker, while some categories of consumption contracted. In contrast, increased demand for health products and services led to higher spending on health & education. There was a decline in spending by non-profit institutions serving households, which includes spending by political parties, partly due to a high base effect on account of the strong pre-election spending in Q1 2019. High-frequency indicators for private consumption in April and May signal further deterioration in economic activities in Q2. Retail, motorcycle, and passenger car sales all posted double-digit contractions, with passenger car sales declining 97 percent yoy in May. In contrast, Government consumption rose 3.7 percent yoy in Q1 compared to a 0.5 percent increase in the previous quarter, supported by fiscal measures that front-loaded some expenditures.

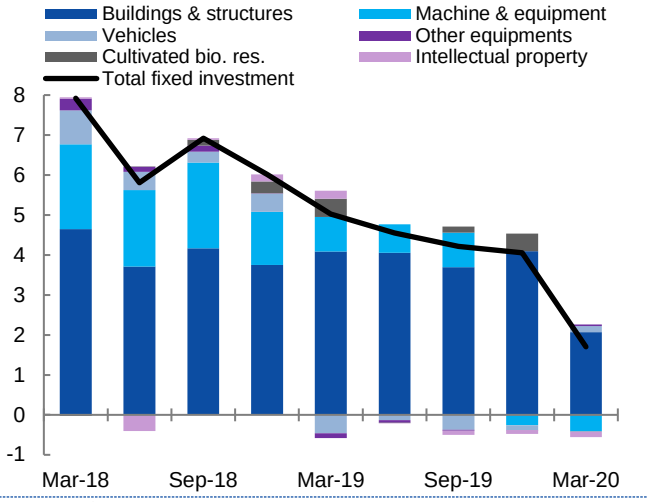
Investment growth fell by more than half, as heightened uncertainty, travel restrictions, and lower commodity prices discouraged investors and led to project delays

Fixed investment growth declined from 4.1 percent yoy in Q4 2019 to 1.7 percent in Q1 2020 (Q1 2019: 5.0 percent), as commodity prices,[3] domestic demand, and investor confidence slumped. Buildings and structures, which accounts for three quarters of total fixed investment, saw growth drop from 5.5 percent yoy in Q4 2019 to 2.8 percent in Q1 2020, consistent with the 50 percent slash in construction sector growth, as investors postponed projects (Figure A.4).[4,5] Machine and equipment investment declined for the second consecutive quarter, in line with weakness in the manufacturing and the mining and quarrying sectors, hindered by supply-chain bottlenecks and lower commodity prices. Concomitantly, nominal capital goods imports declined 13.4 percent yoy in Q1 from -8.3 percent in Q4.[6] Leading indicators of investment

[3] Prices of Indonesia's main export commodities, which include coal, crude oil, palm oil, rubber, liquefied natural gas and base metals, on average contracted 8.9 percent yoy in Q1 2020.
[4] Reuters (April 20, 2020). UPDATE 1-Indonesia warns of investment delays as Q1 FDI shrinks on virus hit.
[5] Mongabay (March 31, 2020). Mining activity in Indonesia takes a hit from COVID-19 pandemic
[6] Based on Balance of Payments data from Bank Indonesia.

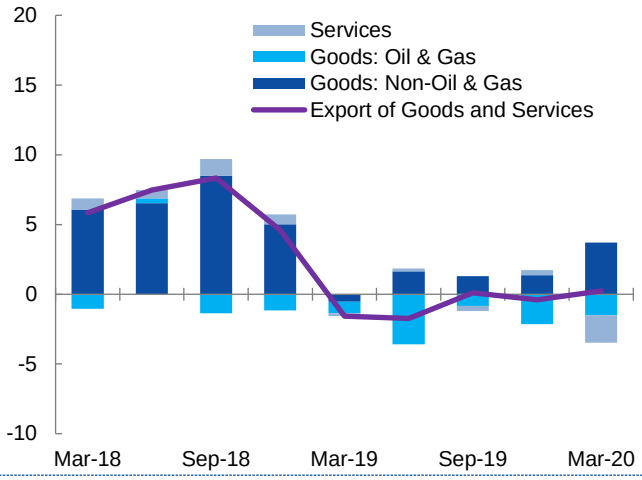
indicate significant further deterioration in Q2. Business sentiment, as captured by the Purchasing Managers' Index for manufacturing, collapsed to a record-low of 27.5 in April but picked up in June as domestic containment measures eased, leading to a Q2 average of 31.7, far below the 50 threshold.[7] Meanwhile nominal capital goods imports continued to contract, falling 40.0 percent yoy in May.[8]

Figure A.4: Investment growth decelerated sharply as investments in buildings and structures decelerated
(contribution to growth yoy, percentage points)



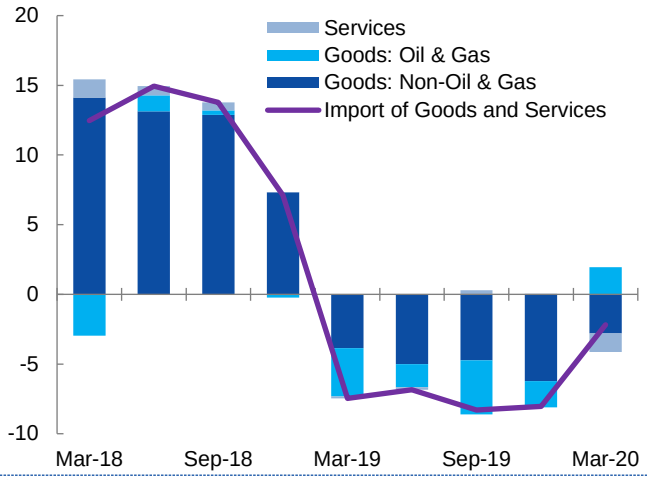
Source: BPS; World Bank staff calculations

Figure A.5: Exports growth nudged into positive territory with a large contribution from non-oil and gas exports
(contribution to growth yoy, percentage points)



Source: BPS; World Bank staff calculations

Figure A.6: Import growth was less negative on higher imports of oil and gas for inventory-building
(contribution to growth yoy, percentage points)



Source: BPS; World Bank staff calculations

Exports grew, buoyed by a surprise jump in exports of manufactured items that more than offset a slump in tourism

Service exports contracted as expected from the global transport and tourism freeze, but goods exports were surprisingly robust amid the shock to global demand, partly due to production dislocation from China.[9] Overall, export volumes of goods and services grew modestly at 0.2 percent yoy in Q1, after contracting 0.4 percent in Q4 (Q1 2019: -1.6 percent). Services exports contracted by 18.3 percent yoy in Q1, with transport and tourism hit hard by flight restrictions in overseas jurisdictions, heightened caution by travelers, and the suspension of numerous foreign carrier connections to Indonesia.[10] Overseas visitor arrivals were down 64.9 percent yoy

[7] An index value of 50 represents an even balance between survey respondents reporting better conditions and those reporting worse conditions. The April result indicates that worse conditions have become much more prevalent. It is the lowest result on record for the series, well below the previous record-low of 45.3 which was reported a month earlier.
[8] Based on foreign trade data from BPS.
[9] See detailed discussion in Section A.2
[10] The Jakarta Post (March 9, 2020). More than 12,000 flights canceled in two months over virus fears, says Angkasa Pura I.

in March and 31.1 percent for the quarter. On the other hand, non-oil and gas goods exports, which represent the majority of Indonesia's export basket, expanded by 4.7 percent and offset the decline in service exports (Figure A.5). Export growth was driven largely by manufactured products (iron and steel, footwear, paper, vehicles and electrical machinery). Oil and gas exports extended its long-running decline,[11] as plunging global demand,[12] a global LNG supply glut,[13] the Russia-Saudi Arabia crude oil price war,[14] and depleting domestic gas fields[15] weighed on commodity prices and domestic production.

Imports contracted less than in Q4 2019

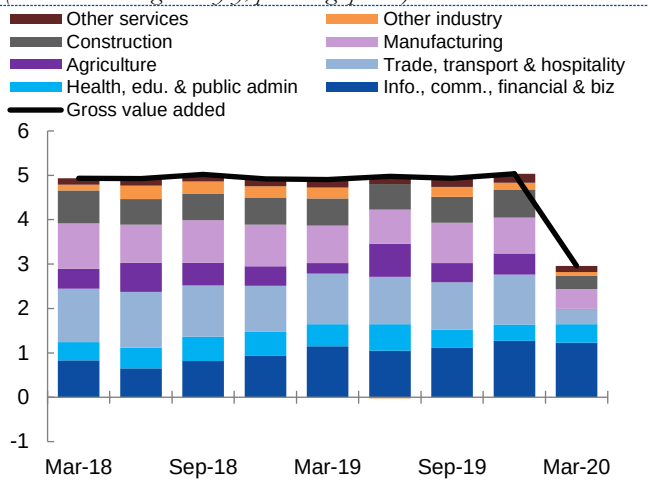
Indonesia's import volumes shrank by 2.2 percent in Q1 2020, after falling 8.0 percent in Q4 2019 (Q1 2019: -7.5 percent). This deceleration in import contraction was primarily driven by higher oil and gas imports as importers took advantage of the plunge in oil prices to build inventories (Figure A.6). Moreover, non-oil and gas imports contracted by less than that in Q4 2019, partly due to the pick-up in export growth that required imported raw material inputs and partly offset by slower raw material imports for domestic consumption. Meanwhile, services imports declined sharply, partly due to fewer Indonesians travelling overseas.

Growth slowed in labor-intensive, low-value-added sectors such as manufacturing, construction and retail, whereas knowledge-intensive sectors such as finance and health were resilient

Growth slowed across most major sectors (Figure A.7). Agricultural production was the weakest, recording zero growth, and was constrained by a 10.3 percent decline in farm food crops due to climate-driven delays to the main annual harvest of various crops including rice paddy.[16] Manufacturing slowed to 2.1 percent, largely because of slower growth in food and beverage manufacturing, linked to a combination of the weak performance in food crop production and mobility restrictions. Some manufacturing subsectors were relatively resilient (paper, basic metals and transport equipment all grew by at least 4 percent yoy), in line with the unexpected export growth in those sectors. Traditional services (trade, transport and hospitality), which employ many workers in informal jobs and were particularly hard-hit by mobility restrictions, saw a significant slowdown from 5.7 percent in Q4 2019 to 2.0 percent in Q1. On the other hand, health, education and public administration – sectors closely associated with the delivery of core public services – saw an uptick in growth, while information, communication, financial and business services also performed well, underpinned by significant strength in financial & insurance activity and information & communication as some businesses started moving to work-from-home arrangements.

Figure A.7: The slowdown in growth was broad-based across the sectors with agriculture showing flat output

(contributions to growth yoy, percentage points)



Source: BPS; World Bank staff calculations

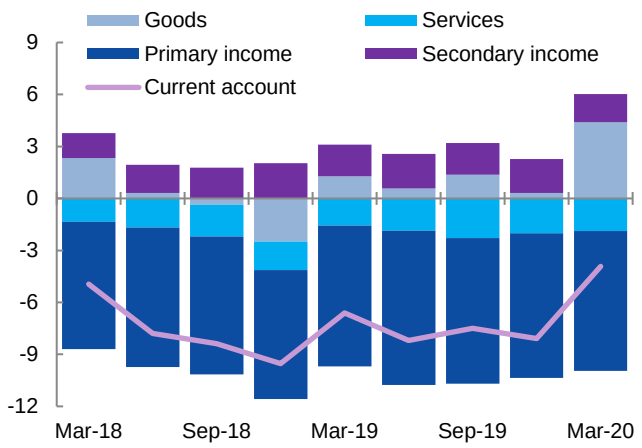
[11] Oil and gas exports have been declining in yoy terms since Q3 2018.
[12] World Bank (2020e).
[13] Natural Gas Intel (April 29, 2020). LNG Supply Glut Likely to Outlast Demand for Years, Says IGU.
[14] CNBC (April 1, 2020). 5 charts that explain the Saudi Arabia-Russia oil price war so far.
[15] Asia Times (February 4, 2020). Time winds down on Indonesia's oil and gas future.
[16] Republika (May 5, 2020). Harvest shifts, agriculture sector slows down.

2. The current account deficit narrowed, while portfolio investment saw record outflows

The current account deficit narrowed to a three-year low due to a wider goods trade surplus

Largely due to the strong performance of manufacturing exports, the current account deficit (CAD) narrowed to USD 3.9 billion in Q1 2020 from USD 8.1 billion in Q4 2019 (Q1 2019: USD 6.6 billion) (Table A.1 and Figure A.8). As a share of GDP on a four-quarter rolling sum basis, the CAD continued to improve to 2.5 percent of GDP in Q1 from 2.7 percent in Q4 (Q1 2019: 3.1 percent). A wider goods trade surplus (USD 4.4 billion from USD 0.3 billion in Q4 2019) was the main driver of the CAD narrowing. The services account deficit narrowed slightly (from USD 2.0 to 1.9 billion), while the income account deficit was relatively flat at USD 6.4 billion.

Figure A.8: Current account deficit narrowed in Q1 in line with the slowdown in domestic demand
(USD billion)



Source: BI and World Bank staff calculations

In addition to the temporary pickup in manufactured export volumes, higher palm oil prices through most of Q1 contributed to growth in export values

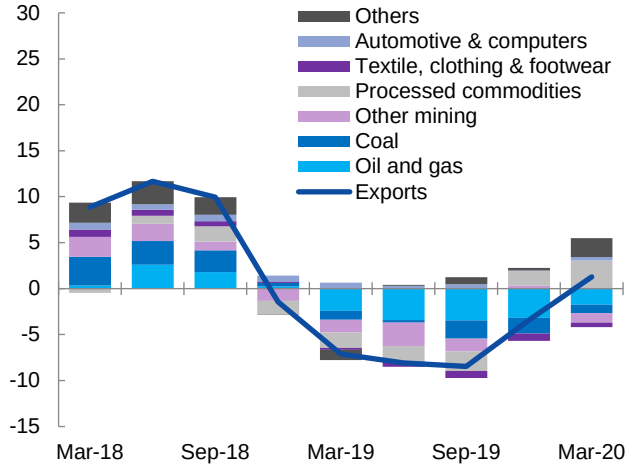
In line with higher volumes, goods export values increased by 1.3 percent yoy compared to a 3.4 percent decline in Q4 2019 (Q1 2019: -7.1 percent) (Figure A.9). The temporary increase in exports was mainly from manufactured products (iron and steel, footwear, paper, vehicles and electrical machinery) and processed commodities. Due to the shutdown of most Chinese manufacturing production during most of Q1 due to COVID-related restrictions, some of Indonesia's export growth represented a re-direction of production away from China.[17] Among processed commodities, crude palm oil and base metals were the key drivers, with the latter supported by both higher prices and volumes (Q1: +3.9 and +29.7 percent yoy, respectively); and the former largely by stronger prices (Q1: +32.8 percent yoy) that offset a contraction in volumes (Q1: -17.1 percent yoy)[18]. In contrast, export values of oil and gas and other raw commodities, such as coal, contracted largely on lower prices.[19]

Despite the slowdown in domestic demand, reduced exports from China, and a weaker Rupiah, contraction in goods imports decelerated

Also similar to the trend in volumes, goods import values contracted by less than that in the previous quarter (Q1 2020: -6.5 percent; Q4 2019: -9.2 percent yoy) (Figure A.10). Raw material[20] imports contracted by less than that in Q4, possibly because of the increase in exports, but still made the largest contribution to the decline; raw materials for the food and beverages industry[21] was especially weak. Fuel import values also contracted less than in Q4, with crude oil imports increasing in Q1 as importers took advantage of low prices to stock up.[22] In line with slow investment growth, capital goods imports contracted 13.4 percent yoy, the largest decline since March 2016, and were the second largest contributor to the import contraction.

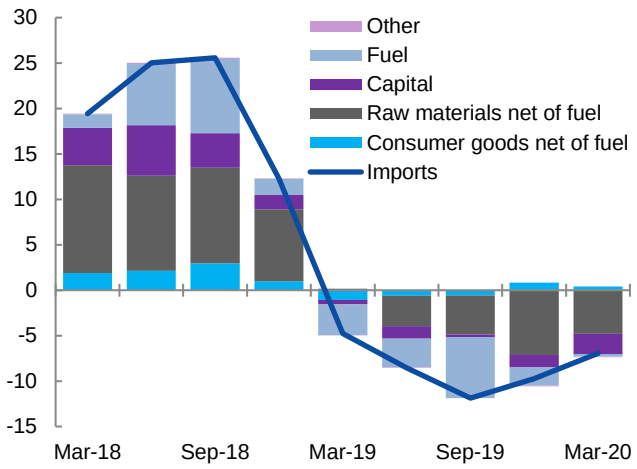
[17] Categories of Indonesian goods exports that recorded higher nominal growth to destinations in Q1 that concurrently saw substantial contractions in imports from China within the same goods category include "Base Metals and Articles" to Malaysia, Singapore, and Taiwan, China; and "Electrical Machinery & Equipment" to Hong Kong SAR, United Kingdom, Germany, and the United States.
[18] Coal prices declined 28.9 percent yoy in Q1. Source: Table 3, in Bank Indonesia (2020). Balance of Payments Report, Q1 2020.
[19] Crude oil prices fell 18.8 percent yoy in Q1. Similarly, coal prices plunged 28.9 percent in Q1.
[20] This is the raw materials net of fuels, including primary and processed.
[21] Bank Indonesia (2020). Balance of Payments Report, Q1 2020. This is partly due to the slowing of the food and beverage manufacturing sector, which eased to 3.9 percent yoy in Q1, down from 8.0 percent yoy in Q4 2019.
[22] Crude oil import values rose 22.3 percent yoy in Q1, compared to a decline of 2.6 percent in Q4 2019, despite Brent oil prices falling 20.1 percent yoy over Q1.

Figure A.9: Goods exports of processed commodities improved whilst exports of oil and gas declined
(contribution to growth yoy, percentage points)



Source: BI and World Bank staff calculations

Figure A.10: Goods imports contracted by less than that in Q4 as imports of raw materials and fuel were resilient
(contribution to growth yoy, percentage points)



Source: BI and World Bank staff calculations

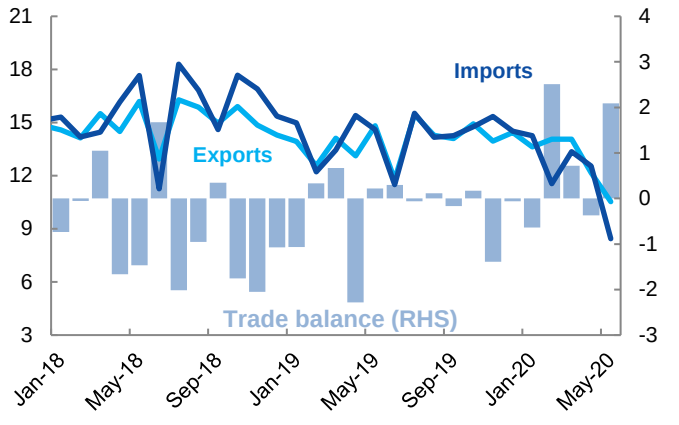
With the sudden stop in global travel, both services exports and imports plunged

As flight and entry restrictions were imposed globally, Indonesia's inbound and outbound travelers in Q1 were down by 30.6 percent and 32.7 percent yoy,[23] respectively. Accordingly, services exports contracted by 18.8 percent yoy from an increase of 5.2 percent in Q4 2019 (Q1 2019: -6.5 percent), while services imports declined by 12.1 percent from an increase of 8.1 percent in Q4 (Q1 2019: -3.1 percent). The sudden freeze on global mobility had a two-fold impact on the services trade deficit. While the deficit in transportation services[24] declined by USD 596 million relative to Q4 2019, the surplus in travel services[25] also declined by USD 191 million from Q4 2019. Therefore, the overall services deficit narrowed modestly.

The monthly goods trade balance posted another surplus in May, with imports contracting more than exports

With production in China coming back online and global demand plummeting, Indonesia's goods exports fell back into negative territory in May, contracting by 28.9 percent yoy. Goods imports fell more steeply than exports at 42.2 percent, as mobility restrictions weighed on domestic demand. As a result, the monthly goods trade balance posted a surplus of USD 2.1 billion in May, bringing the year-to-May cumulative trade balance to a

Figure A.11: Imports and exports plummeted in May
(USD billion)



Source: BPS and World Bank staff calculations

[23] Using Bank Indonesia's Balance of Payments data. Overseas visitor arrivals data from BPS also gave similar information, where the number of international visitors decreased by 31.1 percent yoy in Q1 2020.
[24] Transportation includes passenger, freight (movement of goods), and other transport services. International flight services are treated as transportation-passenger services, whereas domestic flight services are treated as travel services. More details are in IMF's BoP Manual (BPM6). Freight constitutes the largest share of transportation service imports in Indonesia and averaged at nearly 80 percent in 2019.
[25] Travel services exports cover expenditures of non-residents when traveling, such as accommodation, local transport, food-serving services and others. It excludes expenditure on international passenger transport, as noted above. More details are in IMF's BoP Manual (BPM6).

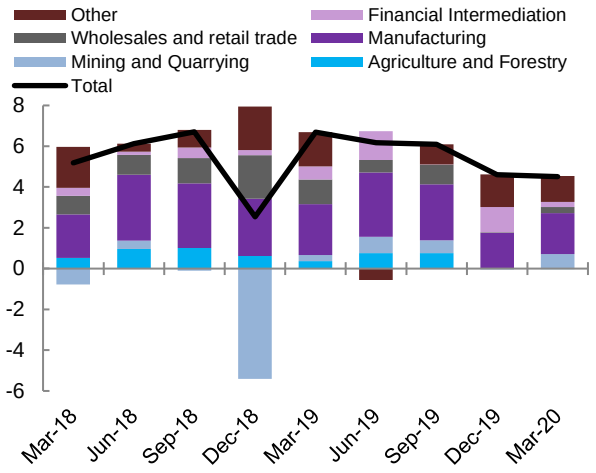
surplus of USD 4.3 billion (Figure A.11).

FDI was relatively stable in Q1

Despite heightened global economic uncertainty, foreign direct investment (FDI) declined only slightly to USD 4.5 billion (1.6 percent of GDP), from USD 4.6 billion in Q4 2019 (Q1 2019: USD 6.7 billion). Mirroring the surprisingly positive outcome in manufactured goods exports, there were healthy FDI inflows to the manufacturing sector, driven by debt withdrawals made by several manufacturing firms,[26] and which offset lower FDI elsewhere. Manufacturing remained the main destination for direct investment, followed by mining and quarrying, which together accounted for 60.2 percent of total FDI (Figure A.12). As the decline in Indonesian direct investment abroad was larger than the small decline in FDI inflows, net direct investment (direct investment in Indonesia less Indonesian direct investment abroad) rose by USD 0.3 billion to USD 3.5 billion in Q1, to finance 90 percent of the CAD.

Figure A.12: FDI was remarkably stable amid global uncertainty

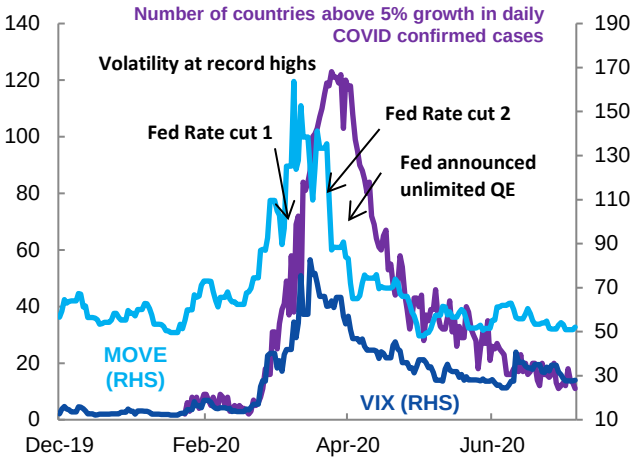
(USD billion)



Source: BI and World Bank staff calculations

Figure A.13: Global financial volatility peaked at the end of Q1 with the spread of COVID-19 infection…

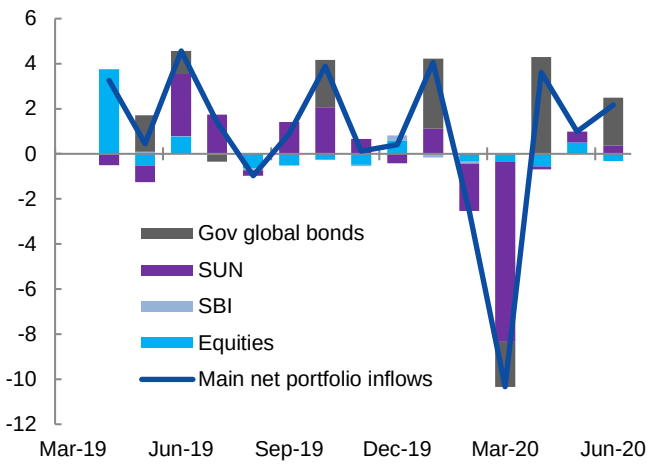
(LHS: number of countries; RHS: index)



Source: Deutsche Bank Global Research, Johns Hopkins University, Bloomberg, and World Bank staff calculations
Note: The VIX index measures volatility in the U.S. equity market, while the MOVE index measures volatility in the U.S. bond market

Figure A.14: …which led to large portfolio outflows from Indonesia in Q1 but which has since recovered

(USD billion)



Source: BI and World Bank staff calculations
Note: Sertifikat Bank Indonesia (SBI) and Surat Utang Negara (SUN) are local currency bonds

Surging global financial volatility resulted in massive portfolio outflows

The COVID-induced spike in global financial volatility (Figure A.13) led to a sudden stop in capital flows to all emerging economies, leading portfolio investment to swing to a record net outflow of USD 5.8 billion in Q1 from a net inflow of USD 7.1 billion in Q4 2019 (Q1 2019: +USD 5.2 billion). Portfolio outflows over the quarter were larger than those during the peak

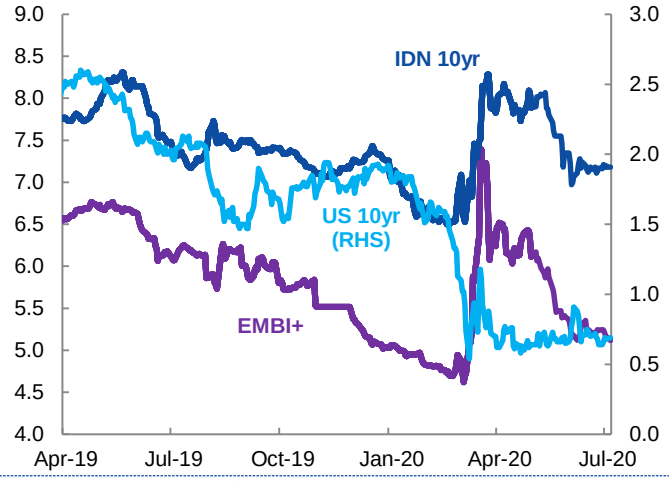
[26] Bank Indonesia (2020). Balance of Payments Report, Q1 2020.

from Indonesia in Q1 leading to a large deficit in financial account in Q1

of the Global and Asian financial crises, with USD 9.0 billion (3.3 percent of GDP) worth of government bonds sold within weeks (Figure A.14). This resulted in the 10-year government bond yields surging by 57 basis points (bps)[27] (Figure A.15), the Rupiah depreciating by 17.7 percent in nominal terms,[28] and by 5.7 percent in real effective terms[29] in Q1 (Figure A.16), both relative to Q4 2019. Outflows were partially offset by inflows of USD 4.2 billion to global bonds issued both by the Government[30] and public corporations.[31] As global central banks aggressively eased monetary policy, including the U.S. Fed cutting its benchmark rate twice to near-zero and the ECB implementing the EUR 750 billion Pandemic Emergency Purchase Programme in March, BI moved in tandem and lowered the policy rate twice in Q1.[32]

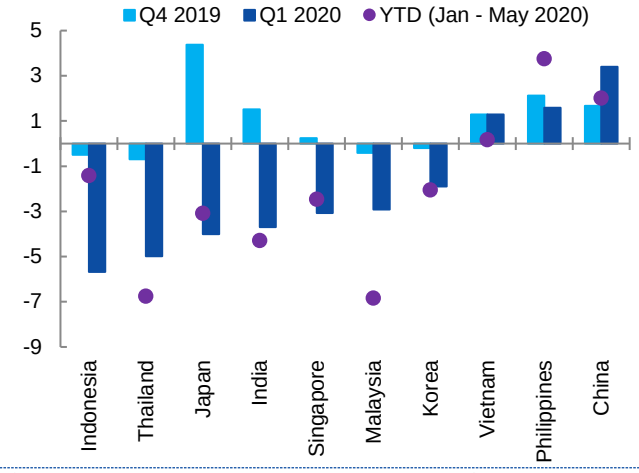
The unprecedented portfolio outflows led to a USD 2.9 billion deficit in the financial account, from a USD 12.6 billion surplus in Q4 2019 (Q1 2019: +USD 9.9 billion). Other investment saw a turnaround and posted a deficit of USD 0.5 billion in Q1 2020, mostly driven by an increase in private sector deposits in overseas banks.

Figure A.15: Bond yields jumped as foreign investors sold government bonds…
(LHS: IDN 10-yr and EMBI+, percent; RHS: U.S. 10-yr, percent)



Source: JP Morgan and CEIC
Note: EMBI+ is a JP Morgan emerging market bond index yield to maturity

Figure A.16: …and the Rupiah depreciated the most among regional peers in real effective terms
(percent change)



Source: JP Morgan Real Effective Exchange Rate, CPI based (2010=100), and World Bank staff calculations
Note: Downward movement represents depreciation

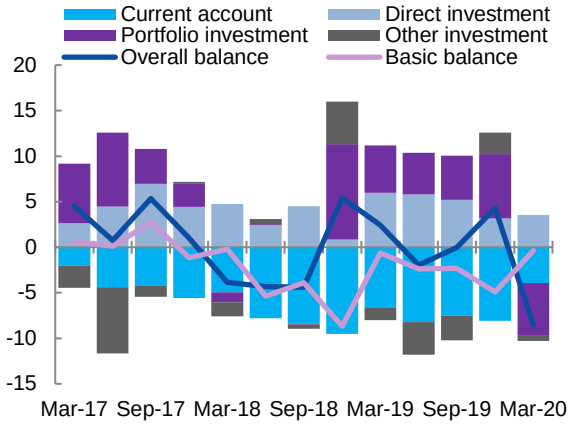
[27] In comparison, the Emerging Markets Bond Index Plus (EMBI+) increased 121 bps during Q1, as some other emerging markets experienced a steeper increase in their bond yields. For example, 10-year bond yields of Turkey rose by 226 bps, Mexico rose by 96 bps, and Philippines rose by 76 bps.
[28] In response to the weakening Rupiah, since March, Bank Indonesia has actively stabilized the currency by intensifying triple interventions: in spot market, domestic non-deliverable forward (DNDF) market, and buying government bonds in the secondary market. Until March 20th, BI has bought IDR 163 trillion worth of government bonds in the secondary market. However, despite these large-scale interventions, the Rupiah ended in Q1 was worse than other emerging market (EM) currencies, with JP Morgan's EMCI depreciating by 12.9 percent in Q1.
[29] Real effective exchange rates are based on trade weighted averages of bilateral exchange rates and adjusted by consumer prices.
[30] DG Financing and Risk Management. MoF (January 14, 2020). The government issued dual-currency bonds in January 2020, with total amount of USD 2 billion and EUR 1 billion.
[31] With half of it coming from Pertamina. Investor (February 16, 2020). Pertamina sold a USD 1.5 billion global bond to finance its capital expenditure.
[32] The 7-day Reverse Repo Rate was lowered in February and March by 25 bps each time, to reach 4.5 percent and has been held steady since then.

With the wider financial account deficit more than offsetting a narrower CAD, reserves declined

The overall BoP booked a deficit of USD 8.5 billion in Q1 (Figure A.17 and Table A.1), after a USD 4.3 billion surplus in Q4 (Q1 2019: +USD 2.4 billion). Consequently, international reserves fell to USD 121.0 billion at the end of March 2020, from USD 129.2 billion at the end of December 2019 (Q1 2019: USD 124.5 billion). Notwithstanding this decline, reserves are adequate to finance 7.0 months of imports and external debt repayments, well above the import coverage of 4.0 months at the end of 2008 during the Global Financial Crisis.

Figure A.17: The balance of payments swung to a deficit as portfolio outflows more than offset a smaller CAD

(USD billion)



Source: BI and World Bank staff calculations
Note: Basic Balance is the sum of current account balance and direct investment

Table A.1: Indonesia's Balance of Payments (BOP)

(USD billion, unless otherwise indicated)

	2018	2019	Q1-2019	Q4-2019	Q1-2020
Nominal GDP	1,042.2	1,119.2	267.7	285.7	275.6
Overall Balance of Payments	-7.1	4.7	2.4	4.3	-8.5
As percent of GDP	*-0.7*	*0.4*	*0.9*	*1.5*	*-3.1*
As percent of GDP, four-quarter rolling sum	*-0.7*	*0.4*	*-0.1*	*0.4*	*-0.6*
Current Account	-30.6	-30.4	-6.6	-8.1	-3.9
As percent of GDP	*-2.9*	*-2.7*	*-2.5*	*-2.8*	*-1.4*
As percent of GDP, four-quarter rolling sum	*-2.9*	*-2.7*	*-3.1*	*-2.7*	*-2.5*
Goods trade balance	-0.2	3.5	1.3	0.3	4.4
Services trade balance	-6.5	-7.8	-1.6	-2.0	-1.9
Income	-23.9	-26.1	-6.3	-6.4	-6.4
Capital and Financial Accounts	25.2	36.7	9.9	12.6	-2.9
As percent of GDP	*2.4*	*3.3*	*3.7*	*4.4*	*-1.1*
As percent of GDP, four-quarter rolling sum	*2.4*	*3.3*	*3.1*	*3.3*	*2.1*
Direct Investment	12.5	20.1	6.0	3.2	3.5
Portfolio Investment	9.3	21.7	5.2	7.1	-5.8
Other Investment	3.3	-5.4	-1.4	2.4	-0.5

Source: BI, World Bank staff calculations

Global financial volatility eased since April, supporting the recovery of the Rupiah and bond yields

The COVID-19 shock has led many central banks to implement an quantitative easing at an unprecedented scale[33], which stabilized capital flows to emerging countries. These interventions moderated global financial volatility, helped the government[34] and SOEs[35] issue nearly USD 10 billion worth of global bonds in April and May, and in Indonesia, supported the recovery of the Rupiah and bond prices. Accordingly, in Q2 compared to Q1, USD 6.8 billion worth of capital

[33] This was led by the Fed, whose weekly purchase of Treasury securities annualize to USD 2.5 trillion. Institute of International Finance (May 14, 2020). Global Macro Views – QE in Emerging Markets

[34] Reuters (April 7, 2020). Indonesia raises USD 4.3 billion in first 'pandemic bond'.

[35] CNBC (May 19, 2020). Global bonds flooded the market. There was at least USD 5.6 billion worth of global bonds issued by SOEs: Inalum (USD 2.5 billion), BNI (USD 2 billion), Hutama Karya (USD 600 million), and Bank Mandiri (USD 500 million).

flows returned to Indonesia, the Rupiah appreciated by 12.6 percent, and the 10-year bond yield fell by around 62 bps.

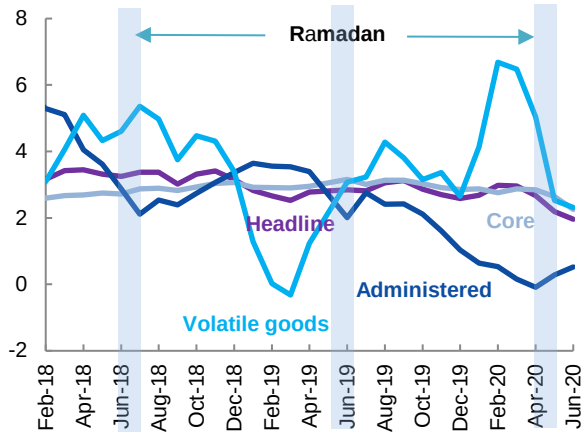
3. Headline inflation edged up modestly in Q1 on higher food prices[36]

Lower food crop production led to a pick-up in food inflation

In Q1 2020, headline consumer price inflation edged up to an average of 2.9 percent yoy from 2.7 percent in Q4 2019 (Q1 2019: 2.7 percent; Figure A.18), still well within BI's targeted inflation band of 2.0 to 4.0 percent. The uptick in headline inflation was driven by higher food inflation. Food prices increased an average of 5.8 percent yoy in Q1, close to double of the average of 3.1 percent in Q4, due to import delays[37] and disruptions to domestic supply due to adverse weather conditions[38] and damaged harvest crops[39] in production centers. Beyond Q1 and in the face of both demand and supply shocks, headline inflation fell to a twenty-year low of 2.0 percent in June and a Q2 average of 2.3 percent, despite Ramadan and Eid festivities.

Figure A.18: Headline inflation edged up in Q1 driven by higher volatile foods inflation

(change yoy, percent)



Note: Calculated using 2018 base
Source: Haver Analytics; World Bank staff calculations

Core and administered inflation eased in Q1

Amid low energy prices, core inflation,[40] which excludes volatile and administered prices, ticked down to an average of 2.8 percent yoy in Q1 from an average 2.9 percent in the previous quarter (Q1 2019 average: 2.9 percent) despite a weaker Rupiah, buoyant prices for health and personal care services, and rising gold prices.[41] Meanwhile, administered price inflation was subdued at 0.4 percent yoy, down from an average of 1.6 percent in the previous quarter, partly driven by a high base effect stemming from higher domestic airfares a year ago[42] and airfare promotions to support dwindling demand.[43] Core inflation fell to 2.6 percent in Q2 as downward price pressures from slumping domestic demand outweighed upward pressures from supply shortages on the back of factory closures, input shortfalls, and a weaker Rupiah.[44]

[36] Data and analysis in this inflation section is based on the new 2018 CPI base series (see Box A.1).
[37] There were delays in the issuance of import licensing for sugar and garlic. The chairman of the Onion Import Association claimed the delay in the issuance of Horticultural Product Import Recommendation (*Rekomendasi Impor Produk Hortikultura*) and the Import Approval Letter (*Surat Persetujuan Impor*) by the Ministry of Agriculture and the Ministry of Trade were the main factors behind the price increase as Indonesia imports 95 percent of its domestic garlic supply from China. Tirto (February 5, 2020).
[38] The culprit in the chili price increase was the rainy season at the end of 2019 which had caused delays in the chilies planting season. Kompas (April 2, 2020).
[39] Shallot prices increased due to a 10 percent decrease in production at the Brebes production center in Central Java as the extended rainy season and pests decreased yields and damaged previous harvest stock. Kompas (April 30, 2020).
[40] Following Bank Indonesia's definition, energy prices are included in core inflation, which consists of everything except foods and administered prices. Included in core is the international commodity prices. https://www.bi.go.id/en/moneter/inflasi/pengenalan/Contents/Disagregasi.aspx.
[41] Gold prices have been rallying with double-digit growth since Q3 2013, supported by low interest rates and safe haven demand.
[42] In early 2019, the Indonesian aviation industry was takenby surprise by the upward adjustment of the ceiling airfares move initiated by Garuda. Kompas (January 16, 2020). The early 2019 adjustment followed what were already high airfares in end-2018, bringing an increase of 40 to 120 percent for many domestic routes. CNN Indonesia (January 15, 2020).
[43] The aviation industry had offered airfares promos for 10 national destinations in February to maintain demand, although the stimulus was only effective in March. CNN Indonesia (February 26,2020).
[44] According to the IHS Markit Indonesia Manufacturing PMI April 2020 report, higher input prices due to input shortages were not paired with higher output prices, partly due to lower output demand.

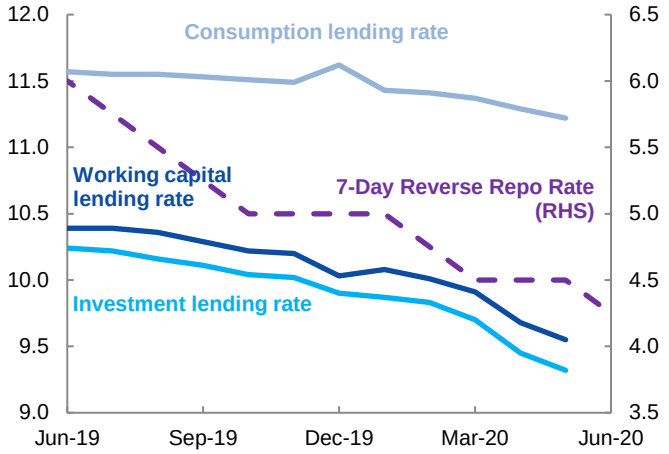
4. Authorities responded to financial market volatility with easing measures

BI lowered the policy rate and implemented liquidity easing measures

As global central banks aggressively eased monetary policy in response to the COVID-induced spike in financial volatility (Section A.2), BI also moved in tandem by lowering the policy rate twice in Q1, despite strong capital outflows. The 7-day Reverse Repo Rate was lowered in February and March, and also in June by 25 bps each time, to reach 4.25 percent. Similarly, the deposit and lending facility rates were also reduced in February, March, and June each time by 25 bps. Since March, BI has also taken several liquidity easing measures: the maximum duration for repo and reverse repo operations have been extended to up to twelve months; repo auctions have been conducted daily; the frequency of foreign exchange swap auctions has been increased; and reserve requirement ratios for banks have been lowered.[45]

Figure A.19: Despite currency depreciations, Bank Indonesia eased the policy rate twice in Q1

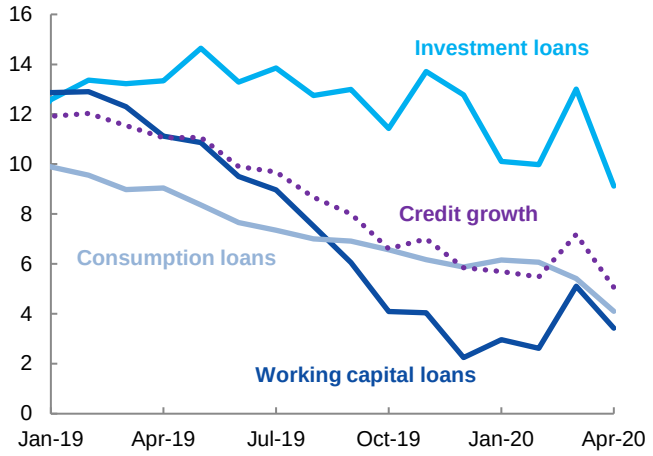
(percent)



Source: BI, CEIC, and World Bank staff calculations

Figure A.20: Credit growth saw an uptick in March, after OJK announced relaxation measures

(yoy growth, percent)



Source: BI, CEIC, and World Bank staff calculations

Credit growth picked up following the lowering of lending rates and credit relaxation measures

In line with the decreasing policy rate, domestic lending rates have also been trending downwards, though not proportionately. The average lending rate[46] fell to 10.3 percent in Q1, from 10.5 in Q4 2019 (Figure A.19). Lower borrowing costs, coupled with measures implemented by the Financial Services Authority (OJK) that temporarily allow special treatment for loans to MSMEs and other COVID-affected debtors[47] partly contributed to credit growth increasing to 7.1 percent yoy in Q1, from 5.9 percent yoy in Q4 2019 (Figure A.20). The uptick in credit growth mostly came from stronger growth in working capital and investment loans.[48] While the average lending rate continued to decline in May to 10.0 percent, credit growth fell to 5.1 percent in April from a six-month high of 7.2 percent in March.

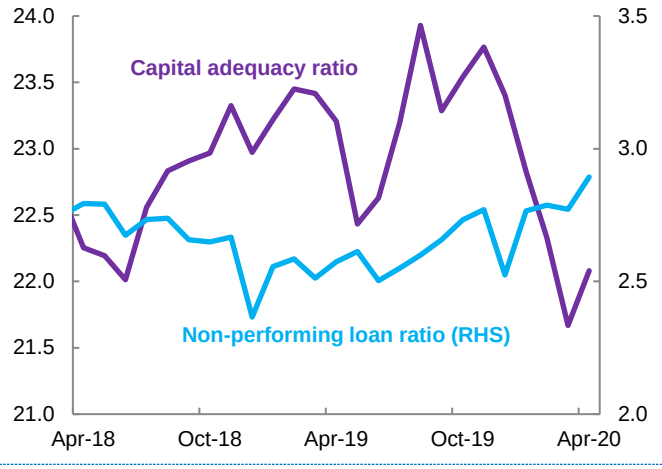
[45] See the press releases of BI's Board of Governors Meeting in March and April 2020 for more information.
[46] The average includes lending rates for consumption, working capital, and investment loans.
[47] On March 16th, OJK introduced a loan relaxation package to help MSMEs and other COVID-affected debtors in addressing liquidity issues arising from contraction in economic activities. The package includes a one-year postponement of credit or leasing payments for loans up to IDR 10 billion for MSMEs and informal workers; and a postponement of credit or leasing payments without ceiling limits in accordance with the debtors' ability to pay the credit.
[48] Investment loans are medium- to long-term credits to purchase capital goods, while working capital loans are short-term credits to finance the working capital. During Q1, working capital loans went up 5.1 percent yoy (Q4: +2.3 percent), and investment loans went up 13.0 percent yoy (Q4: 12.8 percent).

The banking sector remained broadly healthy, with authorities preparing measures in anticipation of liquidity issues

Banking stability indicators signal that the banking system is currently still sound overall. Although the capital adequacy ratio (CAR) decreased to 21.7 percent in Q1 from 23.4 percent in Q4, it remains well above the minimum regulatory CAR of 12 percent. Mirroring the stronger growth in working capital credit, non-performing loans (NPL) for working capital credit also saw the highest growth,[49] which brought the NPL ratio to 2.8 percent in Q1, higher than the 2.5 percent in Q4 2019 (Figure A.21). In the face of possible liquidity pressures, where banks' lending capacity and cash flows would be adversely impacted by the pandemic, the Government has also introduced several measures to protect lending portfolio and ensure credit availability.[50]

Figure A.21: Banking system remains sound

(percent)



Source: BI and CEIC

5. Fiscal policy reacted quickly to the shock to boost spending on health and livelihoods

Successive fiscal packages were announced to enhance healthcare and to cushion the adverse economic impacts associated with the infection

As the understanding of the scope and impact of the pandemic evolved, the Government expanded its fiscal response accordingly. From a small package limited to mitigating the impact on tourism that was announced in February, the 2020 State Budget[51] was most recently revised to incorporate an expanded package of IDR 695.2 trillion, with an overall expected impact on the budget of IDR 711 trillion or 4.3 percent of GDP above and below the line (World Bank estimate)[52], pushing the budget deficit to 6.3 percent of GDP. Key priorities include strengthening health care, expanding social protection, and helping prevent Indonesian businesses from falling into bankruptcy and workers from layoffs. The rule stipulating that the fiscal deficit is not to exceed 3 percent of GDP was relaxed through 2020-22 by the issuance of a Government Regulation in-lieu of Law (Perppu No. 1/2020),[53] as issued by President Jokowi on March 31 this year.

Expenditure measures include additional funding for healthcare, social protection and industry support

The fiscal package will be implemented through a combination of revenue, expenditure and below-the-line financing measures, with expenditures taking the lion's share, amounting to IDR 506.1 trillion for improving health care, expanding social protection, and providing industry support. Total projected expenditures for 2020 were therefore raised to 16.7 percent of GDP from 14.6 percent in the initially approved 2020 budget (Table A.2). The additional expenditures will be funded in part by budget reallocations at the central government level and via the

[49] NPL in working capital loans increased 24.0 percent yoy in Q1 (Q4: +17.4 percent), followed by the NPL increase in consumption loans of 14.5 percent yoy, and investment loans of 11.1 percent yoy. Historically, more than half of NPL came from working capital loans.
[50] Detailed analysis of these measures is provided in Section B.4.
[51] On March 31, the Government announced the first revision to the 2020 State Budget to accommodate the fiscal measures valued at IDR 434 trillion or 2.7 percent of GDP.
[52] Compared to the announced package, the World Bank estimates the impact of the new fiscal measures in the revised budget compared to the original budget, excluding the part of social assistance spending (PKH, Kartu Prakerja and Sembako) that was already in the original budget (IDR 62.7 trillion) and including compensation payments to Pertamina and PLN and the B-30 renewable energy subsidy (total IDR 77.4 trillion) as well as the net increase in DID transfers (IDR 3.5 trillion instead of the announced IDR 5 trillion).
[53] The Government Regulation (Perppu No. 1/2020) was later approved by Parliament thereby becoming Law 2/2020.

composition of transfers to sub-national governments, predominantly at the expense of infrastructure spending.[54]

Table A.2: World Bank estimates of the fiscal impact of the announced fiscal measures in the revised 2020 budget

Fiscal Measure [1]	Revenue	Expenditure	Financing [2]	Total Cost	As percent of GDP[3]
Health		84.6		84.6	0.5
Social protection		139.7		139.7	0.9
MSMEs		40.3	80.8	121.1	0.7
SOEs		76.1	60.2	136.2	0.8
o/w subsidy compensation		76.1		76.1	
Tax incentives	55.0	68.1		123.0	0.8
Other		97.4	3.4	100.8	0.6
o/w labor intensive supports		18.4	3.4	21.8	
o/w transfers to SNGs		12.2		12.2	
o/w reserves		58.9		58.9	
Sub-total	55.0	506.1	144.3	705.4	4.3
Unallocated below the line PEN Program			5.7	5.7	0.0
Total	55.0	506.1	150.0	711.1	4.3

Source: Ministry of Finance and World Bank staff estimates

The fiscal deficit is expected to increase predominantly due to lower revenues

Excluding tax subsidies that are included as expenditures, tax relief measures are expected to reduce revenue by approximately IDR 55.0 trillion. The economic downturn itself is projected to reduce the initial 2020 budget revenue by about IDR 479 trillion. Total Government revenue is therefore projected to fall to 10.4 percent of GDP from 12.8 percent in the initial approved 2020 budget.[55] Consequently, the fiscal deficit is expected to widen from 1.8 percent of GDP in the initial approved 2020 budget to 6.3 percent of GDP. Also included in the COVID package is the borrowing of IDR 150 trillion as below-the-line spending for the National Economic Recovery program (PEN/Pemulihan Ekonomi Nasional).[56] Total debt financing is projected to increase from IDR 351.8 trillion in the initial 2020 budget to IDR 1,220.5 trillion.[57]

The details of the announced fiscal mitigation measures include:

- **Health care:** IDR 84.6 trillion (0.5 percent of GDP)[58] for the procurement of medical equipment (rapid tests, disposable laboratory equipment, personal protective equipment (Alat Pelindung Diri, APD)), preparation of health facilities, enhanced benefits for health care workers, and tax measures such as temporary income tax relief for COVID health care providers, and import duty and VAT waivers for goods associated with the management of the infection.[59]

[54] The investment in infrastructure will be affected through the cuts in the central government budgets for MoPWH as well as transfers to SNGs like DAK Fisik cuts and the subnational infrastructure spending relaxations of 25 percent of DBH and DAU to allow regions to utilize it, in part or in full, for the handling of COVID. This may be for spending in the health sector and social safety net in the form of the procurement and distribution of logistics and/or other urgent spending as determined by the Government.

[55] The revised revenue target is 23.9 percent lower than the revenue target in the initial approved budget.

[56] The PEN program as stipulated by Government Regulation 23/2020 has four policy components including capital injections, bailouts (Government investment), provision of working capital loan guarantees and fund placements. Investor (May 12, 2020).

[57] The total Government debt stock is projected to reach 36.4 percent of GDP, still below the 60 percent legal threshold. In accordance with PERPPU 1/2020, the Government is allowed to finance the budget by using the surplus cash (Saldo Anggaran Lebih, SAL) from previous years; the accumulation of endowment funds; other cash controlled by the government; and funds managed by BLUs. Further, the Government can issue government's bonds and/or Syariah (Islamic) bonds earmarked for COVID-19 that can be bought by Bank Indonesia (in the primary and secondary markets), BUMN, Private Corporate Investors and/or retail investors.

[58] Excludes additional subsidies for BPJS-Health premiums, which has been included in social assistance.

[59] Kontan (April 22, 2020).

- **Social protection:** IDR 139.7 trillion (0.9 percent of GDP)[60] to support the rollout of new social assistance programs, expansion of existing social assistance programs, including the pre-employment card program, and additional subsidies such as the BPJS-health premiums and electricity bill waiver.[61]
- **Support to MSMEs**: IDR 121.1 trillion (0.7 percent of GDP)[62] covers mainly interest subsidies on MSME loans for 3 to 6 months, the placement of funds to provide liquidity support to banks involved in MSME loan restructuring and a guarantee fund for new working capital loans for MSMEs.
- **Support to SOEs:** IDR 136.2 trillion (0.8 percent of GDP), includes mainly additional energy subsidy compensations to PLN and Pertamina (IDR 76 trillion), which is largely due to uncompensated subsidies from earlier years, capital injections[63] and bailouts (mainly from infrastructure, financing and transport SOEs).
- **Tax relief:** IDR 123 trillion (0.8 percent of GDP)[64] This is largely due to the temporary waivers for personal income tax (including final income tax paid by MSMEs), corporate income tax, import income tax, accelerated VAT refunds and the permanent reduction of the corporate income tax rate from 25 to 22 percent.
- **Other spending measures:** IDR 100.8 trillion (0.6 percent of GDP) for the Cash for Work Program under line ministries, support to labor-intensive industries in the form of fund placements for loan restructuring, transfers (DAK Fisik and DID), grants to SNGs for revenue declines associated with the slowdown in the tourism sector (to compensate SNGs for lower hotel and restaurant tax revenue), B30 renewable energy subsidies, housing incentives for low income households, and other potential fiscal measures.

Government expenditure increased in June due to higher spending across most spending types

Largely due to implementation of COVID-19 fiscal measures and relaxation of the LSSR (PSBB), government expenditure increased from IDR 220.0 trillion in May to IDR 225.0 trillion in June. This was due to higher spending across all expenditure categories, except personnel spending and interest payments. Social spending increased compared to May due to the realization of the new and expanded social assistance programs such as Kartu Sembako and PKH (Program Keluarga Harapan; Figure A.22 and Figure A.23).[65] In contrast, personnel spending was smaller than in May and similar to the amount last year due to the postponed disbursement of the civil servants one month salary bonus (*gaji ke-13*).[66]

The deficit narrowed from May to June

The deficit in June at IDR 78.1 trillion was narrower than in May, but net financing[67] was lower at IDR 60.1 trillion for the same period. Together, this resulted in a deficit financing of IDR 18 trillion indicating that the Government had used up some of the frontloaded financing made in

[60] Includes the IDR 3 trillion earmarked for partial subsidies of BPJS-Health premiums for non-wage workers and the unemployed.
[61] New programs include unconditional cash transfers (BLT) for households outside Greater Jakarta, direct in-kind food assistance (Sembako) households in Greater Jakarta and BLT Desa funded by the Village Fund to cover the bottom 50 percent of population. Expansions of current programs include a 3-month extension to the duration of benefits from the PKH program (Family Hope Program) which is targeted at the bottom 20 percent of the population, increases in the number of beneficiaries for Kartu Sembako (cash food vouchers) as well as higher benefit amounts, catering to the bottom 30 percent of the population. In addition, the budget for the pre-employment card program, which provides incentives for unemployed workers to join skilling and re-skilling programs, will be doubled to increase coverage, or equivalently, the number of eligible participants.
[62] Excludes subsidies to MSMEs for final tax payments, which is included under tax relief.
[63] The capital injection to SOEs in some cases is to support the economic recovery. For instance, capital injection in PT SMI as a channel to provide soft loans to Sub-National Governments, BPUI as an insurance holding SOE that would support MSME loan guarantees, ITDC to support tourism in Mandalika (West Nusa Tenggara), HK to complete the Sumatra toll road project.
[64] Excludes health care tax incentives which are included under health care
[65] Implementation of the COVID fiscal package has been relatively slow, partly due to operational and administration issues. Liputan 6 (June 16, 2020).
[66] Republika (July 2020).
[67] Difference between total net government debt issued and total government investment.

the previous months to finance the deficit. The year-to-June cumulative amount was IDR 416.2 trillion or 40 percent of the expected deficit this year. Net issuance[68] of Government IDR securities (bonds and sukuk) and global bonds debt was IDR 430.4 trillion[69] for the year until June. As of May, total outstanding debt was 32.1 percent of GDP. Despite an increase of domestic and foreign holdings of bonds in May, the recent declines in bid-to-cover ratio and increases in yields signal that local and global financing conditions have tightened. In response, BI purchased a total of IDR 200.3 trillion in the year-to-May in both primary and secondary markets, and relaxed reserve requirements to increase liquidity in the domestic financial sector.[70]

Figure A.22: Spending increased in June following increases across almost all spending types
(monthly realization, IDR trillion)

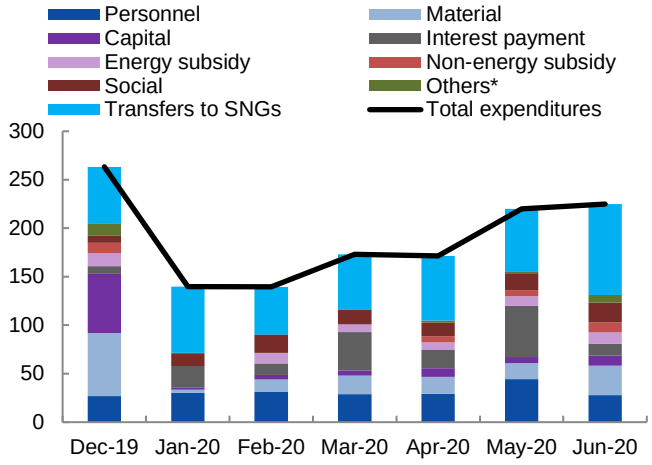
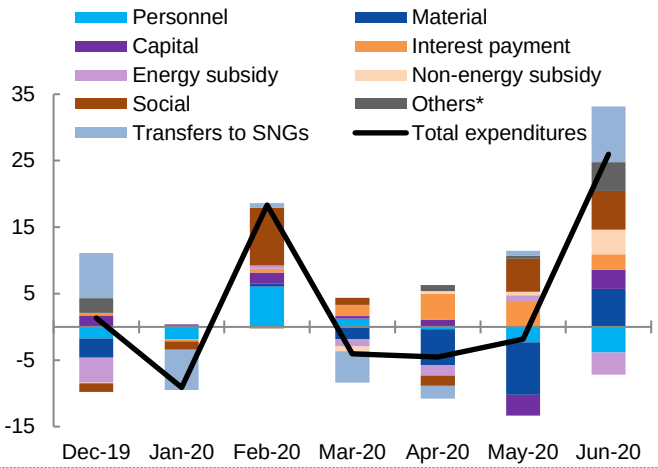


Figure A.23: Almost all expenditure types grew yoy in June except personnel and energy subsidy
(monthly realization, contribution to yoy growth, percent)



Source: Ministry of Finance, World Bank staff calculations
Notes: *Other includes arrears payments from previous energy subsidies

Revenue collections in June fell on reduced economic activity, slumping commodity prices, and declining imports

Amid easing of the LSSR, fiscal revenue collection increased to IDR 146.9 trillion in June from IDR 114.8 trillion in May (Figure A.24), mainly due to higher non-tax revenue from SOEs' shared dividend and BI surplus as well as non-oil & gas income taxes and VAT. The cumulative year-to-June collection reached IDR 811.2 trillion, equivalent to 47.7 percent of the revised revenue target.[71] Compared to last year, revenues in June plunged 14.0 percent yoy as total income tax revenue and non-tax revenue from natural resources fell due to reduced economic activity, lower prices of key commodity exports and tax relief measures (Figure A.25).

[68] Net Issuance refers to the absolute amount of bond issuance less the absolute amount of bond redemptions for the same period.
[69] Kontan (June 16, 2020).
[70] The Board of Governors Regulation 22/2020 formally supports BI's effort to help finance the Government during the COVID-19 pandemic which allows BI to offer the initiative to purchase bonds through additional auction session (Green Shoe Option) and to some extent, private placement if the Government fails to fulfill the auction target at the regular day
[71] By the end of June 2020, total Government revenue reached 47.7 percent of revised revenue target (PERPRES 72/2020), higher than in the same period in 2019 (41.5 percent) as the revised revenue target declined by about 21.5 percent compared to the 2019 target.

Figure A.24: Revenue collection in June increased largely due to non-tax revenue from SOEs' shared dividend and BI surplus
(monthly realization, IDR trillion)

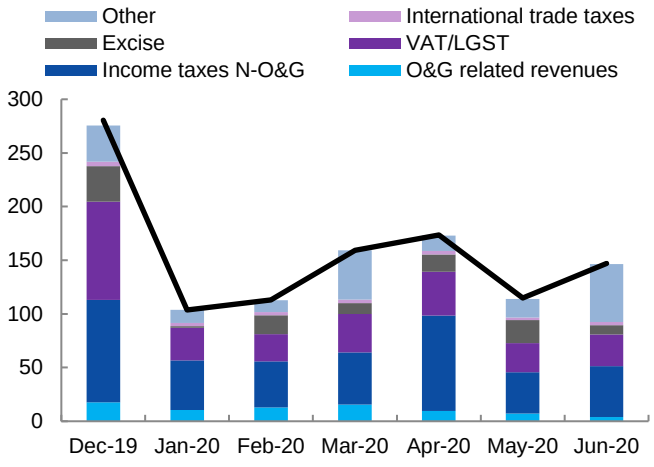
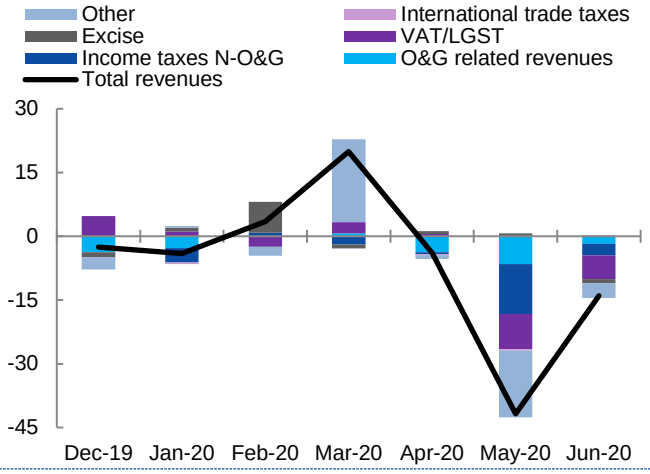


Figure A.25: Revenue collection plunged in June compared to last year as the economic downturn took hold amid stricter containment measures
(monthly realization, contribution to yoy growth, percent)



Source: Ministry of Finance; World Bank staff calculations
Note: O&G related revenues refer to oil and gas income tax, dividends and royalties (non-tax revenues), N-O&G stands for non-oil and gas income tax; VAT/LGST stands for value-added tax/luxury goods sales tax; "Other" includes: land/property taxes, other tax revenues; non-oil and gas non-tax revenues; other non-tax revenues (profits of public enterprises, revenues from Public Service Agency [BLU], and other non-tax revenues [PNBP]); and grants.

6. Labor market conditions deteriorated sharply

Until February 2020, labor market indicators were stable…

Prior to the local spread of COVID-19, Indonesia's employment rate[72] was stable at 65.7 percent in February 2020 (Figure A.26). Between February 2020 and the year prior, 1.6 million jobs were created, the lowest annual increase since 2016.[73] The lack of employment growth is likely driven by a combination of slower growth in the working age population and stagnant wages[74,75] The unemployment rate also remained stable at 4.9 percent. Underemployment declined slightly in February 2020 from a year before (Figure A.27), with a decline in involuntary underemployment slightly offsetting an increase in voluntary underemployment.[76]

…but have deteriorated rapidly since

The COVID-19 pandemic has thrown labor markets into disarray, both globally and in Indonesia. Q1 2020 statistics largely miss capturing these changes as mobility restrictions largely came into effect only in late March. However, more recent data from other sources, such as the World Bank panel phone monitoring (HiFy) survey, is informative of the depth of the disruption in the labor market (Box A.2).

[72] The employment rate is the number of employed workers divided by the total working-age population. Its recorded value tends to be higher in the February Sakernas than the August Sakernas.
[73] Source: BPS February 2020 Labor Press release. Between February 2019 and 2020, the largest contributors to job creation were the education and construction sectors which saw 400,000 and 345,000 new jobs, respectively.
[74] Lack of higher wages to attract the inactive working age population into the labor force.
[75] Indonesian labor market statistics are published twice a year in February and August. However, comparisons of February and August data values are avoided as there are seasonal differences, such as differences in crop seasons, which would affect workforce employment and other labor market statistics. This trend has been unfolding over the last 3 years and can be consistently observed in both August and February yoy trends.
[76] The growth in voluntary underemployment has been commensurate to the rise of a gig economy, where people are working on shorter term contracts or in free-lance work. Over the last decade this trend has increased, though it has somewhat stabilized over the last two years, both for women and men, with 34 and 17 percent respectively of those underemployed being voluntarily so. This modest shift that is taking place in the labor market indicates that more workers, and particularly women, prefer shorter and more independent jobs associated with more flexible work arrangements or may be resorting to taking up jobs that are available.

Figure A.26: The employment and unemployment rates remained constant between February 2019 and 2020

(percent, percent)

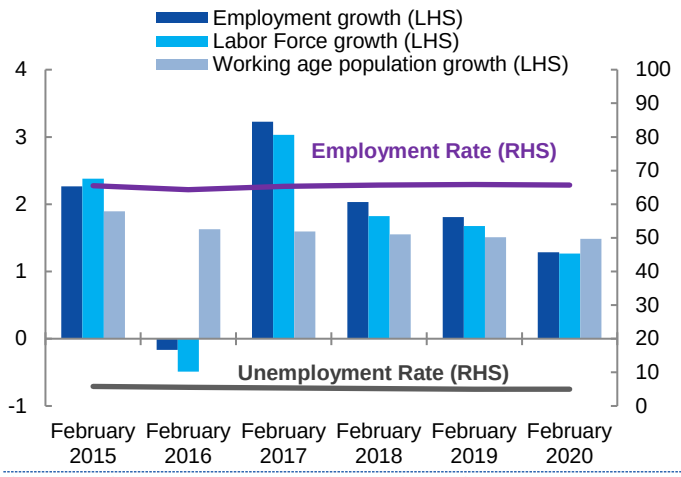
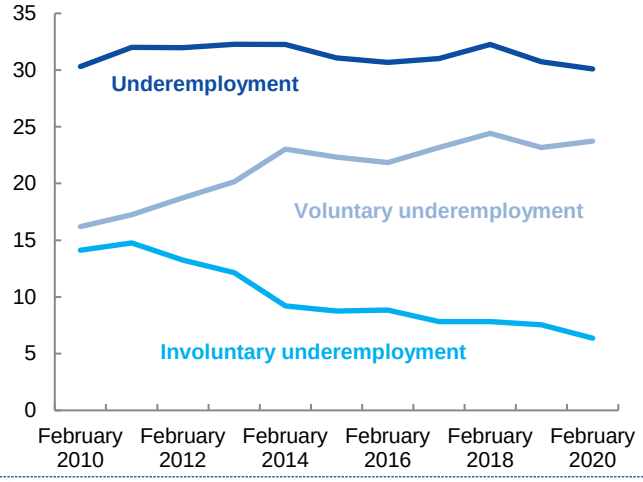


Figure A.27: Underemployment has fallen, driven by an increase in voluntary unemployment.

(percent)



Source: BPS National Labor Force Survey (Survei Angkatan Kerja Nasional, Sakernas), WB staff calculations
Note: Includes February readings only. February 2020 data updated from the BPS February 2020 Labor Press release.

Nearly a quarter of survey respondents had stopped working

The first round of the HiFy survey on the socio-economic impacts of COVID-19 on households has shown that many workers who were active before the pandemic, had to stop working.[77] By late May, 24 percent of survey respondents said they were not currently working. While cessation of work happened in all sectors and seasonality may play a role, most of the respondents who reported that they stopped working were in the hard-hit manufacturing, construction and transport, storage and communication sectors (see Section A.1, Figure A.28).[78] While there was no significant variation found between poor and non-poor respondents,[79] there were difference between men and women in terms of likelihood to having to stopped working (Box A.3)

Around two-thirds of the survey respondents who were still working experienced reduced income

Among those that reported in the survey that they were still working, 64 percent experienced reduced income. 90 percent of workers in the transport, storage and communication sectors and 84 percent of those in the trade, hotel and restaurant sectors reported lower incomes. Some workers were flexible enough to continue working albeit in different jobs in the same sector or different jobs in another sector. Of those still working, 11 percent noted that they had switched jobs. For instance, of the 54 percent that were earlier in the service industry, 46 percent switched to work in agriculture, 13 percent switched to the industry sector, while another 41 percent switched jobs within the service sector.[80]

The impact on livelihoods has been greater on the less educated and those living in urban areas

As of February 2020 unemployment rates were highest for those with a vocational (SMK) degree, at 8.5 percent. However respondents to the HiFy survey who stopped working in late May came from all levels of education. About a quarter of those with junior secondary or lower or senior secondary education have stopped working, compared to only 14 percent of those with a tertiary education. Meanwhile, those with junior secondary education have a higher chance of facing reduced income, than those with senior secondary and tertiary education.

[77] Those who have stopped working can be defined as unemployed, therefore comparisons to unemployment are not made.
[78] Though there was zero growth in agriculture partly due to a delayed harvest, employment in the agricultural sector is found to be the most resilient, as expected.
[79] This is in some contrast to broadly comparable household survey data that suggests that employment is slightly higher, at 64 percent, for the poor than at 60 percent for the non-poor.
[80] Ibid.

Workers with lower education are more often employed in sectors such as manufacturing and construction where many workers reported having stopped working in the HiFy survey.

While the COVID-19 pandemic is affecting workers in all areas, those in urban areas are significantly more likely to have stopped working (26 percent) versus those in rural areas (19 percent). Respondents residing in Jakarta had the highest propensity to have stopped working at 29 percent versus 26 percent outside Jakarta in Java and 19 percent for those outside of Java.[81] Nevertheless, the shift of workers to agriculture puts pressure on agricultural labor markets and shows indicates how the shock can spill over to rural areas. No significant gender differences were found among those who stopped working (Figure A.29).

Figure A.28: Significant increases in those not working versus employment shares in February 2020 is found in both industry and service sectors

(percent)

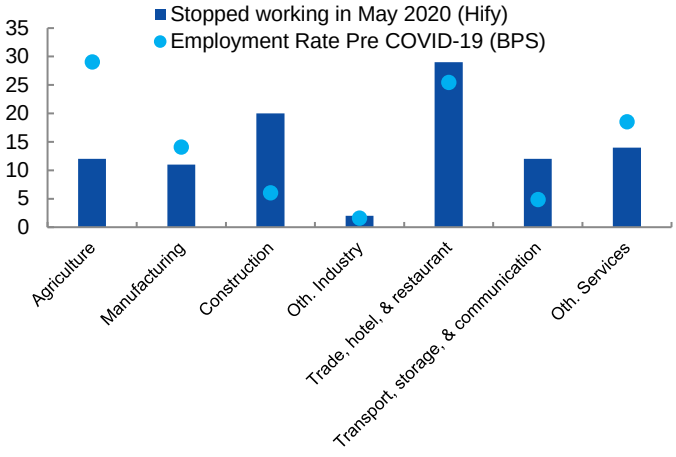
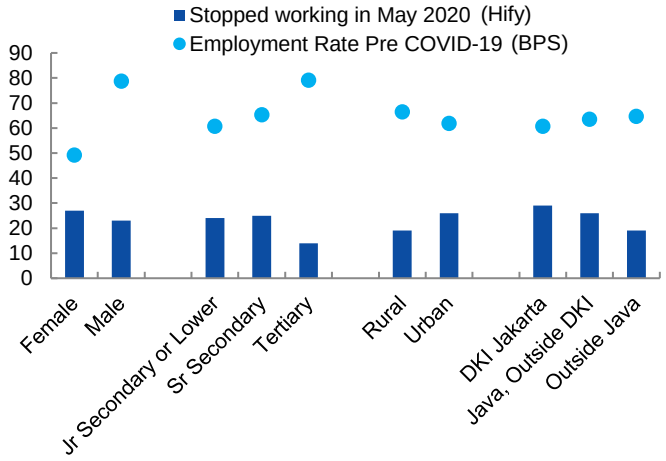


Figure A.29: Those not working more often reside in DKI Jakarta and, urban areas and hold lower education credentials

(percent)



Sources: For during-COVID-19 estimates for May: World Bank (2020) Indonesia High-frequency monitoring of COVID-19 Impacts. For pre-COVID-19: Source: BPS National Labor Force Survey February 2020 (Survei Angkatan Kerja Nasional, Sakernas), WB staff calculations.

It is estimated that only 21 percent of the jobs in Indonesia can be performed from home

COVID-19 social distancing measures might have persistent effects on the labor market and those who can work from home will be less affected. Because of the continuation of social distancing, many jobs will continue to be performed from home in the coming months or even permanently. It is estimated that only 21 percent of the jobs in Indonesia can be performed from home, with jobs in construction hotels and restaurants, or those that are informal or conducted in rural areas being less amenable to be done from home (Box A.4).[82]

7. Without emergency social assistance, COVID-19 could push millions into poverty

If not mitigated, losses in employment and

In the absence of the Government's social assistance measures for households (henceforth referred to as "relief measures for households"), model estimates suggest that the economic fallout of the pandemic could push 5.5 to 8 million Indonesians into poverty in 2020.[83] This

[81] World Bank (2020) Indonesia High-frequency monitoring of COVID-19 Impacts.

[82] Of course, there are jobs that cannot be done from home but will not be affected as much if these are in essential businesses. Likewise, there are jobs that are amenable to be done at home though the workers might suffer (wage) losses or even lose their jobs if the demand for their firms' goods and services diminishes.

[83] Estimates as of 15 June 2020 based on the World Bank's recent work "Poverty and distributional impact of Covid19 in Indonesia: A macro-micro simulation approach". The model for simulating the pandemic's impact on poverty combines macroeconomic projections for GDP and sectoral output growth with pre-crisis microdata from household and labor force surveys (SUSENAS and Sakernas 2019) to predict income and consumption at the individual and household levels under three scenarios: (i) business-as-usual (growth estimate of 5.0 percent); (ii) a mild shock

household income can lead many families to fall into poverty

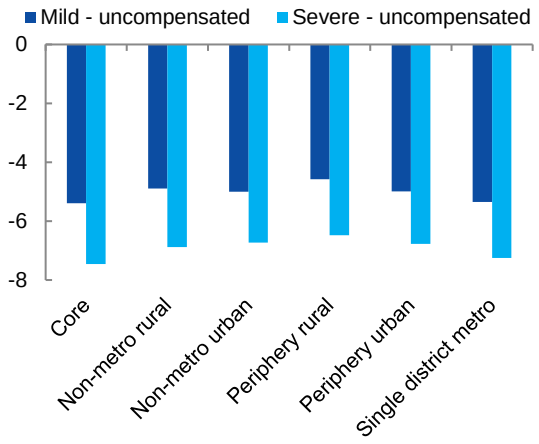
would result from an aggregate decline in household incomes of between 5 and 7 percent – mainly due to lower earnings – as well as employment losses among 2.6-3.6 million Indonesians who would either lose jobs or become inactive. The sharpest declines in earnings would occur in the traditional services and agriculture sectors, followed by manufacturing. As observed on the ground through the HiFy survey, employment losses[84] are concentrated in the traditional services sector, followed by manufacturing and other industries, while employment in agriculture would register a net gain, serving as a buffer for some who lose jobs in other sectors.

Income and employment impacts vary by location

Households living in core and single district metro (urban centers) would experience the highest fall in overall income of between 5.5 to 7.5 percent, depending on the duration of regional mobility restrictions (Figure A.30). Across island-regions in the country, the impact on household income is relatively homogenous, except Papua with a relatively higher household income loss of 8.7 percent.[85] The impact on employment would vary across geographies, depending on region-specific reliance on adversely affected economic activities. Java and Sumatera would account for half of job losses expected across the country.[86] This is due to the large share of workers in these regions relying on traditional services. More than half of workers who become inactive or lose their jobs reside in non-metro rural areas.

Figure A.30: COVID-19 would cause income shocks, with the largest drop among urban households

(percent change)



Source: World Bank staff calculation.
Note: The percent change is relative to benchmark 2020. 'Uncompensated' scenario shows estimated income shocks without the government's relief measures for households. 'Mild' case assumes 0 percent GDP growth, whilst 'Severe' case assumes -2.0 percent GDP growth.

In response to the crisis, the GoI has instituted substantial increases in social assistance and economic support measures for households…

The Government's social protection response to the crisis has been strong. Measures to mitigate adverse impacts among the poor and vulnerable include vertical and horizontal expansion and repurposing of several existing social assistance programs, as well as addition of new ones (Table A.3). Most of the measures target households in the bottom 40 percent of the income distribution, for whom information was readily available in the existing social registry (DTKS), including those that were not covered by existing programs.[87] Additional programs to capture those that might be affected but whose information was not already available were also put in place, including those who reside in areas with high rates of infection and mobility restrictions (Sembako for Jabodetabek), those who reside in rural areas (reallocation of the Dana Desa funds

(growth estimate of 0 percent estimated under assumptions of a deep global recession and moderate domestic restrictions); and (iii) a severe shock (growth estimate of -2.0 percent estimated under assumptions of a deep global recession and severe domestic restrictions). Macroeconomic forecasts for growth in sectoral GDP are as follows, for the mild and severe impact scenarios respectively: Agriculture (-0.6% and -2.1%), Manufacturing (-2.6% and -5.3 percent), other industry (-0.8 and -2.8), traditional services (-1.1% and -3.7%), and modern services (5.2% and 4.7%).

[84] "Job losses" refer to both the unemployed and those who have become inactive due to the pandemic. The simulation model is based on the March 2019 SUSENAS that does not distinguish between the two.

[85] This is because nearly 65 percent of workers in Papua rely on agriculture, whereby the average earnings are expected to be the highest by 6 percent under severe and unmitigated cases.

[86] Java would experience the highest job losses equivalent to 1.1 million under the severe impact scenario, followed by Sumatera with 0.7 million jobs lost.

[87] DTKS contains information on households in the bottom 40 percent of the population and – pre-COVID-19 – was used primarily to target programs aimed at supporting consumption of the bottom 15 percent (PKH) and bottom 25 percent (Sembako).

for Unconditional Cash Transfers) and those who lost work and wished to undertake skills training (*Kartu Prakerja*). Most of the programs were announced in April, and will in principle be implemented for a duration between 3 and 12 months. These generous measures effectively double the Government's spending on core social assistance relative to that in the 2019 budget realization, and if they reach the target population, they would significantly offset much of the aggregate income loss to households, lowering it to between 3.4 and 5.3 percent. Households in non-metro-rural areas would benefit most from the mitigation efforts, with the fall in average income half of what it would have been without the relief measures.

Table A.3: Government's full response package to COVID-19

Program name	Benefit type, beneficiary selection, and coverage	Increased coverage above pre COVID-19	Benefit incidence & duration	Implementation	Budget (IDR tn)
Sembako (Staple food)	Existing food assistance program, targeting the poorest 25 percent households included in the DTKS	Expansion from 15.2 to 20 million households, identified among those already in the DTKS	Increased benefits of IDR 200,000/month (for 12 months)	monthly, for 9 months (starting in March for existing households, expansion started in April)	15.5
PKH	Existing family conditional cash transfer, targeting the poorest 15 percent in the DTKS	Expansion from 9.2 to 10 million households identified among those already in DTKS	Increased benefits by 25% for 12 months	monthly-for 9 months (starting in April)	8.3
***Kartu Prakerja* (Pre-employment card)**	Pre-employment card targeting job seekers, aged 18 or above who are not in formal education and not receiving PKH or Sembako _	Expansion from 2 to 5.6 million individuals in total	Training: IDR 1 million/month, benefits of IDR 600,000/month (4 months), IDR 50,000/month (3 months)	Launched in April, rolling out progressively	10
UCT (Non-Jabodetabek)	Newly launched unconditional cash transfer, targeting households in DTKS and *outside* Jabodetabek area, who are not currently covered in any of the existing programs (Sembako, PKH, and Prakerja)	9 million households	IDR 600,000/month (3 months), then IDR 300,000/month (6 months)	April-December, 2020	32.4
Sembako (Jabodetabek)	New food transfer covering COVID-19 affected vulnerable household residents of Jakarta and districts surrounding the capital (Bodetabek)	1.2 million households in Jakarta, 600,000 households in peripheral districts (Bodetabek)	Food package equivalent to IDR 600,000/month (3 months), then IDR 300,000/month (6 months)	April-December, 2020	6.8
Electricity Subsidy	Newly launched electricity fee waivers and partial discounts	All households subscribing to 450VA and 900VA electricity connection.[88]	HHs with 450 VA – fee waiver (6 months) HHs with 900 VA – 50% off bills (6 months)	April-September, 2020	6.9
BLT Dana Desa (Village Fund)	Newly launched unconditional cash transfers using 31 percent of Indonesia's Village Fund (Dana Desa) program will be re-allocated to target rural households that are not covered by the Sembako, PKH, and Prakerja programs but affected by Covid-19	11 million rural households, prioritizing those who lost main source of income due to COVID-19[89]	IDR 600,000/month (3 months), then IDR 300,000/month (3 months)	April-September, 2020	31.8

[88] These add up to 50 million households in the 2019 SUSENAS.
[89] The WB simulation model assumes 11 million households on basis of earlier data from MoF.

Source: World Bank staff compilation from various sources.

…that have the potential to significantly mitigate the increase in the poverty headcount rate due to the pandemic

Absent the GoI's relief measures for households, following the outbreak of the pandemic, Indonesia was projected to face a poverty headcount rate of anywhere between 10.7 and 11.6 percent in 2020, translating into 5.5 to 8 million new poor relative to the year before, with the pandemic threatening to wipe out gains in poverty reduction over the last seven years (Figure A.31). If the planned relief measures were fully executed as planned and delivered to the target population without overlaps between programs, and if people returned to work as mobility restrictions are phased out in the third and fourth quarters of 2020, the estimated poverty rate, instead of rising, could fall to between 8.2 and 9.0 percent, with the poverty rate in the mild crisis scenario falling below even the benchmark rate of 8.6 percent in a 2020 without COVID-19 (Figure A.32). This could translate into the equivalent of 1.3 million households either being *lifted out* of poverty in the mild impact scenario, or at most 920,000 households *entering* poverty in the severe impact scenario. The relief packages could also mitigate the adverse impact on inequality, lowering the Gini coefficient from between 38.5 and 38.7 to 37.3 and 37.5 in the mild and severe impact scenarios respectively, slightly lower than the 2020 benchmark of 38.2.[90]

Figure A.31: Without Government social assistance measures, seven years of accumulated gain in poverty reduction would be erased
(poverty rate in percent)

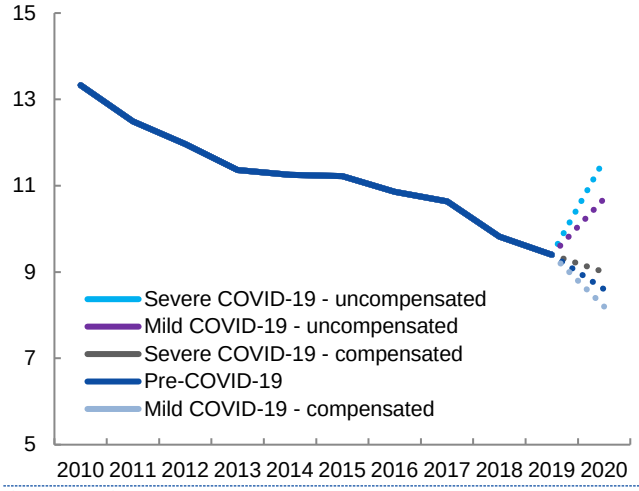
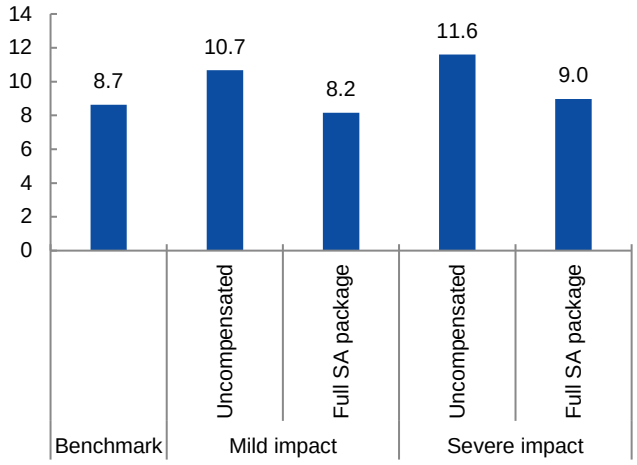


Figure A.32: Full government responses could offset increase in poverty due to COVID-19
(poverty rate in percent)



Source: BPS, World Bank staff calculation
Note: Pre-COVID-19 level refers to year 2019, and adjusted with the actual coverage of social assistance (SA) measures; 2020 number refers to simulated poverty rate. 'Benchmark' shows the forecasted poverty rate in 2020 without COVID-19 shock; 'Uncompensated' scenario shows the 2020 COVID-19 poverty shock when there is an absence of government compensation; 'Compensated' scenario shows 2020 poverty rate (simulated), after taking into account the full SA package.

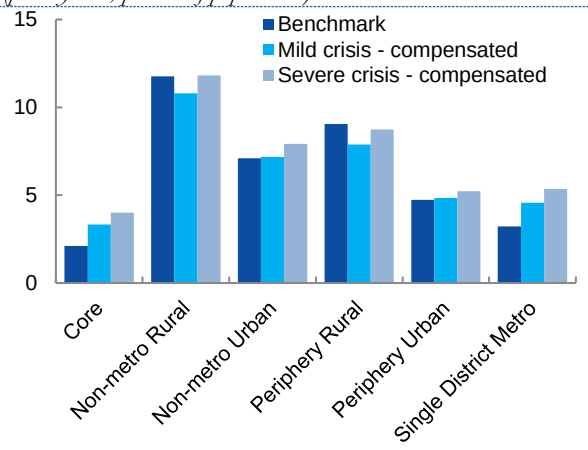
[90] The relief packages would also mitigate the adverse impact on depth of poverty, lowering the poverty gap – a measure of how far the mean income of the poor lies below the poverty line – from between 2.18 and 2.55 to 1.56 and 1.87 in the mild and severe impact scenarios respectively, but would not completely offset it given the benchmark 2020 gap of 1.40.

GoI's pandemic response could be particularly effective in preventing deepening of poverty in rural areas

Poverty rates after taking into account the GoI's pandemic response measures for households vary across locations. If measures were fully implemented as planned and appropriately targeted, poverty in non-metro rural areas even under the severe impact scenario could be maintained at the benchmark level projected for 2020 without the pandemic,[91] but would be reduced to a level slightly *lower* than the benchmark in peripheral rural areas (Figure A.33). Similarly, assuming flawless execution of measures, poverty in Java and Papua could be maintained at benchmark levels even under the severe impact scenario. But urban centers and areas like Bali with relatively heavy reliance on affected sectors (e.g. tourism) could face poverty rates higher than the 2020 benchmark.

Figure A.33: Government responses could mitigate impact on the poor, mainly among rural households

(poverty rate, percent of population)



Source: World Bank staff calculation.
Note: The percent change is relative to benchmark 2020. 'Uncompensated' scenario shows estimated income shocks without the government's relief measures for households. 'Mild' case assumes 0 percent GDP growth, whilst 'Severe' case assumes -2.0 percent GDP growth.

Figure A.34: The new poor would mainly engage in traditional services, one of the most affected sectors due to COVID-19

(share of poor, percent)

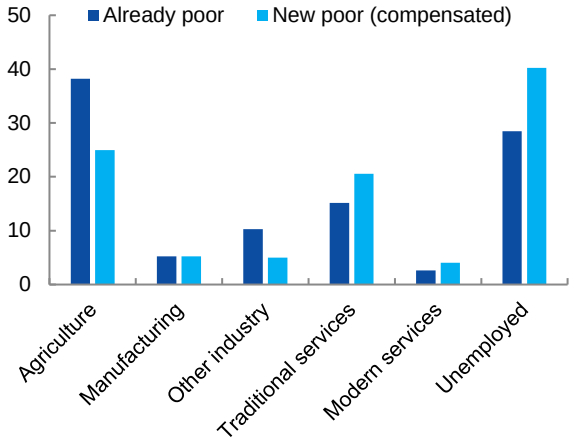
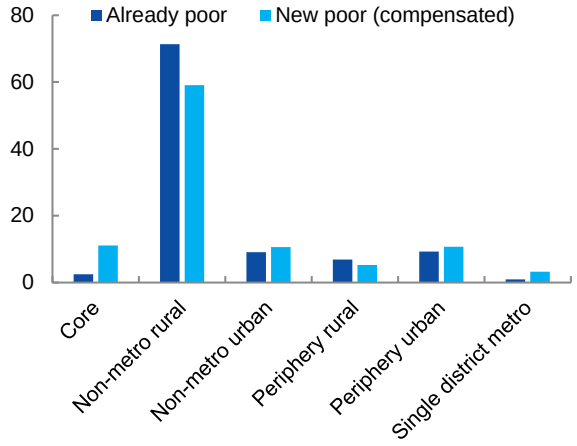


Figure A.35: More than half of the new poor also reside in rural parts of Indonesia

(share of poor, percent)



Source: BPS, WB staff calculation.
Note: 'Already poor' (or structural poor) refers to individuals who would become poor in 2020 (both in benchmark and severe case). 'New poor' refers to who would become poor under severe case. Traditional services include wholesale and retail, transport and warehousing, accommodation and restaurants, and other services. Modern services include ICT, finance and insurance, real estate, company services, government administration, defense and social security, education and health services.

The *new poor* would work mainly in agriculture and traditional services,

Under the severe shock scenario, even if all social support measures were fully implemented as planned and appropriately targeted, there could still be around 920,000 additional poor – as a

[91] The benchmark level refers to what the poverty rates would be in year 2020, in the absence of the COVID-19 pandemic.

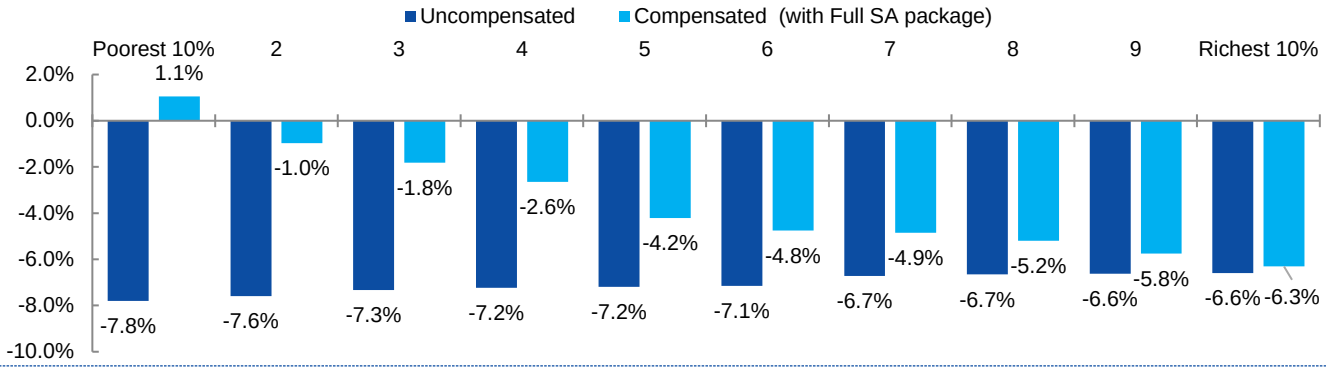
and reside in non-metro rural areas

result of employment and income shocks.[92] Among the new poor in 2020, after taking into account the GoI's COVID-19 response, 40 percent could be unemployed or become inactive, followed by a quarter relying on agriculture and 21 percent on traditional services (Figure A.34). Most of the structural poor (i.e. those who were already poor before the pandemic and would remain so in 2020) would be in the agriculture sector, followed by traditional services. The traditional services sector is forecasted to suffer the most due to the pandemic, with the highest expected job losses. More than half of the new poor (those who become poor due to COVID-19) also reside in non-metro rural areas (Figure A.35). Even if all support measures were fully delivered a planned, many of the new poor would be in non-metro rural areas, indicating deepening of poverty pockets in rural areas.

GoI's pandemic response packages targeted to households do not fully offset welfare losses, particularly for the 5th to 8th deciles of the income distribution

The relief packages will help cushion the economic shock for the lowest deciles (Figure A.36), but will not fully offset welfare losses among the bottom 40 percent, especially in the third and fourth deciles. The standard benefit programs are equivalent to IDR 600,000 (per month, per household) for the first three months, and then lowered to IDR 300,000 for the next months. These are far below the national poverty line of IDR 404,398 per person per month, and much lower than the poverty line in some areas with high poverty incidence (e.g. Papua with an IDR 520,117 poverty line). Even after receiving the cash transfers, the poor or vulnerable who lose jobs would not be receiving enough support to be lifted out of poverty in the case of a severe economic shock. Households between the fifth and eight deciles would experience higher welfare losses of up to 5 percent in the severe impact scenario even after accounting for the impact of the relief packages, the majority of which are by design targeted towards the most vulnerable.[93]

Figure A.36: Current social assistance package does little in protecting households above the bottom 40
(percent change in per capita consumption over the benchmark scenario)



Source: World Bank staff calculation.
Note: The above figure presents employment impact of COVID-19, comparing benchmark (2020 as business as usual scenario, if there is no COVID-19) and severe case of COVID-19. Percent change is relative to the benchmark (2020 without COVID-19 shock).

To ensure mitigation of the adverse impacts on poverty, it is essential that GoI relief measures

The Government's social assistance and economic relief packages for households have the potential to mitigate the pandemic's projected impact on the poverty headcount. However, for this to be realized in practice, interventions must reach those who are targeted, with minimal leakage, and be implemented in a timely manner. Current progress shows high spending realization of many of the social assistance programs (see Part B). Nevertheless, findings from

[92] The full SA package provides economic cushion mainly to compensate income losses due to COVID. However, government mitigation against employment losses remain limited. If economic shock becomes more severe, the full SA package would not be able to fully compensate welfare losses among the Bottom 40 (especially those in the third and fourth decile consumption distribution) and the limited mitigation measures on employment provides no protection against job losses due to COVID.
[93] Some programs are accessible also to those not previously identified as vulnerable in DTKS, and due to imperfect targeting some of the benefits targeted to the poor are received by households above the poorest 40 percent but overall the SA packages aim to primarily protect the poor and vulnerable.

for households be rolled out faster in the coming months and reach those targeted

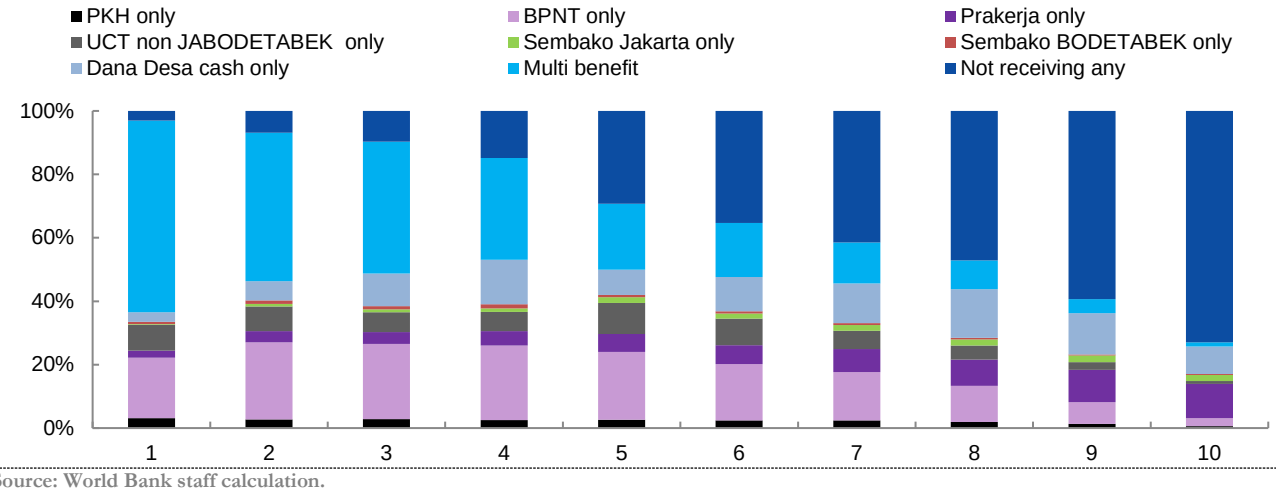
the HiFy survey suggest that there is still much more work to be done on both dimensions. In early May 2020, most households (54 percent) in the bottom 40 percent reported benefiting from at least one GoI social assistance program since February 2020, and the share rose to 78 percent after accounting for loan deferment and electricity subsidy programs. Still, just over two in five households in the bottom 40 percent had not received any assistance under the PKH, *Sembako*, BLT, *Kartu Prakerja*, or cash-for-work programs. The share stood at 51 percent of households whose breadwinners had stopped working, and 56 percent among those experiencing reduced incomes. 20 percent of households in the bottom 40 percent who reported shortage of food had not received *Sembako*, while a recently launched *Kartu Prakerja* and BLT programs have, within about a month, reached 13 percent and 14 percent of its target respectively[94]. To achieve the program targets the Government has committed to, implementation efforts need to focus much more sharply on improving delivery of assistance to the targeted poor and vulnerable households.

Millions of households relying on informal work remain unprotected

Just over half of households relying on income from vulnerable informal sector jobs, but who are not in the bottom 40 percent, are projected to receive some form of social assistance in 2020 (Figure A.37). This translates into about 4 million households who are in between the fifth and eighth deciles and rely on informal work, but will not have access to assistance under *any* of the GoI's seven COVID-19 response measures except *Kartu Prakerja*. More than half of households relying on the informal sector for income and who are not covered engage in the traditional sector, where the sharpest declines in employment are expected. Nearly 60 percent of these are self-employed, 45 percent have no access to any health insurance, over 70 percent have no access to credit and over half do not own a bank account. Around half of them reside in rural areas.

Figure A.37: Current SA package covers over half of households in the 5th-8th deciles that rely on informal sector jobs, yet many of them remain with no access to any kind of government assistance

(percent to total SA package)



Source: World Bank staff calculation.
Note: Houseohlds here refers to households relying on informal jobs.

Social protection architecture to reach those above the

The Government's pandemic response packages do little to protect most of Indonesia's aspiring middle class, that is, households in the fifth to eight deciles of the consumption distribution and among whom many engage in informal sector work, a group vital to expanding the middle class

[94] As of early May 2020, BLT and Kartu Prakerja have been received by 4 percent and 1 percent of about 71 million Indonesian households respectively. Taking into account the Kartu Prakerja's target of 5,6 million and BLT's target of 20 million, the proportion of the programs' recipient households could be translated into about 13 percent and 14 percent of the programs' target respectively.

bottom 40 percent is urgently needed

and crucial for unlocking Indonesia's development potential as well as attaining high-income country status.[95] Measures to extend support them are discussed in Section B.5.

8. Economic outlook and risks

Economic growth is projected to weaken substantially this year but expected to recover in 2021-2022

With the onslaught of both domestic and external shocks, Indonesia's economic outlook has turned significantly weaker with the COVID-19 pandemic especially for 2020, but is projected to recover over 2021-2022.

Real GDP growth is forecast to plunge to zero percent in 2020 on account of COVID-19 effects

Real GDP is expected to be flat in 2020, unchanged from 2019, despite expansionary monetary and fiscal policy (Table A.4).[96] Private consumption is expected to slow sharply and investment to contract this year with social distancing and the imposition of travel restrictions and the large-scale social restriction (LSSR). With a substantial portion of the population undertaking home-based-work and other personal preventive behaviors to avoid infection, growth of consumption of services are all expected to weaken sharply. Job losses and the decline in consumer confidence will exacerbate the slowdown in private consumption. Investment is also projected to shrink due to the large uncertainty associated with the infection and its containment, weaker domestic economic activity, lower commodity prices and the global recession. Even with the ease of mobility restrictions, social distancing and personal avoidance behaviors are likely to persist until a vaccine is discovered and widely administered. While Government consumption growth is projected to accelerate with fiscal mitigation measures, it is unlikely to offset the weaker components of domestic demand. Both export and import volumes are projected to slump on adverse external conditions with the global economy expected to contract by 5.2 percent this year.[97] However, imports are projected to shrink more rapidly on sharply weaker domestic demand.[98] Net exports are therefore expected to make a positive contribution to overall headline growth.

[95] World Bank (2020). 'Aspiring Indonesia: Expanding the Middle-Class'

[96] The baseline scenario assumes the current LSSR restrictions in place since March are phased out in stages as announced. In particular, it assumes a transition to a full re-opening in June and July, with no further restrictions from August. It also assumes that the global economy will contract by 5.2 percent this year. See World Bank (2020). Global Economic Prospects, June 2020. Econometric analysis suggests that each percentage point decline in global growth leads the Indonesian economy to slow by 0.2 percentage point.

[97] The global economy is projected to undergo a severe recession, contracting by 5.2 percent in 2020 (World Bank 2020. *Global Economic Prospects*. June 2020. Washington, DC: World Bank). This is approximately 223 percent more severe than the global contraction during the Global Financial Crisis. Correspondingly, Indonesia's exports are assumed to contract 223 percent more than the observed decline in exports during the Global Financial Crisis. Given that Indonesia's real exports contracted around 10 percent in 2009, exports are therefore assumed to contract by around 23 percent in 2020.

[98] Due to a number of factors, Indonesia's imports have been trailing exports throughout 2019 and are expected to continue doing so this year, especially given the observed slump in imports from China in Q1 this year. In addition, as observed in past crisis years, the sharp demand in domestic demand is expected to lead to import compression, which further contributes to a weaker performance relative to exports.

Table A.4: Key economic indicators
(growth yoy, percent, unless otherwise indicated)

	Annual				Revision from Dec 2019 IEQ
	2019	2020e	2021f	2022f	2020
1. Main economic indicators					
Gross Domestic Product (GDP)	**5.0**	**0.0**	**4.8**	**6.0**	**-5.1**
Private consumption	5.2	1.0	5.0	5.3	-4.1
Government consumption	3.2	5.0	2.0	4.5	1.3
Gross fixed capital formation	4.4	-3.5	4.5	6.5	-8.5
Export volumes of goods and services	-0.9	-23.0	1.0	12.0	-24.5
Imports volumes of goods and services	-7.7	-27.0	-1.5	10.3	-27.5
2. Other economic indicators					
Consumer price index	2.8	2.6	2.8	3.0	..
3. Economic Assumptions					
Exchange rate (IDR/USD)	14237	..	..	..	..
Indonesian crude price (USD/bbl)	67.5	24.4	26.4	28.0	-2.4

Source: BPS; BI; CEIC; World Bank staff projections
Note: 2019 figures are actual outcomes; f stands for forecast. Statistical discrepancies and changes in inventories are not presented in this table. All GDP components are based on the latest GDP data. Exchange rate and crude oil price assumptions are average annual data. Revisions are relative to projections in the December 2019 edition of the Indonesia Economic Quarterly.

An economic recovery is forecast for 2021-2022 predicated on the flattening of infection rates domestically and abroad

Despite the severity and the extent of the economic fallout associated with the pandemic, the downturn is expected to be temporary and a gradual economic recovery is projected once the infection is contained locally and globally. Predicated on the flattening of infection rates curve sometime this year and the absence of infection flare ups or subsequent waves, economic growth is expected to strengthen as social distancing measures and mobility restrictions are dialed back domestically and abroad as infection rates ease, production activities gradually normalize, and domestic and global demand slowly recover. An economic recovery that spans the next two years (2021-2022) is projected with private consumption gradually recovering first, followed by private investment. The recovery in investment growth is projected to lag because firms' balance sheets are expected to be impacted with domestic containment measures and require time to be repaired before further investment can be undertaken. In addition, with banks' high exposure to the corporate sector, the banking sector will also require some time to recapitalize and to reduce the share of non-performing loans, weighing on financing for investment in the interim.[99]

Uncertainty surrounding the outlook is extremely high given that the infection is still evolving within and outside Indonesia

The precise magnitude and timing of the recovery, however, will largely depend on the extent of mobility measures domestically and aboard, which will in turn be contingent on the extent, severity and duration of the infection. Uncertainty surrounding the growth outlook is extremely high, given that the infection is still evolving locally and globally and could still impact domestic and external economic conditions. Risks to the outlook are still substantially tilted to the downside. Key risks include a longer-than-expected duration of the pandemic, a muted economic recovery, a prolonged period of heightened financial stress, and a sharper- and longer-than-expected contraction in global trade compounded by re-escalating trade tensions.

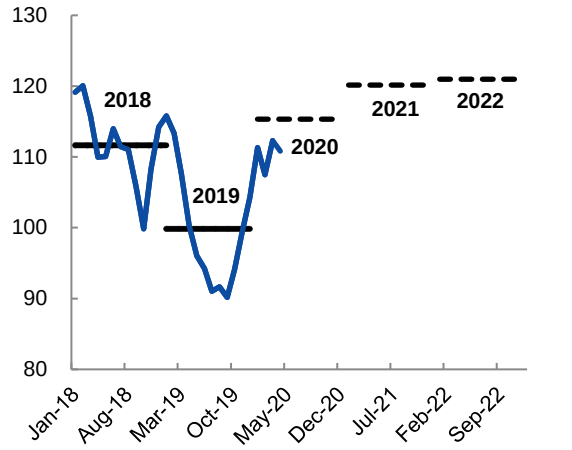
[99] While corporate foreign exchange regulations have helped nonfinancial corporates to increase their share of hedged foreign currency loans, their elevated foreign-currency debt levels (close to 45 percent of total nonfinancial corporate debt) also leaves them exposed to foreign exchange volatility. The refinancing risk of maturing corporate debt and higher cost of funding in the capital markets is likely to put further pressure on Indonesian corporations and local banks.

Terms-of-trade is expected to improve substantially as oil prices are projected to be significantly lower than last year

With the exception of base metals and palm oil, prices of Indonesia's key commodity exports are projected to decline in 2020. In particular, crude oil prices are forecast to average at only USD 25 per barrel in 2020, less than half of the 2019 average of USD 61.4 per barrel. As Indonesia is a net oil importer, the plunge in oil prices will more than offset the smaller price declines of the other key commodity exports, thereby rendering a substantial improvement in the terms-of-trade (ToT) in 2020. The ToT as measured by the net trade-commodity price index (NTI)[100] is estimated to increase by around 15 percent in 2020 compared to 2019 (Figure A.38) and is expected to provide a boost to the trade and current account balance this year. In 2021, the ToT is expected to strengthen further as most commodity prices are forecast to improve.

Figure A.38: Indonesia's term of trade is projected to strengthen in 2020

(index 2019=100)



Source: BPS and World Bank Commodity Markets Outlook; World Bank staff calculations.
Note: Net trade-weighted price index is constructed over Indonesia's six major export commodities (rubber, base metals, coal, oil, gas, and palm oil).

The current account deficit is projected to narrow substantially in 2020 as imports contract more than exports, coupled with a sharp improvement in the terms-of-trade

The CAD is projected to sharply narrow to 1.9 percent of GDP in 2020 from 2.7 percent of GDP in 2019, mainly due to a substantial improvement in the trade balance. In line with the global economic contraction, supply chain disruptions, restrictions in global travel, soft commodity prices, and the Phase One Trade Deal between the U.S. and China, export values are expected to contract sharply in 2020. Meanwhile, import values are also expected to decline significantly due to falling exports and substantially weaker domestic economic activity amid mobility restrictions, travel restrictions, and other domestic containment measures. Moreover, given that Indonesia is a net oil importer, a strengthening ToT, with lower projected prices of Indonesia's key commodity exports being more than offset by lower expected oil prices, will further support the goods trade balance. Beyond this year, the CAD is forecast to widen modestly to an average 2.1 percent of GDP for 2021-2022 as domestic activity recovers supporting import demand outpacing improvements in exports values.

Headline inflation is expected to be lower as economic activity remains below potential

Despite a weaker Rupiah and supply shortages, consumer price inflation is expected to remain muted in the near term. Economic growth has slowed sharply and a sizable negative output gap is expected to emerge this year, which coupled with record-low energy prices, would broadly weigh on prices across the economy. Headline inflation is expected to ease to an annual average of 2.6 percent this year, lower than the 2.8 percent average of 2019. As domestic and global economic activity gradually recover along with energy prices, inflation is expected to tick up to 2.8 percent in 2021 and to 3.0 in 2022.

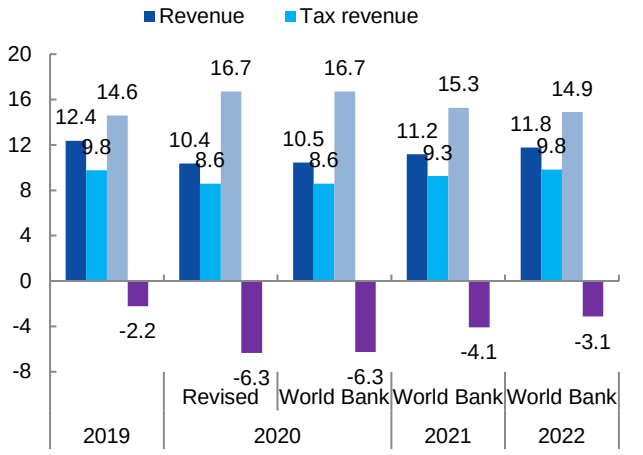
[100] The Net Trade-Commodity Price Index (NTI) is defined as follows: $NTI_t = \frac{Weight_{i,p}\, xPrice_{i,t}}{Price_{i,t}}$ where $Weight_{i,p} = \frac{(E_{i,t})-(I_{i,t})}{\sum(E_{N,t})-\sum I_{N,t}}$ and i= commodity type; t= month; p=period (e.g. 5 year average); N = number of commodities; T= base year; E=value of export; I=value of import

Tax revenues are projected fall to 8.6 percent of GDP in 2020, the lowest in the last two decades and will reach 2018 levels only in 2024 with some tax reforms

In line with the economic slowdown, contracting imports, softer commodity prices, tax relief measures, and lower tax compliance due to cash constraints on the part of both firms and individuals, total revenue is expected to decline to 10.5 percent of GDP this year, notably less than 12.4 percent in 2019 (Figure A.39). Tax revenues will correspondingly decline to 8.6 percent of GDP, the lowest in two decades. In addition, revenues are projected to recover more slowly than the economy, as cash constraints are assumed to be only resolved after a period of time. The recovery in tax revenues is therefore expected to be more gradual, with the tax-to-GDP ratio reaching the 2018 levels of 10.2 percent only in 2024, predicated on the implementation of some tax reforms such as broadening of the tax base, increasing tax rates, introducing new taxes, and improving compliance.[101]

Figure A.39: The fiscal deficit is expected to widen to 6.3 percent of GDP in 2020 with higher expenditures and lower revenues

(percent of GDP)



Source: Ministry of Finance; World Bank staff calculations
Note: 2019 is preliminary actual figures

Fiscal deficit will remain above 3 percent of GDP until 2023 and a structurally higher debt level is projected over the medium term

Meanwhile, total expenditures are forecast to increase to 16.7 percent of GDP in 2020, significantly higher than the 14.6 percent in 2019,[102] primarily due to the fiscal mitigation measures. Consequently, the fiscal deficit is expected to widen to 6.3 percent of GDP in 2020, 3.5 times the size of the initial approved 2020 deficit of 1.8 percent of GDP (Table A.5). Moreover, the deficit is expected to remain above 3 percent of GDP until 2023 but could widen even further to 3.5 percent of GDP, if tax reforms are not implemented. The wider deficit over the medium-term will be largely financed by borrowing, resulting in central government debt levels rising from 30.2 percent of GDP in 2019 to close to 40 percent in the medium term, again predicated on the implementation of some tax reforms.[103] As a result of the larger debt overhang, the ratio of interest to non-interest expenditures will increase from 13.5 percent in 2019 to 17.6 in 2021, and to 21.5 percent in 2024, highlighting that debt servicing will compete with and crowd out more productive government expenditures in the medium term.

[101] The corporate income tax rate is assumed to be 22 percent in 2020-2021 and 20 percent in 2022-2024. The other announced COVID-19 tax relief measures are assumed to be timebound and in place only for 2020.
[102] It is assumed that only half of the COVID-19 increase in social protection and the additional material spending will be continued post 2020. Meanwhile, the additional subsidies for MSME interest payments is assumed to be only a temporary measure for 2020. With it being cut in 2020, capital expenditure is projected to recover beginning in 2021. In addition, it is assumed that central government transfers to SNGs in the form of DAK Fisik will be increased to make up for the current reduction in infrastructure spending.
[103] The baseline forecast for debt level also assumes that there will be a reduction in the capital injections to SOEs in future years.

Table A.5: A wider deficit and a structurally higher debt ratio is projected over the medium term
(IDR trillion, unless otherwise indicated)

	2019 Actual	2020 Budget	2020 Revised (Perpres 72/2020)	2020 MOF Outlook	2020 World Bank	2021 World Bank	2022 World Bank
A. Revenues	1,961	**2,233**	**1,700**	1,700	**1,681**		
1. Tax revenues	1,546	1,866	1,405	1,405	1,381		
Oil & Gas Income taxes	59	57	32	32	20		
Non-Oil & Gas Taxes, o/w:	1,274	1,585	1,167	1,167	1,136		
Non-Oil & Gas Income taxes	713	872	639	639	604		
VAT/LGST	532	686	508	508	503		
Land and building tax	21	19	13	13	21		
Other taxes	8	8	7	7	8		
Excises	172	181	172	172	189		
International trade taxes	41	43	33	33	37		
2. Non-tax revenues	409	367	294	294	297		
Natural resources revenues	155	160	79	79	71		
Oil & Gas	121	127	53	53	37		
Non-Oil & Gas	34	33	26	26	34		
Other non-tax revenues	254	207	215	215	226		
3. Grants	5	0	1	2	3		
B. Expenditures	2,309	**2,540**	**2,739**	2,739	**2,689**		
1. Central government	1,496	1,683	1,975	1,975	1,906		
Personnel	376	416	404	404	384		
Material	334	360	273	273	426		
Capital	178	187	137	137	151		
Interest payments	276	295	339	339	285		
Subsidies	202	188	192	192	378		
Energy	137	125	96	96	184		
Fuel	84	71	41	41	86		
Electricity	53	55	54	54	98		
Non-energy	65	62	96	96	194		
Grants	6	2	5	5	10		
Social	112	108	175	175	251		
Other	12	128	451	451	20		
2. Transfers to regions	813	857	764	764	783		
C. Overall Balance	**-349**	**-307**	**-1,039**	-1,039	**-1,008**		
D. Financing	**402**	**307**	**1,039**	1,039	**1,008**		
1. Debt financing	438	352	1,220	1,219			
2. Investment financing	-44	-74	-257	-257			
3. Lending	-6	5	6	7			
4. Guarantee obligation	0	-1	-1	-1			
5. Other financing	15	25	71	71			
Memo items (as % of GDP)							
Total Revenues	12.4	12.8	10.4	10.4	10.5	11.2	11.8
Tax Revenues	9.8	10.7	8.6	8.6	8.6	9.3	9.8
Non-Tax Revenues	2.6	2.1	1.8	1.8	1.8	1.9	1.9
Total Expenditure	14.6	14.6	16.7	16.7	16.7	15.3	14.9
CG Expenditure	9.5	9.6	12.1	12.1	11.8	10.3	10.0
Transfer to regions and Village Fund	5.1	4.9	4.7	4.7	4.9	4.9	4.9
Fiscal Balance	-2.2	-1.8	-6.3	-6.3	-6.3	-4.1	-3.1
Primary Fiscal Balance	-0.5	-0.1	-4.3	-4.3	-4.5	-1.8	-0.7
Central Government Debt	30.2	29.4-30.1*	36.67-37.97*	NA	37.4	38.9	39.3
Assumptions:							
Nominal GDP (IDR trillion)	15,834	17,452	16,391	16,384	16,088	17,166	18,340
Real GDP growth rate (%)	5.0	5.3	-0.4-2.3	-0.4-1.0	0.0	4.8	6.0
CPI/GDP deflator*	2.7	3.1	2.0-4.0	1.98-4.03	1.9	1.8	0.8
Exchange rate (IDR/USD)	14,146	14,400	14,900-15,500	14,500-14,800	15,000	14,500	14,000
Crude-oil price (USD/barrel)	62.4	63.0	30-35	29.9-35.3	25.0	27.0	28.6

Source: Ministry of Finance and World Bank staff calculations
Note: * KEM-PPKF in 2020 and 2021, MOF Outlook as in Semester I 2020 Budget Realization Report

Risks to the growth outlook are substantially tilted to the downside

Downside risks to the outlook continue to be severe

Despite the significantly reduced growth forecast for 2020, risks to the outlook are still heavily tilted to the downside, given the high uncertainty surrounding the continued local and global spread of the virus and the associated adverse economic effects.

A resurgence of the infection domestically and abroad could prompt additional lockdowns and further reduce economic activity

Since early June, Jakarta and several other regions in Indonesia have begun to transition towards a new normal by gradually easing mobility restrictions (Table A.6). With greater mobility and reduced social distancing, a resurgence of the infection or subsequent waves of the infection could occur, potentially compelling the Government to introduce another bout of mobility restrictions. Such containment measures will again curtail demand and supply and weigh on domestic economic activity. Similarly, infection flare ups could also occur in China and the advanced economies, prompting additional lockdowns in other countries that could further disrupt trade and investment flows, and reduce commodity prices and global demand.

Table A.6: Indonesia's gradual reopening plan

Period	Key Modalities
Phase 1 (June 1)	Industries and services can operate with strict COVID-19 health protocol in place Malls, shops and markets are still closed (cannot operate), except shops selling masks and health-related items
Phase 2 (June 8)	Malls, shops, and markets may operate with the COVID-19 health protocol in place. Stores or businesses that have the potential for physical contact such as salons and spas may not operate yet
Phase 3 (June 15)	Malls continue to operate as in Phase 2, but there will be evaluation on possibility to open places of business such as salons and spas. COVID-19 health protocol remains in place. Schools are opened with a rotation system
Phase 4 (July 6)	Gradual opening of places of business such as restaurants, cafes, and gyms with strict health protocols in place Outdoor activities with more than 10 people, out of region travel with limited air travel arrangements, and worship activities with limited number of worshipers are permitted
Phase 5 (July 20 and 27)	Evaluation of opening social activities on a large scale It is expected that all economic activities have been opened by the end of July or early August 2020

Source: Announcement from the Coordinating Minister of Economic Affairs
Note: The Coordinating Minister continues to emphasize that the Government will evaluate the conditions of the next two weeks to determine the actual course of action.

The economic recovery could take longer-than-expected given the severity of the economic downturn

Given the unprecedented severity and scope of the adverse economic effects associated with the pandemic, there is a risk that domestic output could take a longer-than-expected period to recover, weighing on the growth outlook in the medium-term. For instance, there is a risk that Indonesian firms' balance sheets are severely impacted and will require an extended period of time to be repaired. Moreover, the banking sector, with its high exposure to the corporate sector, could also require a protracted period to recapitalize and to reduce the share of non-performing loans, which disrupt financing for investment in the interim. Lastly, both domestic and foreign investor confidence could be shaken due to the uncertainty surrounding the effectiveness of Government measures to prevent further outbreaks and policies to kickstart the economic recovery, therefore investment demand could be subdued in the medium-term.

Re-escalation of U.S.-China trade tensions could delay a recovery in global economic activity

There is also a potential risk of the re-escalation U.S.-China trade tensions which would further disrupt global value chains and trade flows, and further weigh on global economic activity (Box A.5). Weaker-than-expected global demand or a more gradual-than-expected economic recovery among the advanced economies and China would also pose risks to Indonesia's external sector and hence the growth outlook.

The Indonesian economy could enter a recession if containment measures are extended into Q3

As discussed, uncertainty surrounding the growth outlook especially for 2020 is extremely high, given that the infection is still evolving locally and globally and could still impact domestic and external economic conditions. The economic outlook is predicated on the global economy contracting around 5 percent this year and the Government easing LSSR restrictions in five stages through June and July as announced, with the economy fully open in August.

and Q4 and/or if the global recession is more severe than expected

A scenario with the Indonesian economy facing a recession could materialize if infection flare ups occur or new waves of infection emerge compelling the Government to impose additional large-scale mobility restrictions in the third and fourth quarters, thus leading to slower growth in domestically oriented sectors. The low-case scenario also assumes a deeper contraction of the global economy, by 7.8 percent in 2020, and further dampening on investment and exports, again weighing on Indonesia's economic growth. In such a situation, the Indonesian economy could contract, by as much as 2 percent in 2020. In addition, second round effects from lost incomes to consumption and investment are more pronounced, and quarterly growth would not recover to pre-crisis levels until well into 2021.

B. COVID-19 Impact and Responses

1. Introduction: Overcoming COVID-19

The COVID-19 pandemic continues to spread across the world and in Indonesia

The COVID-19 pandemic and the associated containment measures continue to cause tremendous damage and disruption to the global economy. Now active in over 200 countries, the virus has been reported to be responsible for over 13 million cumulative confirmed cases and at least half a million deaths. In Indonesia, the epidemic has expanded rapidly since the first local cases were identified in early March (Figure B.1). At the time of writing, Indonesia had 80,094 cumulative confirmed cases, with about 39,000 of these having recovered and nearly 3,800 deaths. About 630,000 COVID tests[104] have now been carried out and the current daily pace of around 10,000–12,000 people tested gives rise to about 1,500 new case confirmations each day. The epidemic has spread across the country, with cases in all provinces, and the largest cumulative caseloads being reported in East Java and Jakarta.

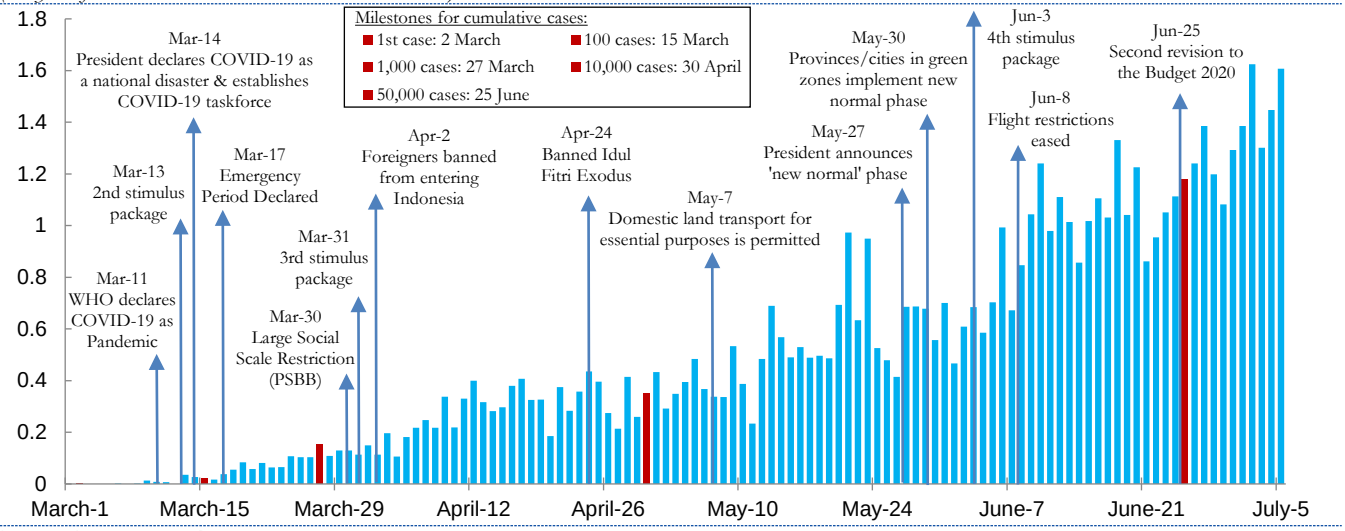
After a partial lockdown, the Government is reopening the economy to prevent further economic distress to the people

Strict social distancing and mobility restrictions, such as the Large-Scale Social Restrictions (LSSR) imposed from April to June, combined with precautionary behavior by households to avoid infection, and the blowback from disrupted global demand, international trade and tourism, and financial market volatility, have given rise to sharp domestic slowdowns in Q1 and likely in Q2 (Section A.1). In an effort to restart economic activity to prevent further economic distress to the people and damage to the economy, the Government in June began a gradual, phased easing of mobility restrictions spanning two months to safely reopen the economy.

[104] Cumulative total of the number of persons tested per day.

Figure B.1: The evolution of the outbreak in Indonesia and major policy responses

(daily confirmed new COVID-19 cases, thousands)



Source: Our World in Data

As the economy continues to reopen, a robust health system is required along with support to firms and families to help them weather the downturn

As the Government considers the path ahead, until a vaccine is developed and widely administered, it will need to balance the immediate urgency of caring for the sick and managing the epidemic, while cushioning the effects of the economic downturn as well as repositioning the economy for a rapid and full recovery over the next few years, to become even stronger than before. To support a safe and sustainable reopening of the economy, the priority remains to have in place a robust health system (Section B.2). Due to flare-ups and subsequent waves, a safe and sustainable reopening requires continued improvements in health system capacity and readiness, including continued expansion of testing and surveillance. Many businesses will require continued support to ride out the economic downturn (Section B.3) and households will need social assistance for subsistence (Section B.6). A sound financial system is also necessary to extend liquidity to firms and help supplement their cash flows (Section B.4).

To build back better over the medium term, higher spending on human and physical capital are critical and workers need support to retool and upskill

In the medium term, "building back better" will require rejuvenating the private sector to meet post-COVID-19 demand, with conditions in place to facilitate the entry of new firms and addressing long-standing constraints to investment (Section B.3). Moreover, there needs to be higher public spending on health and social protection to help build, employ, and protect Indonesia's human capital. Also, COVID-19-driven cuts to public capital spending and postponements of infrastructure projects need to be reversed to avoid putting the Government's growth-enabling infrastructure agenda at risk (Section B.7). Efforts to catalyze private sector participation in infrastructure are paramount, but additional spending will also be necessary. With millions of jobs destroyed during the crisis, and the possible acceleration of trends in labor demand that favor the skilled, the unemployed need to be supported in their job search and upskilling to meet employer needs in the post-COVID-19 labor market (Section B.5).

Flattening the debt curve is also paramount

Given these expenditure needs as well as the imperative of flattening the debt curve, temporary fiscal measures need to be gradually unwound, and revenues increased (Section B.8). The economic downturn's heavy fiscal burden has put public debt on an elevated trajectory, entailing higher debt servicing costs that, if not reversed through revenue-enhancing reforms, will eventually crowd out priority spending or risk jeopardizing Indonesia's hard-earned investment-grade credit rating.

2. Health: Safely adjusting to the New Normal

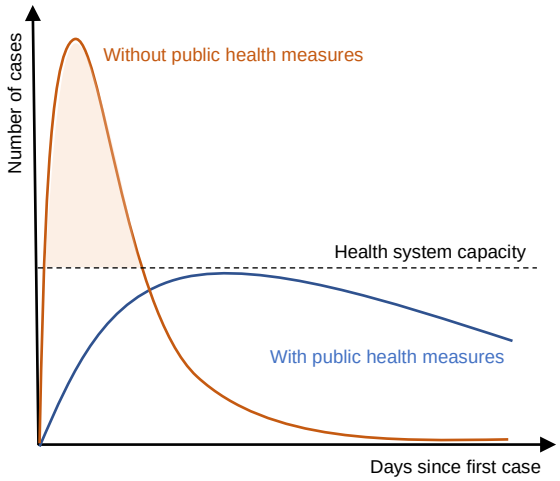
Public health policy has focused on reducing infection rates and boosting health system capacity

Since the onset of the epidemic, public health policy has been focused on non-pharmaceutical interventions aimed at managing the spread of the epidemic while enhancing health system capacity. This has entailed the implementation of behavior change measures, such as promoting hand washing and mandating face masks in public, together with social restriction measures such as mandating home-based work, coupled with temporary business closures and travel restrictions. Sub-national governments have also been permitted to impose varying degrees of social restriction measures depending on local epidemic conditions, thereby increasing the flexibility of localized responses to outbreaks. Moreover, spending reallocations within the budget have made additional financial resources available to boost health care capacity.

There is a trade-off between slowing the spread of COVID-19 and maintaining economic activity

The most severe public health impacts of a pandemic arise when caseloads rapidly increase and surpass the treatment capacity of the health system, leading to shortages of critical health services along with higher mortality rates. Given the significant unknowns and limited ability to test and isolate those who have COVID-19, strict containment measures appear to be the only option for most countries to "flatten the infection curve." By reducing physical proximity and human interactions, social restrictions tend to slow the spread of the infection, which reduces and delays its eventual peak, and provides the Government with breathing space to expand the capacity of the health system through policy interventions and additional resourcing before it is overwhelmed (Figure B.2). Furthermore, by expanding health system capacity and other COVID-19 response protocols when caseloads are still manageable, the Government can begin unwinding some of these restrictions earlier while sustainably handling a larger burden of cases. Containment measures, while necessary, carry high economic costs. The more extensive and severely enforced, and the longer limitations on mobility are in place, the slower is the spread of the virus, but at a higher economic cost. The appropriate balance depends on the severity of the viral outbreak, the capacity of the health system, and the ability of the economy and the population to weather the economic downturn. This tradeoff highlights the importance of collecting timely and adequate data to calibrate policymaking.

Figure B.2: Flattening of the infection curve



Source: Reproduced from World Bank (2020). East Asia and Pacific Economic Update: East Asia and Pacific in the time of COVID-19. April. Washington D.C.: World Bank

The ability of Indonesia's health system to provide the infrastructure necessary for a calibrated response to COVID-19 would be critical for a managed reopening of the economy

With the right policies and settings in place, there is an opportunity to transition safely toward a "New Normal," that is, to ease social restrictions, thereby facilitating economic activity while keeping the infection in check. After implementing the Large-Scale Social Restrictions in Jakarta and surrounding satellite cities, the Government of Indonesia has begun implementing a gradual and phased reopening. The ability of Indonesia's health system to provide the infrastructure necessary for a calibrated response to COVID-19 will be critical for a managed reopening of the economy. These necessary public health measures include:

i. understanding the epidemic and monitoring the level of the disease transmission and progression with scaled up capacity for confirmatory testing,

ii. undertaking contact tracing and isolation of confirmed cases and their contacts to contain spread, and
iii. increasing the availability and readiness of health services to cater to all the needs of patients at any given point of time – especially the severe respiratory cases requiring critical care.

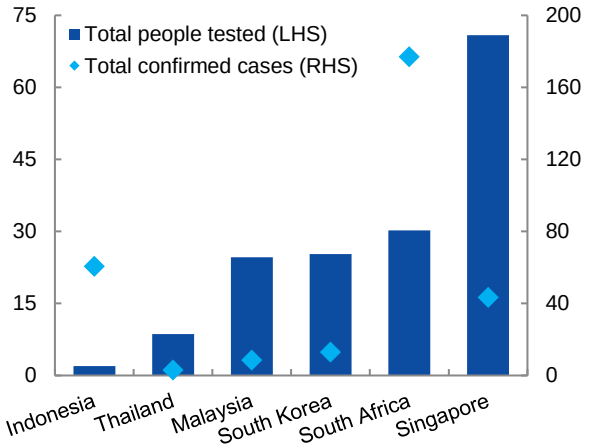
Improved pandemic surveillance and health system information management will be essential for managing the reopening of the economy

To provide the best chance of successfully navigating this reopening, focused efforts are needed in pandemic surveillance, health system information management, testing, and health system preparedness for surges in infections. Due to an absence of reliable data on pandemic and health system indicators, such as the virus reproduction rate, it is difficult for policymakers to assess the costs and benefits of changes in the intensity of containment measures. Integrated information systems between laboratory, surveillance (to enable contact tracing), and health facilities can help overcome these challenges, as can expanded testing for more representative data, and further support for health system availability and readiness for potential new surges. This calls for a number of measures that the Government could immediately consider:

Laboratory confirmatory testing capacity across the country needs to be improved with the accelerating spread of the infection outside Jakarta

i. Expand laboratory capacity in confirmatory testing across the country. Despite significant recent increases[105] in COVID-19 testing capacity, Indonesia's daily rate of testing remains low relative to the scale of the epidemic and also relative to its peers after accounting for its large population (Figure B.3). As infection rates have picked up significantly outside Jakarta, laboratory facilities outside the Ministry of Health network have been encouraged to increase their involvement, though appropriate quality assurance needs to be enforced. Improvements in regional supply chain management and distribution of test supplies will be needed. Staff training at laboratories will need to be scaled up and quality assured, particularly in the use of technologies that were rolled out during the pandemic. Improved information sharing from laboratories to health providers and decision makers at the local level will support contact tracing and facility planning, and ultimately ensure that expanded testing translates into better health and policy outcomes.

Figure B.3: A low rate of testing can hinder the calibration of the Government's crisis response
(total people tested per thousand population; total confirmed cases, thousands)



Source: Our World In Data
Note: Data based on latest reporting for all countries as at 4 July

Information systems integration is a core activity in strengthening the surveillance system

ii. Integrating information systems is central to strengthening the surveillance system. Better linkages between laboratories, disease surveillance, and health facility information systems would improve early detection of cases and support policy calibration**.** The integration would require uniform definitions of cases and indicators across reporting sites, as well as adequate supervisory mechanisms to ensure timeliness and quality of reporting.

[105] The average daily number of people tested increased almost fourfold from around 2200 in April to around 8500 in June.

Strengthening sentinel surveillance[106] and community-based reporting would require strong coordination with subnational governments.

Hospitalization data can provide more information on the extent of the infection

iii. *Collect hospitalization data to better gauge the extent of the epidemic.* Due to inadequate testing, as well as the time lag in reporting, official COVID-19 case reporting may provide inaccurate information on disease transmission and progression. On the other hand, additional data on hospital outpatients, inpatient admissions, and claims data on respiratory illnesses from the National Social Health Insurance information system could be used to supplement existing information. For instance, hospitalization rates for respiratory diseases, which is not currently mined and analyzed, might characterize the past evolution of the epidemic, and could be of use in the early warning system (EWARS[107]) and to predict the epidemic's growth.

Health care system capacity needs to be expanded to meet possible surges in COVID-19 cases while continuing to be able to deliver basic health services

iv. *Ensure health service availability and readiness for possible upcoming surges of new cases, and for functioning optimally in the "new normal".* Ongoing efforts are needed to ensure that health services can cater to an increasing burden of, and occasional spikes in, COVID-19 cases. Strengthening and expanding the hospital and laboratory network remains critical and should be informed by the integrated disease surveillance system. Stocks of personal protective equipment must remain adequate and surge-resilient for front line health workers, and so too the required medical equipment and supplies for managing moderate-to-severe respiratory illnesses. Innovative services such as telemedicine and e-learning that have been successfully introduced during the pandemic need to be sustained and further developed. At the same time, challenges in the delivery of key basic health services such as immunization, nutrition, maternal health, and chronic diseases should continue to be addressed.

New antibody-based testing technology is crucial to inform disease containment and suppression strategies

v. *Use antibody-based testing technology to assess the level of COVID-19 exposure among the general population.* Assessing the extent to which the population has been exposed to, and has developed, antibodies as a result of previously undetected infection, is crucial to inform disease containment and suppression strategies. Mobility restrictions could be relaxed if baseline measures (such as hand hygiene, face mask, face shield, and social/physical distancing) are properly implemented, and widespread testing is available to reliably quarantine those with COVID-19 or those with an elevated risk of infection.[108] This would require using newly developed antibody testing technologies to test representative samples of the population, starting with areas that have confirmed outbreaks.[109,110]

Risk communication to the public is essential for public cooperation with containment measures

vi. *Improve risk communication to the public.* Clearly communicating information about the Government's response to the epidemic aims to educate the public on the nature and level of risks they are exposed to and to engage them in the response. Striking the right balance between improving transparency of information on the epidemic's progression and protecting the privacy of patients, and at the same time destigmatizing the affected individuals, is a very demanding task but still something that can be achieved with a strong public communication and education strategy.

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[106] Sentinel surveillance refers to "Monitoring of the rate of occurrence of specific conditions to assess the stability or change in health levels of a population. It is also the study of disease rates in a specific cohort such as in a geographic area or population subgroup to estimate trends in a larger population" (Last, J., 1988. Dictionary of Epidemiology, 2nd Ed).

[107] The WHO's Early Warning, Alert and Response System (EWARS) is designed to improve disease outbreak detection in emergency settings, such as in countries in conflict or following a natural disaster

[108] Those with an elevated risk of infection who may need to be quarantined include healthcare workers, caregivers and family members of those under quarantine, and persons with a recent history of contact with those who have COVID-19.

[109] See Laurenço et al. (2020) and Bendavid and Bhattacharya (2020) for arguments in favor of this approach.

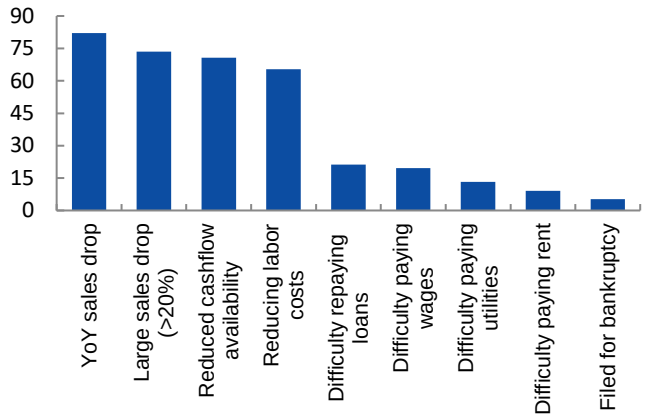
[110] However, note that some concerns have been expressed over the accuracy of antibody tests.

Preparations for the production and distribution of the vaccine across the country should begin now

vii. *Ensure the country's preparedness for production and distribution of the COVID-19 vaccine.* There is a critical need to begin preparing for the vaccination roll-out even though a COVID-19 vaccine may only be available after a considerable waiting period. When the vaccine is available, the Government may need to ensure that the country has the capacity to rapidly package and distribute it across the country, and also be ready to administer a national COVID-19 vaccination program. Lastly, the vaccination roll-out needs to identify a priori priority groups to receive the vaccine as well as the operational definition of eligibility, given that initial availability may only be for a very limited quantity.

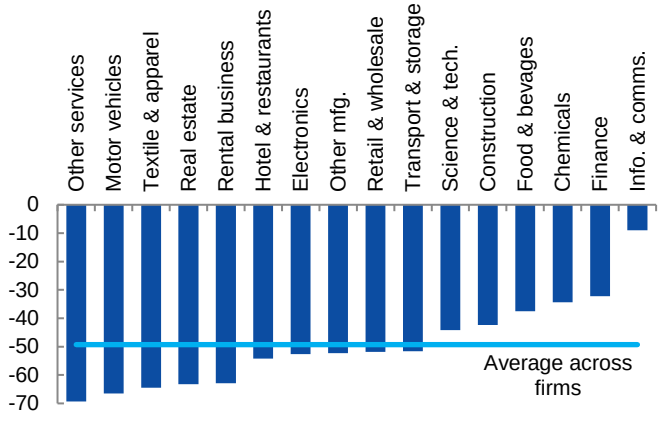
3. Rejuvenating the private sector: Helping firms to stay afloat and facilitating the creation of new enterprises

Figure B.4: The COVID crisis has hit Indonesian firms hard …
(share of firms that experienced difficulties in May or June 2020, percent)



Source: World Bank COVID-19 Business Pulse Survey, World Bank Staff calculations

Figure B.5: …in almost every sector of the economy
(average change in yoy monthly sale, May-June 2020, percent)

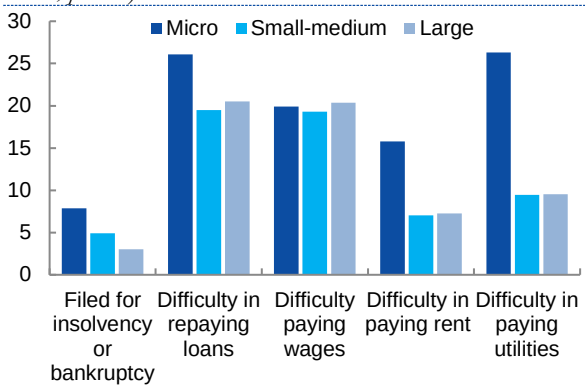


Source: World Bank COVID-19 Business Pulse Survey, World Bank Staff calculations

The economic fallout from the epidemic has reverberated across the private sector

The COVID-19 epidemic has affected all sectors of the Indonesian economy. With a few exceptions, such as those related to the digital economy, firms in most economic sectors suffered a severe negative shock (Figure B.4 and Figure B.5, Section A.1). While the worst of the crisis may have occurred in Q2, the recovery is expected to be slow in some sectors, especially those that involve face-to-face interaction (such as retail or personal care), gatherings (such as entertainment), and/or travel (such as transport and hospitality). While firms of all sizes have been impacted, micro firms tend to have less capacity to weather the economic downturn due to lower access to finance and cash buffers (Figure B.6). Even with the development of a vaccine that may normalize activity in portions of the economy, trends in remote work and heightened salience of health concerns will mean that the private sector that emerges from the pandemic will likely be structurally different. Building a better private sector post pandemic requires a two-pronged strategy.

Figure B.6: Many Indonesian firms are struggling to make ends meet, particularly micro firms
(share of firms by size that experienced difficulties in May or June 2020, percent)



Source: World Bank COVID-19 Business Pulse Survey, World Bank Staff calculations

There are two broad strategies to help firms

The government can follow two broad strategies to help businesses during the crisis:

1. Help firms "keep the lights on" by ensuring that they have enough cash to pay for their bare minimum expenses even if they have limited or no sales activity.
2. Help existing firms re-start or expand production, and new firms to enter the market, to take advantage of growing demand or changing demand patterns.[111]

The first set of measures aims to limit the destruction of difficult-to-replace value in healthy firms

The first strategy includes short-term liquidity interventions that help healthy firms weather the storm while avoiding extending the life of unproductive zombie firms.[112] Despite the gradual reopening, economic activity is unlikely to fully recover in the near term as personal behavior to avoid being infected will persist until a vaccine is available and widely administered, herd immunity is achieved through other means or a cure is found. Meanwhile, there is a role for the Government to help soften the impact of the crisis on businesses. While the churn of firm destruction and creation is characteristic of a healthy business environment, widespread firm closures due to transitory external shocks can cause long-lasting damage to the productive capacity of the economy.[113] This is especially the case when otherwise healthy firms are sent into crisis-induced closures. Firms hold important intangible capital including knowledge, experience, and relationships with stakeholders such as employees, clients, and supply networks, which are costly and time consuming to build but can be quickly destroyed when firms collapse.[114] While preserving this intangible capital is important for the recovery, it also presents the Government with the difficult challenge of how to avoid keeping unviable firms alive artificially.

These measures, which have begun to be implemented, would be needed as long as the economy's demand remains suppressed. The key elements of this first strategy are:

- targeted liquidity measures that help relieve pressure on firms' cash flow, such as the deferment of tax and social security obligations, expedited processing of government payables to firms, interest subsidies and repayment holidays for debt service obligations, and support for access to credit which can be repaid later;
- temporary amendments to insolvency and restructuring frameworks, including legal frameworks for corporate debt restructuring and out-of-court conciliatory measures, to avoid pushing firms into liquidation based on hard criteria better suited to ordinary economic conditions;
- support for operating costs such as payments to cover wages, rental and utilities; and fee waivers for government licenses, registrations, and permits.

Announced measures are largely to provide liquidity to the private sector

The Government's current menu of assistance to firms is largely aligned with this first strategy that mostly entails temporary measures to reduce cash flow needs. It includes:

1. *Reducing tax payments, which could reduce pressure on firms' cash flows.* The Government has provided accelerated value-added tax refunds to firms, exemptions from income tax withholding arrangements when importing, though with no change to total annual tax obligations, and a 30 percent cut in monthly income tax installments, again with no change to the total annual obligations. Measures that reduce firms' annual tax obligations have

[111] The World Bank (2020). Assessing the impact and policy responses in support of private-sector firms in the context of the COVID-19 pandemic; and COVID-19 Notes, March 26, 2020, mimeo.
[112] Zombie firms are firms that earn just enough money to continue operating and service debt but are unable to pay off their debts, and in turn, unable to invest or grow, thus diverting resources away from healthy, viable firms.
[113] Fernandes and Silva (2020), cited in World Bank (2020g) find that the Global Financial Crisis (GFC)'s negative effects on employment and productivity in Brazil, Chile, Ecuador and Mexico persisted even after revenues and unemployment had recovered.
[114] Didier Brandao, Tatiana; Huneeus, Federico; Larrain, Mauricio; Schmukler, Sergio L. (2020).

included: a 6-month full exemption on MSMEs' monthly final income taxes and payments of employee personal income tax that would have been subject to withholding.

2. *Reducing electricity expenses for small firms* that rely on 450 VA and 900 VA connections by fully exempting the former and providing a 50 percent discount on the latter, effective for 6 months.
3. *Facilitating loan restructuring, especially to MSMEs.* The Government is permitting banks and NBFIs to take certain regulatory forbearance measures to relax credit requirements and provide easier access to loan restructuring.[115]
4. *Providing interest rate subsidies and facilities for new working capital loans, especially for MSMEs and labor-intensive industries.* The Government has allocated IDR 34.2 trillion for interest rate subsidies for 60.6 million MSME accounts with total outstanding loans of IDR 1,602 trillion. The scheme's designated budget is distributed through a variety of MSME funding channels, such as banks, financing companies, online platforms, and is applicable to loans under the Government's subsidized MSME loan program as well as under other non-subsidized products.[116] The Government has also set aside IDR 6 trillion for state-owned enterprises Indonesia Credit Guarantee Corporation (Jamkrindo) and Askrindo[117] to provide credit guarantees on working capital loans to SMEs to sustain and support working capital loan disbursements to the economy. In addition, support to labor-intensive industries in the form of guarantee schemes and fund placements for loan restructuring has been announced.

The second strategy helps firms to adjust and expand during the recovery

The second set of measures entails facilitating the repurposing and production expansion of existing firms and the entry of new firms in the market, to take advantage of growing demand and changing demand patterns.[118] The strategy encompasses temporary stimulus measures but also structural reforms, with the objective of facilitating the emergence of a more vibrant private sector that will be more productive and create more middle-class jobs; it will also be a private sector that increasingly leverages Indonesia's environment rather than putting unsustainable pressure on it. The measures facilitate firms to obtain the necessary resources (capital, employees, and physical and service inputs) to meet rebounding demand and adapt to changes in demand patterns. As the recovery gets underway, firms will then need to reactivate operations, resolve recent supply-chain disruptions, and ramp up production. The recovery phase will also likely see systematic changes in consumption preferences, such as more online shopping and home delivery, more digital services, more home-based work, and more use of anti-COVID products, such as protective gear and hand sanitizers. As a result, the key elements of the second strategy could include:

- ensuring access to credit to expand production or start new or adjusted production or services activities;
- offering loss carryback and accelerated depreciation facilities for businesses that invest in plants and machinery, renovation, and refurbishment;
- exempting foreign skilled workers from permit requirements (except for COVID-19 testing);
- reducing input costs by eliminating non-essential checks and restrictions on imported inputs (e.g. pre-shipment inspections, third-party verification of SNI compliance, port-of-entry

[115] Financial sector measures to support loan restructuring are detailed in Section B.4.
[116] The scheme funds the cost to lenders of providing eligible borrowers with options such as 6-month suspensions of principal repayments and interest payments or 6-month suspension of principal repayments with interest rate reductions of 2 to 6 percentage points.
[117] PT Askrindo (Persero) acts as a guarantor institution that assists MSMEs who are eligible and have sufficient collateral to obtain loans from financial institutions, both bank and non-bank.
[118] The World Bank (2020). Assessing the impact and policy responses in support of private-sector firms in the context of the COVID-19 pandemic; and COVID-19 Notes, March 26, 2020.

restrictions, state import monopolies), fast-tracking other checks, and waiving import duties.

The main measure announced for the recovery phase has been a cut in corporate income taxes

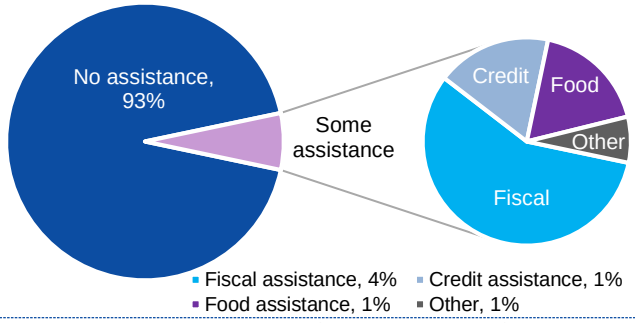
While the implementation of government support has understandably focused on the first strategy and, therein, especially on liquidity relief, the COVID-response packages envision longer-term measures as well. The most prominent is a cut in the standard corporate income tax rates to 22 percent in 2020, with the rate declining to 20 percent in 2022.[119] While the intention of equalizing tax rates with other jurisdictions in ASEAN is understandable, there is no evidence that corporate tax rates are a binding constraint to investment in Indonesia, while the resulting structurally lower tax revenue poses challenges in addressing established competitiveness bottlenecks related to infrastructure and human capital. Another plausible channel to reduce the ongoing costs of firms are wage subsidies, which have been used effectively in other countries to preserve valuable employer–worker relationships. However, these may need to be carefully targeted, as widespread wage subsidies may be too onerous for the fiscal budget. Moreover, it may be challenging to implement in Indonesia's context of high business and worker informality.

The National Recovery Program (PEN) is estimated to cost IDR 150 trillion for recovery-focused measures

The National Economic Recovery program (PEN/Pemulihan Ekonomi Nasional) as stipulated by Government Regulation 23/2020 sets out the latest stimulus policies to soften the economic impact of the pandemic. The program, estimated to cost IDR 150 trillion, comprises tax breaks, capital injections for state-owned enterprises (SOEs), interest subsidies for MSMEs, liquidity support for the banking industry, as well as financial assistance for vulnerable households, among others.

Figure B.7: Only 7 percent of firms have received assistance from the government

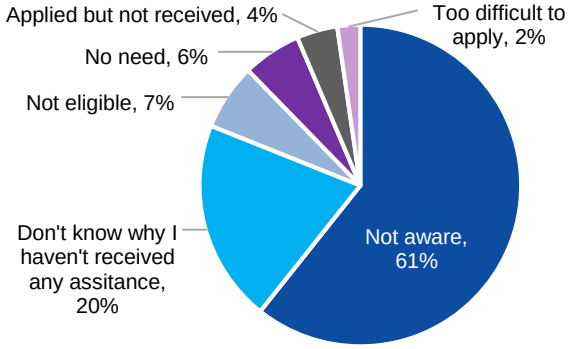
(share of firms that received assistance in May or June 2020, percent)



Source: World Bank Business Pulse Survey, World Bank Staff calculations

Figure B.8: Firms are largely not aware that assistance may be available

(share of firms by reason for not yet receiving assistance, May-June 2020, percent)



Source: World Bank Business Pulse Survey, World Bank Staff calculations

Current measures may not be enough for firms to fully cope with the economic fallout and prepare for the recovery

While it is too early to gauge the adequacy of the measures as the economic downturn is still unfolding, a shortfall in assistance is likely, given the scale of the economic downturn. The World Bank COVID-19 Business Pulse Survey[120] indicates that only 7 percent of firms have received assistance while the large majority of firms are unaware of the existence of assistance (Figure B.7 and Figure B.8). Moreover, despite a relative emphasis on assisting MSMEs – owing to their high vulnerability to sharp negative shocks and their large economic footprint – some of the above measures will have difficulty reaching micro firms. These account for about 89

[119] Public companies with at least 40 percent of their shares listed on the Indonesia Stock Exchange and which meet certain other conditions will continue to receive a 3 percentage point discount on the standard corporate income tax rate.

[120] The World Bank COVID-19 Business Pulse Survey was conducted over May and June 2020. It asked a sample of 850 firms from across Indonesia about COVID-19's impacts on them through channels such as demand, supply, cash flows, and uncertainty.

percent of firms in the country, earn similar incomes to casual labor, and employ limited capital. They are often highly informal, with few linkages to financial intermediaries and the tax system. In many cases, these entities will receive indirect support through the Government's expanded social assistance, but many could also fall through the cracks. Finally, the Government's limited attention to aspects of the second strategy is notable, leaving much legwork to be done to ensure a successful private sector rebound as the economy reopens. The good news is that various measures that can help the rebound entail very little fiscal spending, such as import reforms and revisions to the foreign skilled professional permits.

The Omnibus Bill for Job Creation offers an opportunity for implementing a deep structural reform

The uncertain context that will dominate the outlook makes it critical to promote an environment that is permanently conducive to investment, trade, and innovation. The Omnibus Bill for Job Creation is a potential step in the right direction. The Bill, which is currently being discussed in Parliament, aims to revise 79 individual laws with the view of attracting investments and stimulating the competitiveness of firms in Indonesia. It has the potential to support the post-COVID-19 recovery in the near term, while setting the foundations for faster long-run growth. A number of measures are particularly welcome:

By removing investment restrictions, the Bill will signal that Indonesia is open for business

i. The Bill will signal to the international community that Indonesia is open for business by removing investment restrictions, including discriminatory practices against foreign investors in sectoral laws. The elimination of foreign equity limits could trigger an additional USD 6.8 billion in investment.[121]

The Bill will improve the trading environment and help local firms to participate in global value chains

ii. The Bill will improve the trading environment and increase local firms' participation in global value chains that rely on importing-to-export. Introducing a risk-based approach to licensing for imports and exports could reduce the cost and uncertainties of trading. World Bank analysis suggests that recommendation letters to obtain each import license cost 6 cents for every dollar of imports. Moving the authority for trade-related licenses from sectoral ministries to the Central Government will reduce ministries' discretion and opportunities for corruption.

Reforming the SNI certification process will shorten and reduce uncertainty with the process

iii. Eliminating the Minister of Industry's designation of accredited agencies to perform the Indonesian National Standard (SNI) conformity assessment may speed up and reduce the uncertainty of the SNI certification process. The SNI certification process is estimated to increase the cost of inputs for businesses by 21 percent.

The Bill includes reforms that could have adverse effects on people's health and safety, natural assets, and labor rights

The Bill, however, also proposes reforms that could lead to adverse effects, especially in the current economic environment. For instance, the Bill's proposed relaxation of requirements for environmental protection will undermine natural assets that are crucial for the livelihoods of many and could negatively affect investments. The Government's efforts in this area are targeted at reducing delays. However, the causes of delays and uncertainty when obtaining an environmental permit are cumbersome processing and arbitrary and corrupt implementation, rather than the protections enshrined in the Environmental Law (2009). Moreover, the Bill removes safety principles from several laws regulating licensing of high-risk activities and products, such as drugs, hospitals, and construction of buildings, and no longer considers them as high risk. Further, some of the Bill's proposed revisions to the Manpower Law could reduce workers' protections. The proposed widespread exemptions from minimum wage compliance and the reforms to phase out severance pay without a fully fleshed-out proposal for an effective unemployment benefit and insurance scheme, could weaken the protection of workers and

[121] World Bank staff estimates based on past investment flows and changes in foreign equity limits across sectors and over time in Indonesia.

increase income inequality. This is particularly problematic at a time of heightened unemployment due to the COVID-19 crisis. At the same time, reforms of labor laws are less important than trade and investment reforms for the stimulation of new investments.[122]

Other recent legislation and policies, from mining to agriculture, also risk generating negative spillover effects for society (Box B.1)

4. Financial Sector: Increasing liquidity to the private sector and protecting lending portfolios to preserve financial stability

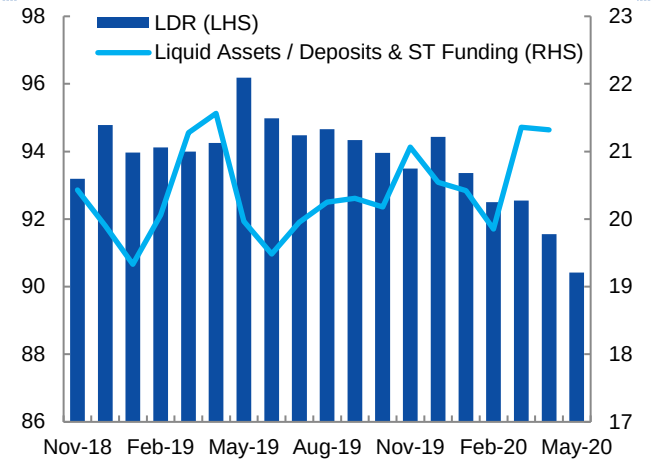
Government measures have focused on ensuring credit availability and protecting lending portfolios to support financial system stability

As the downturn unfolds and more firms and households become severely impacted, there is potential for financial sector vulnerabilities to emerge across the economy as asset quality and balance sheets deteriorate. Mindful of the risks to financial system stability, the Government has responded – thus far, successfully – with measures aimed at shoring up the supply of liquidity and the quality of banks' lending portfolios. BI's interventions have included reductions in the policy rate and reserve requirements, expansion of the repo facility and of the macroprudential buffers, and purchases of government securities in the primary and secondary markets (Section A.4). In the short-term, these measures have had the desired effects of stemming the sizeable capital outflows which took place from mid-February to mid-March, stabilizing the exchange rate, stemming upwards pressure on the yield on Government securities, and preserving the level of credit intermediated by banks. The initial rise in the yield on benchmark Government bonds, of 200 bp between late February and mid-March for the benchmark 10-year tenor, has been partially reversed. Similarly, the depreciation of the IDR/USD exchange rate during the same period by about 15 percent has been almost completely reversed. As of June, the Government's other core financial sector policies for banks and non-bank financial institutions (NBFIs) can be grouped under three categories:

i. *Loan restructuring policies for banks and NBFIs.*[123] Banks and NBFIs are permitted to take certain regulatory forbearance measures to relax credit requirements and provide easier access to loan restructuring. The measures target debtors with credits below IDR 10 billion that are affected by COVID-19 and will be available until March 31, 2021. The credit restructuring method may include: reduction in interest rates; extension of the loan term; reduction of principal arrears; reduction of interest arrears; addition of credit facilities; and conversion of credit to equity. As of the end of June 2020, 100 out of 110 banks have started to implement the restructuring program. As many as 6.4 million debtors, which is 13.5 percent of total bank borrowers, have benefitted from restructurings, with total value of IDR 695.3

Figure B.9: The loan-to-deposit ratio (LDR) has been falling since December 2019

(percent)



Source: Financial Services Authority (OJK); World Bank staff calculations

[122] World Bank (2012).
[123] OJK Regulations No. 11/POJK.03/2020 and 14/POJK.05/2020.

trillion, equivalent to 12.5 percent of the total loan amount in the system. Of all restructured debtors, 5.0 million are MSME debtors with total restructuring value of IDR 282.6 trillion.

ii. *Liquidity relief policies for banks that are providing credit restructuring and additional financing.* The National Economic Recovery Program consists of several measures, including the Liquidity Relief Policies for Banks.[124] Under this program, the Government may provide liquidity support to banks which perform credit restructuring or give additional loans.[125] This policy is timely considering that the banks' liquidity as measured by the loan-to-deposit ratio has been falling this year to reach a near two-year low in April (Figure B.9).

iii. *Interest rate subsidies and credit guarantee policies.* As mentioned in the previous section, the Government allocated budget for interest rate subsidies for MSMEs.[126]

While the adequacy of current measures is not yet clear, it is likely that further measures will be required

Similar to the measures for the private sector, it is too early to assess the adequacy of the government's measures, as they are only now being rolled out and the impact of the crisis on the financial sector through the private sector is still materializing. While the loan forbearance sanctioned by the OJK will allow businesses greater opportunity for loan restructuring, concerns arise as to whether the restructuring of loans will of itself be sufficient, or just result in banks postponing action to address the funding constraints faced by their clients, hence pushing this issue down the road. Moreover, liquidity relief measures for banks offer no assurance that the benefits will be fully passed on to their business borrowers. Banks with squeezed earnings may be tempted to deploy the government's liquidity injection to strengthen their own balance sheets rather than pass on the benefit to their riskier borrowers. Additional policies may be needed to support growth-oriented enterprises, promote reallocation of resources to more efficient companies, and avoid measures that risk propping up "zombie" firms.

Further deterioration in the private and financial sectors are likely...

Despite the broad-ranging assistance being provided to the private and financial sector, it is unlikely to fully offset the impacts of a sharp downturn. Recent months have seen plummeting sales, which is likely to have significantly deteriorated private sector balance sheets, constrained cash flows, and hiked bankruptcy risks. Non-performing loans are expected to rise and overall asset quality to deteriorate, while client credit risks remain elevated and new lending subdued, despite measures to improve credit availability. In addition, extraordinary policy measures that temporarily ease prudential and lending standards to support the private sector will need to be monitored and calibrated in order to manage risks and potentially a growing burden on the financial system.

…but better monitoring and expanded resolution mechanisms will help the authorities manage emerging risks

Close monitoring of systemwide and systemic risks will therefore be crucial to identify emerging vulnerabilities, and the toolkit of resolution mechanisms should be bolstered. Banks should be expected to produce and disclose reliable, frequent, and comparable information regarding loans that have benefitted from borrower relief measures, to support assessment of asset quality, provisioning, and capital adequacy on a continuous basis.[127] Recovery and resolution planning for banks may need to be updated, and NPL management frameworks put in place together with comprehensive insolvency and out-of-court processes.[128] Coordination arrangements between the OJK, as the supervisory agency, and the Deposit Insurance Corporation (LPS), as the resolution authority, should be further strengthened to ensure that LPS is informed of

[124] Government Regulation No. 23/2020 issued on May 11, 2020 as one implementing regulation of Law 2/2020.
[125] The scheme defines two types of banks: participating banks and implementing banks. Participating banks are large, local-majority-owned commercial banks that are to receive government funds placements and provide liquidity buffer funds to implementing banks. Implementing banks refer to any commercial bank that undertakes credit restructuring policies or provides additional financing, directly or indirectly through rural banks or financing companies. Before submitting requests for liquidity assistance from the Government, implementing banks are required to exhaust other means of satisfying their liquidity needs internally and by tapping the interbank money market, repos, or Bank Indonesia short-term liquidity loans.
[126] See discussion in Section B.3.
[127] World Bank (2020f).
[128] World Bank (2020g).

emerging stress at an early stage and prepared for possible resolution measures if the situation deteriorates. This can be facilitated, to a certain extent, through the establishment of effective resolution functions, including the resolution planning and the crisis-situation bank restructuring program. Development of an industry-funded resolution funding mechanism is also desirable, though a public funding mechanism would still be needed, subject to robust safeguards.

5. Skilling Indonesians to get them back into jobs

Labor market trends towards higher skills requirements are likely to accelerate post COVID-19

The pandemic not only led to substantial job losses, but also accelerated trends towards the automation of low-skilled jobs that require physical presence, and the shift work that can be done remotely, for which digital connectivity and skills are essential. Meanwhile, some hard-hit labor-intensive sectors, such as those related to tourism, may take long to fully recover. Sectors related to the digital economy, many of which are compatible with remote-working arrangements, are likely to grow even faster. Overall, workers seeking jobs in the post-COVID-19 economy likely require different and generally higher-order skills, suggesting an important role for policies and programs that support education, training, retraining, reskilling, and redeploying workers.

Closures of education institutions could erode skills of many young labor market entrants, with lower-income students being the most heavily affected

The Ministry of Education and Culture (MoEC) has advised local governments to close schools for the time being and cancelled national exams for about 8 million students. University and post-secondary vocational education schools are closed nationally, affecting another 8 million students. In secondary schools and tertiary institutions, protracted school closures increase the dropout risk, particularly among lower-income students, who are more likely to enter the labor force rather than return to the education system once the situation has normalized, mainly because of the need to mitigate losses in household income and assets.

Given the changing skills requirements of the post-COVID-19 labor markets, this risk of dropouts and erosion of skills, concentrated among lower-income families, is especially concerning. Secondary, tertiary, and vocational training institutions would benefit from guidance on short and medium-term planning, where short-term focuses on supporting educators to deliver distance learning and medium-long term helps build resilience and through EdTech.

Policies to support recent labor market entrants – and to retool those already in the labor market- will be essential to help workers adapt to the post-COVID labor markets

Kartu Prakerja, which has been repurposed to provide quick support to some of the newly unemployed through online training during COVID-19, is well placed to incentivize the acquisition of skills through short-term training. More broadly, the Indonesian Technical and Vocational Education and Training (TVET) systems can gear up to facilitate the development of the skills needed for the adjustment to structural changes brought on by COVID-19 as well as the underlying mega-trends.

Other measures that can be considered include wage subsidies in select sectors that support new hiring (to avoid financing industries populated by large healthy firms) and/or in conjunction with conditionalities to provide on-the-job (OTJ) training, as well as efforts to strengthen job matching assistance, and job-search counseling to facilitate transitions across jobs, economic sectors, occupations, and regions.

Underpinning all of these efforts is the need to improve the quality of existing labor market information and, importantly, to ensure that it can be used easily to inform education policy and training programs, as well as to support labor market intermediation efforts. Critically, the government will need to leverage big data from vacancy postings to take the pulse of the labor market and the occupations and skills on demand, complemented by tailored surveys that gather

granular information to fill in data gaps. Other recently developed tools like the Critical Occupations List, should be programmed on a yearly basis.

6. Strengthening the safety net and ensuring a healthy and productive labor force

Building a modern social protection system that leaves no one behind

The social protection expansion has highlighted gaps in social protection policy and delivery systems

The Government's social protection response to the crisis has been strong. Measures to mitigate adverse impacts among the poor and vulnerable include expansion and repurposing of several existing social assistance programs, as well as the addition of new ones. Quick action translated into additional support for millions of households registered in social assistance programs, and simulations show that the response is effective in protecting incomes of those that are the most vulnerable, even though welfare losses will occur. However, the pandemic and its response also exposed the existing weaknesses of the SP system. Three stand out. First, reaching poor and vulnerable households that were not already captured in the system has been challenging. The main instrument to identify households in need – the social registry (DTKS) – was not designed to capture households that fall into poverty as a result of fast-onset shocks such as COVID-19, or large-scale natural disasters. The absence of an on-demand window that can be easily – and, in the case of COVID-19 – remotely accessed by those seeking assistance, prevents it from being used as a tool to target and reach individuals and households facing sudden changes in circumstances (the "newly poor"). Second, social assistance coverage has been concentrated mostly among poor households with children, leaving other groups, such as the elderly and disabled not adequately covered despite similar welfare conditions.[129] In addition, the so-called middle-class and parts of the aspiring middle class are uncovered. High incidence of labor informality has meant that social insurance coverage is low and stagnant.

Maintaining some of the recent expansions and introducing several additional reforms will lead to more comprehensive social protection

Going forward, there is a need to build, deploy and protect human capital in the longer term. A strong social protection system will help the Government to support longer-term planning by households, reduce poverty and protect lives and livelihoods. Gaps in the social protection system need to be addressed to build a more comprehensive and adaptive social protection system that can deliver a more inclusive and prosperous Indonesia as laid out in the Government's Indonesian Vision 2045. The *Indonesia Social Protection Flagship* report[130] makes it clear that such a system will be increasingly needed to protect Indonesians from the disruptions expected to arise from population ageing, faster technological change, and the rapidly evolving – and increasingly unfamiliar – world of work. Action in three areas should be prioritized:

Certain recent improvements to social assistance should be locked in, and coverage further expanded to the elderly and those with disabilities

i. Locking-in key elements of the social assistance expansion that took place in response to COVID-19 would help fill pre-existing gaps in coverage, while consideration should also be given to further coverage of the elderly and people living with disabilities. Extending social assistance *with tapered benefits* to the poorest 40 percent could define a "guaranteed minimum" level of support provided across the lifecycle through a comprehensive package of programs. Furthermore, Indonesia's social protection programs should be made more responsive to shocks such as natural disasters and epidemics, such as COVID-19.

[129] Notably, the differences in the welfare distribution are relatively small between the poor, vulnerable and aspiring middle class. The aspiring middle class currently does not receive social assistance, by design, and is less likely to access contributory social security programs under SJSN. Protecting this group more through social assistance and encouraging access to social security will be important to help foster a sustainable growth of the middle class.

[130] World Bank (2020a). The findings of the report and additional materials can be accessed from: https://www.worldbank.org/en/country/indonesia/publication/investing-in-people-social-protection-for-indonesia-2045-vision

New and expanded social insurance schemes would complement the country's social assistance programs

ii. A set of mandated and individually financed social insurance programs for consumption smoothing could complement the proposed expansions in social assistance and ensure more comprehensive protection against risk events that may otherwise lead to significant hardship. Examples include Government contributions to help raise social insurance coverage among informal workers; incorporation of the current severance pay system into a prefunded unemployment savings account that can be managed alongside the existing old-age savings program; and support for expanding and improving of health insurance coverage.

Investments should be made in a more comprehensive and regularly updated population database to support a more adaptive social protection system

iii. Further investment should be made in a strong delivery system like a dynamic DTKS that covers a larger share of the population and can be used by an increasing number of programs with a broader range of objectives than poverty-targeted social assistance. The new recipients identified through the on-demand approaches of Kartu Prakerja and the Dana Desa BLT, as well as the in-kind Sembako for Jabodetablek, could potentially be prioritized for full registration into the DTKS and, as a result, almost double the latter's coverage.[131] In the future, investments in a strong local government interface with adequate capacity to carry out regular and on-demand updating of such a database will be critical to ensuring its ongoing reliability, and its suitability to support an adaptive, modern social protection system.[132]

Delivering universal health coverage[133]

Universal health coverage would support healthier, longer, and more productive lives, and help Indonesians achieve their full potential

A health system that ensures affordable access to quality services would complement the improvements in social protection and support a healthier and more productive labor force. Commendable progress has been made in universal health coverage (UHC), with public health expenditure increasing 22 percent annually between 2001 and 2018, supporting health service provision expansions and improvements in population health. The Government's national health insurance scheme (JKN)[134] has played a key role and has quickly expanded to cover 83 percent of the population (224 million Indonesians)[135]. However, despite these positive developments, Indonesia continues to compare poorly against its peers on some key population health metrics. Overcoming these challenges is critical for sustained human capital accumulation and being better prepared for future health challenges, including the next global pandemic.

Wide-ranging public health challenges continue to erode Indonesia's human capital

Despite public health improvements in recent decades,[136] challenges remain especially in maternal health and nutrition, as well as in communicable and non-communicable diseases (NCDs). The maternal mortality ratio today remains high relative to its income-level and regional peers; its rates of under-5 child stunting are the fifth highest in the world, and it is the third-highest global contributor to cases of tuberculosis (TB). The burden of NCDs has increased rapidly, now accounting for 66 percent of the country's disease burden. Moreover, regional and income-related inequalities in health outcomes persist, with poor households exhibiting infant and child mortality rates that are double those of richer households.

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[131] If all were included it could represent as many as 27 million additional households.
[132] World Bank (2020a).
[133] This subsection draws heavily from World Bank (2020). Indonesia Public Expenditure Review 2020 – Spending for Better Results. Washington D.C.: World Bank.
[134] JKN offers wide-ranging health insurance coverage for medically necessary treatment. The scheme charges premiums to users, but the Government currently pays these fees for those least able to afford it.
[135] Though active users account for approximately 75 percent of the population.
[136] Between 1960 and 2016-2017, life expectancy increased from 45 to 69 years, under-5 mortality declined from 222 to 25 per 1,000 live births, and infant mortality declined six-fold to 21 per 1,000 live births.

Challenges to health service provision include inadequate spending, poor distribution of services, inefficient funding allocations, limited performance orientation and weak governance

Underlying these poor health outcomes is a multifaceted set of challenges. Public resourcing for the sector (1.4 percent of GDP in 2018) is about half of that in countries with a similar income level. At around USD 55 per capita, it is well below the recommended USD 110 per capita needed to deliver an essential UHC package nationwide.[137] Frontline providers frequently lack the drugs, equipment, and the training needed to deliver good quality services.[138] Overall health financing is inefficiently allocated – skewed towards curative, rather than preventive, care. The availability and geographic distribution of human resources for health, especially for primary physicians and specialists, is a challenge. A lack of performance orientation in SNG health-care financing has contributed to suboptimal service delivery. Within JKN, inefficient distribution of scheme funds,[139] poorly designed compensation mechanisms for service providers,[140] and generous benefits that are not matched by actuarially costed premiums,[141] hold back the effectiveness of the scheme and jeopardize its the financial sustainability.[142] Finally, weak governance and accountability, and fragmented information systems have more generally made it difficult to link health sector spending with performance.

Action should be taken in three areas

To meet the challenges of realizing Indonesia's vision of universal health coverage, action should be taken in three areas:

i. *Increase resources for health services.* There is a need to raise more revenue for the health sector to enable spending levels on par with regional and lower middle-income averages. It could begin by increasing taxation through excises on the consumption of unhealthy goods and linking corresponding revenues to public health expenditure. Examples of excise reforms include tier simplification and higher rates for tobacco excises as well as the introduction of an excise on sugar-sweetened beverages (Section B.6). There is a need to consider extending the JKN premium subsidies to the informal sector to achieve a significant expansion in scheme coverage, while reducing the per-user cost of the scheme.[143] JKN premiums should also be updated based on actuarial analysis and contributions compliance improved, to ensure that those who can afford to pay for insurance are not being subsidized.

ii. *Manage expenditure growth.* There is a crucial need to ensure that rapidly rising costs of health service provision, particularly of the JKN scheme, are effectively managed through better system design and other efficiency improvements. Budget or volume ceilings can incentivize hospitals to become more efficient and contain hospital expenditures. Cost-sharing for both non-essential services and services prone to over-utilization should also be introduced,[144] which would encourage use of more cost-effective referral pathways, reducing overall health system costs. In addition, the JKN benefit package could be made more explicit and better

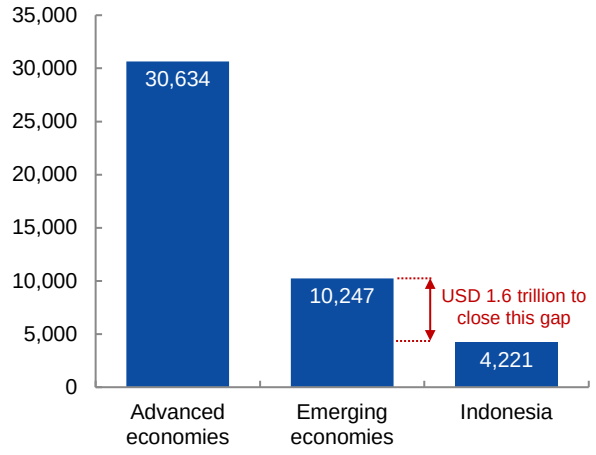
[137] Most recently, the third edition of the international Disease Control Priorities initiative (DCP3) estimated the total cost per person for sustaining an essential universal health coverage package (EUHC) at 80 percent coverage would be US$110 in lower middle-income countries.
[138] These conditions worsened during the COVID-19 crisis, with the system unable to meet the surge in demand for frontline equipment such as protective gear and exposing health workers to higher risks of infection.
[139] 84 percent of JKN funds are being allocated to hospitals despite two thirds of health service utilization taking place outside the hospital system.
[140] In JKN, primary health care services are paid for by capitation – a fixed amount per patient served – which incentivizes over-referrals and under-delivery in weakly monitored and under-resourced systems. Alternatively, payment for hospital services is essentially open-ended, incentivizing waste and unnecessary care.
[141] Costs-to-contributions ratios on JKN insurance claims regularly exceed 100 percent.
[142] JKN has exhibited large and increasing deficits since its inception.
[143] For many in the informal sector, the cost of health insurance is prohibitive. Moreover, those with the lowest risks are will be the least likely to pay to participate in the scheme – a case of adverse selection. If the subsidy is extended to the informal sector, these individuals would enter the scheme and reduce average user risks and costs.
[144] International evidence suggests that, while modest cost-sharing may be appropriate for high-cost/low-effectiveness services and to enforce the gatekeeping system, it is likely to reduce both necessary and unnecessary utilization, particularly for the poor and vulnerable.

align benefits with available resources.[145] Finally, JKN claims data should be analyzed to improve claims management, detect inappropriate or low-value care, and identify potential cost efficiencies related to high-cost or high-frequency services.

iii. *Improve governance and accountability across the health sector.* Pathways to better governance and accountability include annual budget performance assessments for the whole health sector, investments in better-quality data and information systems, and ensuring that all agencies (especially the MoH and BPJS Healthcare[146]) share performance, quality, and insurance claims data, while also simultaneously pushing for greater inter-operability of systems to reduce data redundancy and fragmentation.

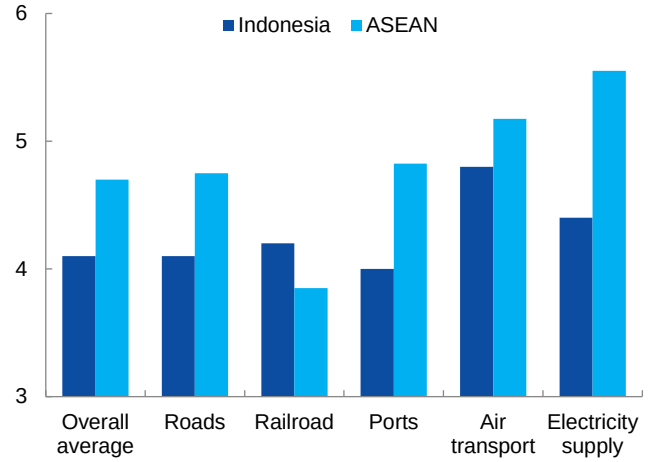
7. Infrastructure: Closing the gap for higher potential growth[147]

Figure B.10: Indonesia's development prospects are impeded by a USD 1.6 trillion public infrastructure gap…
(public capital stock per capita)



Source: IMF data and World Bank staff calculations. Note: Estimates are for 2017, in 2011 constant price USD. Unweighted averages computed for 13 advanced economies and 21 emerging market economies

Figure B.11: …while its existing infrastructure is perceived to be of a lower quality than in ASEAN peers
(quality of infrastructure score, range: 1-7)



Source: WEF Global Competitiveness Report (2017–2018) and World Bank staff calculations. Note: ASEAN is the unweighted average of Malaysia, Singapore, Thailand, and Philippines

A large infrastructure gap constrains Indonesia's growth prospects

Indonesia needs more and better infrastructure to boost economic inclusion, sustain robust growth, and escape the middle-income trap. Infrastructure supports growth-enabling economic connectivity and the delivery of basic services such as water, sewage, and electricity. However, on a per capita basis, Indonesia faces a large and widening infrastructure gap relative to its emerging market peers (Figure B.10), and perceptions of its infrastructure quality are lower in almost all areas compared to ASEAN averages (Figure B.11). To deliver on the enormous infrastructure needs of a rapidly urbanizing and increasingly modern economy, and match the standards set by Indonesia's peers, the Government will need to catalyze large, unprecedented flows of private infrastructure investment as more public financing will not suffice, given the sheer size of the gap.[148] Moreover, the pandemic has increased the enormity of the task by triggering sharp cuts in public infrastructure spending and raising the likelihood of significant

[145] Options include limiting the enrollment period to 2-3 months each year or lengthening the benefit activation period; limiting treatment coverage to lowest class of hospital rooms (class 3) as per the original law; and costing the 144 services covered under JKN capitation to inform future premium and reimbursement rates.
[146] BPJS Healthcare is the entity responsible for managing the JKN scheme.
[147] This section draws heavily on the World Bank's Indonesia Systematic Country Diagnostic 2020, Indonesia Infrastructure Sector Assessment Program Report 2019, and Indonesia Economic Quarterly October 2017.
[148] World Bank (2017).

delays to infrastructure projects in the 2020–2024 RPJMN.[149] As the economy starts to emerge from the downturn, a refocusing of government priorities toward infrastructure development could support the recovery while boosting Indonesia's long-term productivity and international competitiveness.

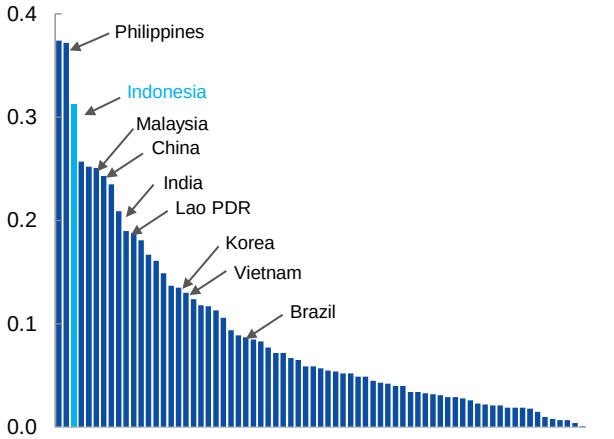
Public investment has often been low and of poor quality, while planning and coordination has been inadequate

Public investment into infrastructure has been insufficient, spending effectiveness has been low, and capacity gaps have prevented adequate planning and execution. While the infrastructure needs far exceed the Government's fiscal resources, historic budget allocations, while increasing, nonetheless still remain low. At the central government level, spending on infrastructure has long been constrained by a combination of tight budgets and low revenue collection. At the subnational level, limited own-source revenues and restrictions on subnational borrowing have had the same effect. Local government development of medium- and large-scale infrastructure has often been hindered by a fiscal transfer system with insufficient funding and predictability for multi-year projects, which has increased the difficulty of partnering with the private sector. Planning and implementation capacity are limited at all levels – especially when coordination is required between different government entities, vertically or horizontally – detracting from the efficiency and quality of infrastructure development.

Highly restrictive and complex regulatory settings help to keep private investors at bay

Private sector financing of infrastructure has been constrained by restrictive regulations, shallow domestic financial markets, and poor support for public–private partnerships (PPPs) amongst line ministries and SOEs. Given that domestic financial markets are relatively shallow, significant mobilization of foreign private investment becomes necessary. However, Indonesia's regulatory restrictions on foreign investment are some of the tightest among middle- and high-income countries, which would weigh on foreign investment including the infrastructure sectors (Figure B.12).[150]

Figure B.12: Indonesia imposes exceptionally tight regulatory restrictions on foreign investment
(FDI Regulatory Restrictiveness Index, 2018)



Source: OECD.Stat

SOEs have been critical to the delivery of infrastructure but have crowded out opportunities for the private sector

Over the past decade, SOEs have been increasingly relied upon to deliver the government's infrastructure investment program. They have been perceived as being able to deliver infrastructure faster, tolerate higher regulatory and financial risks, and overcome bureaucratic hurdles. Their ability to operate as monopolists or dominant players in key sectors, and the regulatory support they receive, such as the right of first refusal over any activity in a sector, have significantly curtailed private sector prospects.[151] SOEs also benefit from public capital injections, easier financing from state-owned banks, presumed protection from insolvency, and explicit government guarantees that place them in advantageous positions compared to private sector participants. This model of SOE-led infrastructure development is becoming unsustainable as the Government's fiscal limits have increasingly forced SOEs to turn to debt

[149] The Jakarta Post (April 23, 2020)
[150] World Bank and International Finance Corporation. Creating Markets in Indonesia: Unlocking the Dynamism of the Indonesian Private Sector. Country Private Sector Diagnostic. World Bank Group, 2019.
[151] Market-dominant infrastructure SOEs include Perusahaan Listrik Negara (electricity), Pelindo II (ports), and Angkasa Pura I and II (airports).

financing, resulting in some SOEs becoming highly leveraged and facing significant financial stress.[152] Amid the current downturn, the Government has significantly expanded support to SOEs, allocating an additional IDR 112.2 trillion for purposes that include additional energy subsidy compensations to PLN and Pertamina (IDR 76 trillion),[153] capital injections, and bailouts (mainly for infrastructure, financing, and transport SOEs).

Cuts to public investment should be unwound as soon as is practicable

As the economic recovery gets underway, it will be essential that the Government recalibrate from a focus on crisis management to one of regaining traction on its longer-term priorities such as infrastructure development. The large COVID-driven cuts to central government capital spending and SNG transfers, which are heavily infrastructure-focused, should be unwound as soon as is practicable. Beyond this, there is a need to double-down on efforts to attract private capital into Indonesia's infrastructure sectors, including through wide-ranging reform of SOEs, while also ensuring more and better public investment. Specifically, the following could be considered:

Improvement of regulatory, institutional, and financial environment for infrastructure investment is critical for enhanced private sector participation

i. *Improve the regulatory, institutional, and financial environment for private sector participation in infrastructure.* Easing of extensive investment restrictions, particularly the narrowing of the negative investment list that prescribes ownership limits, would open an important doorway to global capital. A clear decision-making framework should be implemented to prioritize private financing of commercially viable opportunities and consider their open, competitive tendering. Regulations and institutional arrangements should be improved to promote better PPP project selection, preparation, procurement, and government support processes. Making a broader array of infrastructure subject to user charges would reduce low-value use and congestion, be favorable on the environment, and raise commercial viability.[154] Likewise, basing energy, port, and other tariffs on supply cost and demand considerations would raise the viability of private sector participation. The introduction of new capital market solutions, coupled with enabling regulatory reforms, would help to increase capital mobilization from domestic and foreign sources, and expand the availability of long-term infrastructure financing.[155]

Reform of infrastructure SOEs will be central to facilitating private sector entry, increasing competition and efficiency, and boosting infrastructure quality

ii. *Recalibrate the role and incentives of SOEs to catalyze private sector entry, increase competition, and boost infrastructure quality.* The introduction of key performance indicators and efficiency benchmarks can improve the efficacy of SOE-delivered infrastructure, further harden SOE budget constraints and, where appropriate, improve commercial orientation. Improved – and more restrictive – guidelines on SOE subsidies, financing, and guarantees should be issued to ensure alignment with a more sustainable role for SOEs in infrastructure and the introduction of competitive pressures and other efficiency-inducing mechanisms. SOEs should be encouraged and better enabled to pursue asset recycling within a framework that maximizes public value and ensures fiscally prudent decision-making.[156] Asset recycling, such as through the Limited Concession Scheme[157], can generate new efficiencies in infrastructure while unlocking financing for new projects, but will require more transparency in SOE data.

[152] World Bank and International Finance Corporation. Creating Markets in Indonesia: Unlocking the Dynamism of the Indonesian Private Sector. Country Private Sector Diagnostic. World Bank Group, 2019.
[153] Largely due to uncompensated subsidies from earlier years.
[154] The absence of user charges has usually not promoted access to services by the poor, but rather reduced availability and worsened inequalities (Kessides, 1993).
[155] World Bank (2017).
[156] Asset recycling involves the sale or contracting-out of attractive, commercially viable SOE assets to the private sector to raise funds for new infrastructure projects. Existing brownfield SOE assets are attractive to private investors as they tend to involve less risk and can quickly benefit from private sector efficiency gains. Such efficiency gains can drive significant service quality improvements in the existing infrastructure stock.
[157] The Limited Concession Scheme (LCS) was introduced through a recent Government decree, Perpres 32/2020. The LCS will enable private firms to pay an upfront fee to receive the right to operate, and improve operations of, Government and SOE assets. Funds collected through the scheme will be used by Government to finance new infrastructure.

Fiscal reforms at the central and sub-national government levels are necessary to further increase infrastructure spending

iii. Increase public resources available for infrastructure investment across several sectors and at all levels of government. Additional spending is warranted in several infrastructure sectors such as roads, urban infrastructure, water and sanitation, especially since these public investments would have slowed due to the pandemic but remain critical to growth in the medium-to-long term. Although some reallocation within the budget remains possible, sustainably increasing public infrastructure spending will require fiscal reforms to bring in more revenues (Section B.7). Furthermore, at the sub-national level, enabling SNG borrowing, enhancing the creditworthiness of SNGs, and using innovative instruments to leverage private funding for SNGs can create space for more investment.

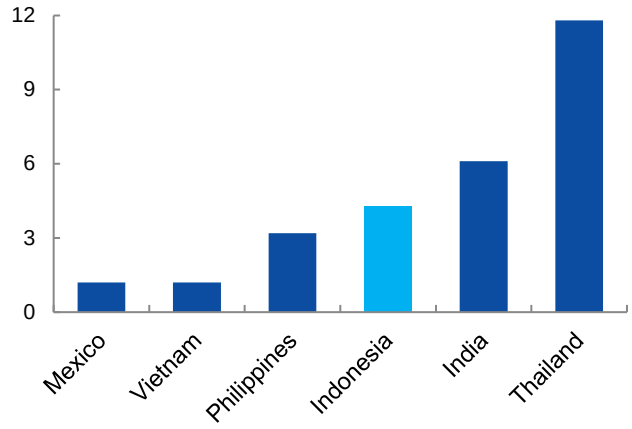
8. Fiscal: Reigning in debt through fiscal reform[158]

Rising debt and interest payments could hinder spending on government priorities and jeopardize the country's investment grade credit rating

The economic downturn and the corresponding measures aimed at mitigating its fallout have translated into a rising public debt trajectory. Public revenues have collapsed, spending has risen (Figure B.13), and the fiscal balance has deteriorated (Section A.5). With the outlook for revenue growth constrained (Figure B.14), central government debt could rise as high as 40 percent in the medium term.[159] Within a tight budget envelope, rising interest payments will begin to crowd out spending on Government priorities, while capital markets may grow nervous about financing public debt. Credit rating agencies have already been highlighting concerns about Indonesia's fiscal position.[160] Failure to improve Indonesia's fiscal fundamentals could jeopardize the country's highly coveted investment-grade credit rating, leading to higher costs of public and private sector borrowing.[161,162] To reign in debt without jeopardizing economic growth, Indonesia must shrink its deficits while allowing for much-needed increases in public spending, which at 16.8 percent of GDP in 2018 is low relative to those of its international peers. To begin with, unwinding crisis-time measures as they outlive their usefulness – especially tax relief and capital injections – could deliver quick gains and resolve any unintended consequences that may have arisen due to their rapid design and implementation.[163] More substantive reforms should be focused on subsidy reform and exploiting opportunities for higher tax collections.

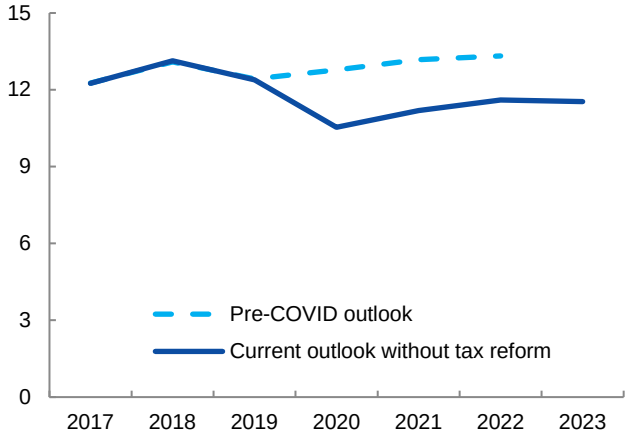
[158] This section borrows heavily from World Bank (2020d).
[159] Although Indonesia's debt-to-GDP ratio is comparatively low by international standards, the country's capacity to repay debt (for instance, assessed by its interest-payments-to-revenues ratio) is also comparatively low on account of low public revenues.
[160] In April 2020, S&P Global downgraded its outlook for Indonesia's sovereign credit rating to negative from stable. S&P Global (2020) stated that "higher deficits over the next two to three years will lead to net general government indebtedness above 30% of GDP for a longer period" and that the "narrow revenue base is an additional constraint on the ratings". Furthermore, "a sustained rise in Indonesia's interest payments … would indicate additional downward pressure on the sovereign rating."
[161] An 'investment grade' credit rating refers to a rating above BBB- from Fitch Ratings or S&P Global, or above Baa3 from Moody's. It is highly vaunted as it facilitates lower-cost borrowing and opens up access to a much broader range of institutional investors.
[162] There have already been over 50 sovereign credit rating downgrades this year for emerging economies, across the three main rating agencies.
[163] Given the rapid pace at which Governments have had to respond to the unfolding crisis, there is the possibility that some policy measures will have created perverse incentives that promote undesirable behavior by firms (e.g. using looser credit conditions to borrow for unproductive purposes) or individuals (e.g. disincentivizing job search), or have a range of other design and implementation shortcomings.

Figure B.13: Fiscal measures have been implemented across the globe in response to the downturn
(cost of fiscal response measures, percent of GDP)



Source: IMF (2020) Database of Country Fiscal Measures in Response to the COVID-19 Pandemic and World Bank staff calculations

Figure B.14: Revenues have fallen during the downturn
(central government revenues, percent of GDP)



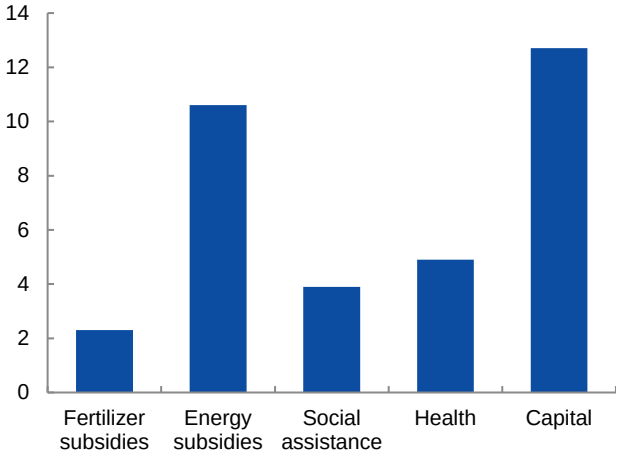
Source: MoF and World Bank staff calculations

Reforming subsidies

Energy and fertilizer subsidies are a large share of the budget but are poorly targeted at the poor and vulnerable

Despite important reforms, energy and fertilizer subsidies still represent a substantial share of Government outlays but are poorly targeted and represent a suboptimal allocation of public funds.[164] In 2018, the Central Government spent IDR 153.5 trillion on fuel and electricity subsidies, and IDR 33.6 trillion on fertilizer subsidies. This was equivalent to 12.9 percent of the total budget, triple the share spent on social assistance programs (3.9 percent) (Figure B.15). These subsidies are a source of financial stress at energy SOEs – which cannot set prices for full cost recovery and are often repaid by Government in arrears.[165] They are also badly targeted, with estimates suggesting that the poor and vulnerable only receive about 21 percent of kerosene and LPG subsidies, 3 percent of diesel subsidies, and 15 percent of electricity subsidies.[166] Likewise, fertilizer subsidies are poorly targeted, regressive, misused, and cost-ineffective at increasing production.[167]

Figure B.15: Spending on subsidies is still high relative to social assistance
(share of central government spending in 2018)



Source: MoF and World Bank staff calculations

[164] World Bank (2020c).
[165] For instance, although global crude oil prices increased by 60 percent over 2016-18, domestic retail prices of RON 88 and diesel barely changed since April 2016. When SOEs such as Pertamina and PLN do not link pricing to cost drivers, the financial burden ultimately falls upon the national budget, whether through direct subsidy spending or through other financial transfers that become necessary to sustain these SOEs.
[166] World Bank (2020c).
[167] There is no evidence that fertilizer subsidies are targeted at all and 60 percent of the subsidies have been found to benefit the largest 40 percent of farmers. Dozens of distributors have been charged by law enforcement for price collusion and selling subsidized fertilizers at higher prices. Moreover, subsidy costs, both fiscal and economic, outweigh the benefits from higher rice yields. See World Bank (2020c) [PER Box 1.6]

Energy subsidies elimination could yield 0.4 percent of GDP in fiscal savings after compensating the poor and vulnerable

Reform of fuel and electricity subsidies could generate fiscal savings of 0.4 percent of GDP after compensating the poor and vulnerable for impacts, while the elimination of fertilizer subsidies could free-up a further 0.2 percent of GDP.[168] Eliminating poorly targeted subsidies for diesel and premium fuels, LPG, kerosene and electricity would reduce budget outlays by 0.7 percent of GDP.[169] At the same time, the bottom 40 percent of households should be protected from the corresponding direct impact of rising energy prices as well as the indirect impacts of price rises in other goods and services that use energy as an input. Providing such compensation through cash transfers would still allow for net fiscal savings of 0.4 percent of GDP. Careful implementation is needed to avoid unnecessary hardship for the bottom 40 percent during the transition. With the elimination of energy subsidies, corresponding improvements should also be made to the governance and institutional frameworks of the key energy SOEs, Pertamina and PLN, to ensure their long-run financial sustainability. The gross fiscal savings from the removal of fertilizer subsidies could finance more effective policy interventions in agriculture.[170]

Collecting more taxes

A long history of low tax revenue mobilization offers the promise of significant new fiscal space through reform

The most promising opportunities for transforming Indonesia's fiscal prospects can be found in reforms to taxation. Underlying the country's low revenue collection is a Central Government tax-to-GDP ratio of just 10.2 percent of GDP in 2018, one of the lowest among Indonesia's regional and emerging market peers.[171] Recent changes to tax policy, which have seen the standard corporate income tax rate permanently reduced to 22 percent, with a further cut to 20 percent scheduled for 2022, will push the ratio even lower.

Government has made some progress, but bolder reforms are needed to accelerate the needed boost in revenue

The Government has taken steps to address the low revenue challenge, but it has not been sufficient. Major tax law changes have been in preparation for some time, and so too a medium- to long-term tax reform strategy to guide the reform process over the next few years. In a commendable effort to improve tax administration and boost taxpayer compliance, the Government is modernizing the Directorate General of Taxation **(**DGT) through improved IT systems[172], organizational restructuring, and staff upskilling. These changes hold the potential for substantial revenue gains but international experience suggests that major tax administration transformations of this sort can take over five years to be fully implemented. More recently, the Government has also sought to boost revenues through changes in tax policy, by legislating to introduce an excise tax on plastic bags and to bring sales on digital platforms under the scope of the VAT. These efforts should be lauded, but only scratch the surface of the needed revenue correction.[173]

The groundwork for a more ambitious tax reform agenda should be set today,

More substantive action should be taken today to lay the groundwork for a return to fiscal sustainability once economic growth returns. Raising taxes in the middle of the crisis can be economically self-defeating and politically unviable. However, crises can also provide an amenable environment – with the required sense of urgency – to pass and secure major reforms,

[168] Does not account for compensatory measures to farmers for loss of fertilizer subsides. Estimates are World Bank staff calculations based on 2017 fiscal data that, notably, precede the implementation of COVID-19 response measures.
[169] World Bank (2020c).
[170] With just a fraction of these savings, important programs could be funded to strengthen farm-, community-, and landscape-level soil, water, and other natural resource management practices and improve investment in agricultural sector education and R&D.
[171] As a comparison, with similar tax rates to Indonesia in 2018, the Philippines, Cambodia and Malaysia achieved tax-to-GDP ratios of 14.7 percent, 17.1 percent, and 12.0 percent, respectively.
[172] Including mechanisms to make tax compliance easier, such as electronic VAT invoices, and electronic e-filing systems for corporate income taxes and withholding taxes from employees' payrolls.
[173] The plastic bag excise revenues may gradually moderate as consumers substitute towards non-plastic alternatives, while digital sales are still only a small share of the economy and will not generate major VAT income in the near term.

to deliver returns once the recovery is underway

even if implementation must wait until the recovery is underway. Viable reforms for boosting revenue mobilization have been identified under three key themes: lower thresholds; progressivity through solidarity; and smart taxes. These are briefly outlined below[174]:

More firms should be brought under the scope of major taxes such as the VAT and CIT

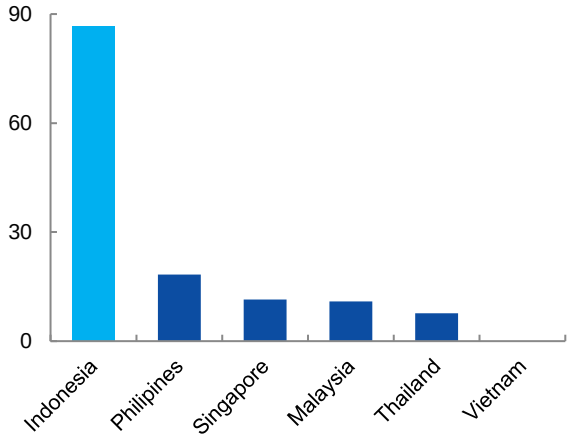
Lower thresholds – to get more firms to pay:

a) *Lower the threshold that defines MSMEs from IDR 4.8 billion to IDR 600 million in business revenue*
MSMEs have been classified as firms earning less than IDR 4.8 billion. Instead of the CIT, MSMEs must only pay a low final tax on sales with limited reporting requirements. As such, most firms, including very profitable ones, fall outside the CIT's scope. The lower tax and reporting burden can discourage firms from growing larger and encourage larger firms to split themselves into smaller below-threshold entities. Returning to the pre-2014 threshold of IDR 600 million would reduce these perverse incentives and increase transparency.

b) *Remove final tax treatment on construction and real estate*
The construction and real estate sectors enjoy a special exemption from the CIT regime and are subject to a low final tax on sales with limited reporting requirements. These sectors also have among the lowest rates of tax compliance. Returning them to the CIT regime will raise transparency and ensure improved horizontal equity across sectors.

c) *Lower the registration threshold for the value-added tax (VAT) from IDR 4.8 billion to IDR 600 million*
The registration threshold of IDR 4.8 billion results in a narrow tax base. As a ratio to GDP per capita, it is the world's highest (Figure B.16) and, combined with other exemptions, results in Indonesia collecting only about 60 percent of its VAT revenue potential.[175] A lower threshold will simplify the VAT system, improve compliance, and allow greater reliance on indirect taxes for revenue mobilization, consistent with more advanced economies.

Figure B.16: Indonesia's VAT registration threshold as a share of per capita GDP is the highest in the world
(VAT threshold as a share of GDP per capita)



Source: Information on VAT thresholds from vatlive.com; data on GDP from World Bank
Notes: GDP per capita is current price LCU in 2018; Vietnam has no minimum VAT threshold. This chart is reproduced from World Bank (2018) and updated for the latest data.

Raise personal income taxes, including for the middle class, while also ensuring that those who have more contribute more

Raise personal income tax rates while also increasing their progressivity so that those who have more can carry a heavier share of the cost of addressing the pandemic:

Change marginal tax brackets and increase the rate on top income
The personal income tax (PIT) regime can be made fairer. The tax brackets could be adjusted so that the current top marginal rates apply to lower incomes, while a new top rate of 35 percent is applied to higher income. This would mirror top rates in peer countries and move Indonesia closer to the OECD 2018 average of 41.2 percent. Raising revenues in this progressive manner contributes to lower inequality.

[174] The following tax policy reform options draw heavily upon World Bank (2020h).
[175] That is, 60 percent of total VAT revenue compared with a benchmark that taxes all consumption at Indonesia's standard rate of 10 percent. See Jin (2018) for further details.

Expand the use of excise taxes with appropriate rates, to raise revenues while creating incentives for desired behaviors

Smart taxes increase the use of excises to discourage the consumption of certain goods and services that cause harm to consumers or third parties[176]:

a) *Apply an excise on all single-use plastics*
This excise would tackle plastic waste that is damaging fisheries and marine tourism.
b) *Apply an excise on sugar-sweetened beverages*
This excise may reduce the consumption of sugar, which contributes to the incidence of non-communicable diseases such as obesity and diabetes.
c) *Introduce an adjustable fuel excise*
An adjustable excise on petroleum products, which could be more easily implemented now that petroleum prices have sharply declined, would raise revenues and reduce emissions.
d) *Increase tobacco excises, via tier simplification*
The numerous tobacco taxation tiers can be further simplified to a single tier with a higher 75 percent tariff/price ratio. This would help reduce Indonesia's high smoking prevalence.

Successful tax reform requires a well thought-out communications strategy

Raising tax revenues over the short-to-medium term needs to be balanced against other objectives, such as impacts on growth and equity, and will face stiff resistance from some stakeholder groups.[177] In Indonesia, there is the potential for strong alignment between more taxation, higher growth, and improved equity. The key challenge is therefore to build a stronger coalition of support around the taxation reforms that are needed,[178] to ensure that political economy settings will allow for change. One approach is to package revenue increases with important but popular spending initiatives, so that support for reform can be broadened.[179] Well-designed tax policy measures should also be implemented in a way that limits unnecessary negative impacts on businesses, and limits compliance costs.[180] Finally, a communications strategy aimed at wide socialization of the proposed reforms and their rationale is important for success.[181]

[176] By incorporating an added cost into the price of a good or service, these excise taxes can help consumers internalize the negative impacts that their consumption has on themselves, other parties and the environment.
[177] World Bank (2018).
[178] Breuer, et al. (2018).
[179] For instance, revenues from excise taxes targeted at socially undesirable activities (e.g. tobacco) could be linked to necessary additional public spending (e.g. financing deficits in the national health insurance scheme).
[180] World Bank (2018).
[181] Sarker (2011).

BOXES

Box A.1: 2018 Rebasing of the Consumer Price Index

The Indonesian Statistics Bureau (*Badan Pusat Statistik* or BPS) introduced a revised Consumer Price Index (CPI) this year with new household consumption categories and weights that reflect the results of the 2018 Cost of Living Survey (*Survey Biaya Hidup* or SBH 2018). The new methodology was implemented beginning with the January 2020 prices data and rebases the CPI to 2018 with a new basket of goods, replacing the 2012-based CPI. Since 1988, BPS has released 6 cost-of-living surveys, serving as periodical five-year updates to the mapping of Indonesian consumer expenditure patterns.

The 2018 SBH, compared to the 2012 SBH:

1. Reflects consumer expenditure patterns from a larger number of cities. The 2018 SBH covered 90 large cities and sampled 141,600 households as opposed to only 82 cities and 136,080 households in the earlier SBH;
2. Added 98 new commodities while dropping 101 commodities. New commodities were added to reflect more recent consumer expenditure patterns which have become more closely associated with technology, while the 101 commodities removed from the basket have become relatively obsolete.[1] For example, online ride-sharing transportation tariffs have been now added, while bus tariffs and post office fees were deleted as they have become relatively uncommon expenditures;
3. Recategorizes commodities from the former 7 household expenditure groups into 11 groups.[2] "Food, Beverage, and Tobacco," a new group in the 2018 SBH, is made up of the former "Raw Food" and portions of the former "Processed Food, Beverages, Cigarette, and Tobacco" categories. Similarly, "Education" is now an independent category, separate from "Recreation and Sports". Likewise, the former "Clothing" category is now divided into "Clothing and Footwear" and "Personal Care and Other-Services" (Figure A.1.1);
4. Assigns higher weights for the core and administered price components, and a lower weight to volatile basket (especially raw food), capturing more recent expenditure patterns where Indonesian urban residents spend more on non-food items relative to food items.[3] Hence, food components in total now have a weight of 33.7 percent, down from to 35.0 percent in 2012 (Table A.1.2).

Table A.1.1: Weights of various CPI components

(percent)

Components	2012	2018
Headline	100	100
Core	65.4	65.5
Administered	18.0	18.1
Volatile	16.6	16.5
Components	**2012**	**2018**
Food	35.0	33.7
Raw food	18.9	18.0
Processed food	16.2	7.0
Food provision/restaurant	**	8.7
Non-food	65.0	66.3

Note: **the sub-components were non-existent in 2012-base CPI.
Source: BPS.

The revised weights have implications for headline consumer price inflation going forward:

1. Lower weights for food components are expected to lead to softer impact of food inflation on headline inflation at times when the food inflation is typically higher, such as during Ramadan and Eid festivities, and less-common instances when there are shortages of essential food items;
2. Stronger impact of non-food prices on headline inflation as the 2018-base assigns higher weights for non-food components, particularly housing and rents, electricity, fuels, higher education, and mobile phone data (Table A.1.2).

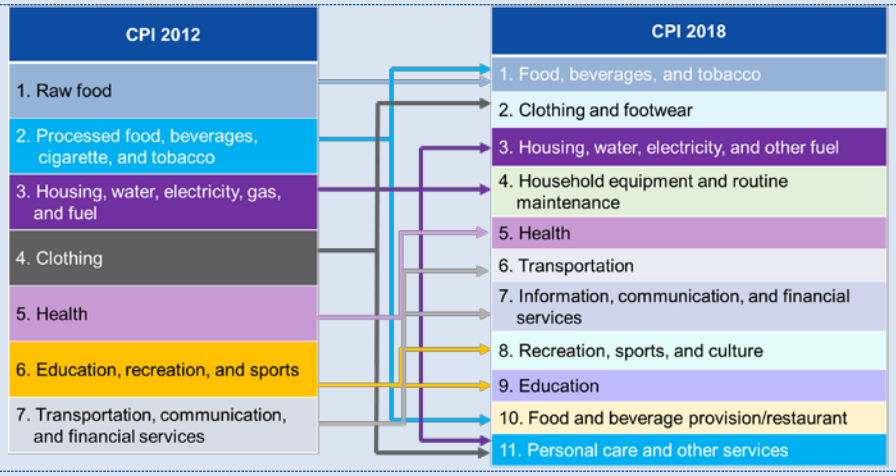
Table A.1.2: Weights of categories in consumer basket of goods and services

(percent)

Goods and services categories	2012	2018	Difference
1. Food, Beverage and Tobacco	27.23	25.01	-2.22
2. Clothing and Footwear	5.06	5.41	0.35
3. Housing, Water, Electricity, and Other Fuel	20.12	20.45	0.33
4. Household Equipment and Routine Maintenance	5.61	5.97	0.36
5. Health	2.80	2.62	-0.18
6. Transportation	12.36	12.38	0.02
7. Information, Communication, and Financial Service	5.81	5.83	0.02
8. Recreation, Sports, and Culture	2.04	2.15	0.11
9. Education	5.41	5.62	0.21
10. Food and Beverage Provision/Restaurant	7.81	8.67	0.86
11. Personal Care and Other Services	5.75	5.89	0.14

Source: BPS.

Figure A.1.1: Reclassifications in the 2018 CPI



Source: Reproduced from BPS's Cost of Living Survey 2018 socialization materials, BPS.

[1] The BPS Chief mentioned that the 2018 CPI includes a number of new commodities in calculating inflation such as mobile accessories, power bank, childcare services, and online ride-hailing transportation expenses, to find out the latest consumption patterns which is usually done every 5 years https://finance.detik.com/berita-ekonomi-bisnis/d-4883368/baru-nih-gojek-grab-hingga-powerbank-masuk-hitungan-inflasi.

[2] In the socialization of SBH 2018, BPS explained that the reclassifications was done to better align Indonesia with the 13 divisions of the United Nations 2018 COICOP (Classification of Individual Consumption According to Purpose). In addition, BPS made further simplifications and remapped the COICOP's 13 divisions to only 11 divisions or groups.

[3] In 2015, 50.0 percent of Indonesian cities' population expenditure was used to consume non-food, a significant increase from only 30.7 percent in 1980. Spending on rice tends to decrease, while spending on processed food tends to go up https://www.bappenas.go.id/files/data/Pengembangan_Regional_dan_Otonomi_Daerah/Statistik%2070%20Tahun%20Indonesia%20Merdeka.pdf. Share of non-food expenditure in Indonesian cities in 2017 increased further to 53.3 percent (BPS, SUSENAS, March 2017).

Box A.2: Near-real-time insights on the socio-economic impact of COVID-19 on households in Indonesia (HiFy)

The COVID-19 pandemic is rapidly evolving. The welfare impacts of the pandemic and its containment measures are expected to be severe. While the impacts are widespread, the effects are particularly deeper and longer-lasting among the poor and vulnerable. Policy makers need timely and relevant information to monitor the impact of the COVID-19 crisis and the effectiveness of their policy measures to mitigate the adverse impacts on livelihoods.

In response to this demand, the World Bank is administering a high-frequency monitoring of the socio-economic impacts of COVID-19 on households (*HiFy*). The *HiFy* is designed as a 15–20 minute telephone interview survey of about 4,000 panel households across 40 districts and 35 cities in 27 provinces. The survey is implemented in five rounds over a six-month period. Households will be tracked every 3–4 weeks for the first three months and every 6–8 weeks for the following three months. The survey provides near-real-time insights on key socio-economic indicators, including social wellbeing, employment and income, food security, access to healthcare, education, social assistance, and households' coping mechanisms. The questionnaire is dynamic, with questions rotating in and out to better capture the rapidly changing situation.

The *HiFy* sampled households drawn from the World Bank's three recent data collection efforts, namely the Urban Perception Survey (2018), Rural Poverty Survey (2019), and Digital Economy Survey (2020). To ensure the survey's representativeness at the national level, the coverage of households is well balanced across five major regions in Indonesia: DKI Jakarta, Java (outside Jakarta) Rural, Java (outside Jakarta) Urban, Off-Java Rural, and Off-Java Urban. The sampled households were also selected with consideration to the gender and education level of the head of the households. The second round of the data collection was recently completed in early June 2020, and the analysis is currently on going.

Box A.3: Economic effects of the COVID-19 pandemic through a Gender Lens

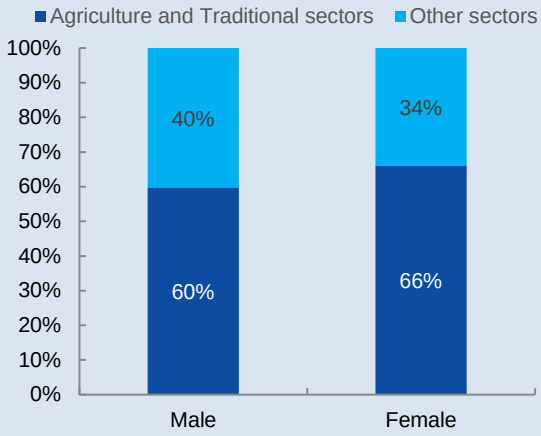
The COVID-19 crisis is unique, comprised of multiple crises interacting in complex ways, and creates substantial uncertainty about people's lives and livelihoods.[1] Given the pre-existing gender differences in economic activities and social norms, amongst others, the crisis may affect women and men in different ways. These differences need to be recognized and measured so that the policy responses and interventions can respond to the various needs and priorities. A failure to do so will exacerbate the existing challenges, with critical negative consequences for the economy. However, monitoring the size of gender-related impacts and the effectiveness of the policy and implementation responses for men and women, and girls and boys, requires an on-going systematic effort to collect and analyze sex-disaggregated data and information.

Women are disproportionately employed in sectors that are more affected by the crisis

Around the world, women are bearing the brunt of layoffs due to the economic downturn. In the United States, female workers accounted for 55 percent of the job losses in April.[2] The United Kingdom Quarterly Labor Survey showed that women are one third more likely to lose their jobs or experience a reduction in their income in Q1 as they disproportionately work in retail and hospitality.[3]

Figure A.3.1: Agriculture and traditional services accounted for 66 percent of the female labor force, higher than that of males

(percent to total labor force)



Source: BPS; World Bank staff calculation

As of May 2020, 1.7 million employees[4] had lost their jobs in Indonesia due to the outbreak. However, it is estimated the net job loss in total will be around 3.6 million[5]. A World Bank modelling of ex-ante poverty impact of COVID-19 crisis[6] found that labor in agriculture and traditional services, such as wholesale and retail, transport and warehousing, accommodation and restaurants, and other services are likely to be hardest hit by the crisis. These sectors account for 66 percent of the total female labor force, compared to 60 percent of total male labor force (Figure A.3.1). A recent World Bank High-Frequency Monitoring of the COVID-19 Impacts (HiFy COVID – Box A.2) shows that 24 percent of breadwinners who worked before the crisis had stopped working by May 2020. Service sector workers constituted the largest share (55 percent) among them, followed by those in industry (33 percent). Even among those who could still work during the crisis, 64 percent received incomes lower than before the crisis. Again, those working in the service sectors are most likely to experience reduced income. Although male and female breadwinners have the same chance of becoming unemployed or experiencing income reduction during the pandemic, more than 80 percent of female breadwinners are in the service sector, particularly in retail, leisure, and hospitality, which are the hardest hit. This put the majority of the female workers at higher risk during the crisis time. However, in absolute terms, many male workers are engaged in service sectors, in addition to male-dominated sectors such as construction and manufacturing which are also severely impacted, making them not immune to the economic shock.

Meanwhile, the slump in economic activity as a result of mobility restrictions will tend to affect workers in informal sector more than those in formal sectors[7]. In Indonesia, the share of women working in the informal sector (60 percent of total female employment) is higher than that of men (53 percent of total male employment).

Micro, small, and medium enterprises (MSMEs) are also vulnerable to economic shocks, and women own around 60 percent of Indonesia's MSMEs, most of which are microenterprises and many of which are in the informal sector. The HiFy survey found that those engaged in non-farm business, which are predominantly micro and small businesses, are the most negatively affected during the pandemic. With more than 60 percent of female breadwinners working in non-farm business, compared to males at around 24 percent, a higher ratio of female breadwinners became vulnerable in this crisis than their male counterparts. Their vulnerability is heightened since this type of work tends to fall outside the coverage of social protection measures. Adding to this vulnerable group are domestic workers, who are over-represented by women.[8]

Overall, the gendered dimension of COVID-19 impacts on employment need to be assessed in the context of pre-existing state. With the already relatively low female labor force participation (FLFP), the possible female job loss from this crisis will potentially reduce the FLFP further, which would potentially weigh on long-term economic growth and competitiveness.[9,10]

Female-headed households are more vulnerable to income shocks and food insecurity

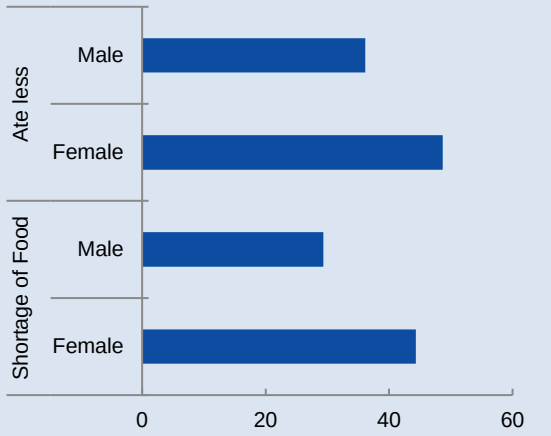
While statistically the employment shocks are not different between female and male breadwinners, and the poverty incidence is similar among female- and male-headed households, the COVID-19 impacts on female- vis-à-vis male-headed households can be disproportionate. One of the mechanisms for differential impacts is households' source of income, of which female-headed households (FHH) are more vulnerable. For example, the HiFy data show that female-headed households relied more on remittances (31 percent) than male-headed household (11 percent). Due to the more restricted conditions for work or other economic hardships, 80 percent of female-headed households received less or even no remittances after the pandemic.[11] Similarly, as female-headed households are more likely to have only one earner, they are more vulnerable economically once the only breadwinner experiences employment shocks. This higher economic vulnerability among female-headed households seems to be transmitted into reducing food consumption as a coping mechanism. Female-headed households are more likely to experience food insecurity, either due to food shortages and/or eating less than they should. (Figure A.3.2).

As the majority of health workers and caregivers are female, women have a higher risk of being exposed to the virus

In line with global trends, women make up the majority of health sector staff in Indonesia. In total, 74 percent of health sector staff, and 63 percent of frontline health sector staff are women. Having direct interaction with infected patients as part of their main jobs, more female health staff will be at risk if they cannot comply with infection control protocols, such as due to shortages of personal protective equipment (PPE) when doing their jobs. In addition, social norms dictate that women take more responsibility for caring for the sick in the family thereby increasing their likelihood of exposure to the virus. During the African Ebola outbreak, women were more likely to be exposed to the virus, as they have roles as caregivers within families.[12]

Figure A.3.2: The prevalence of food insecurity is higher among FHH

(share to total households by gender, percent)



Source: High-frequency monitoring of households, Summary of Results from Survey Round 1.
Note: Shortage of food is defined when a family does not have enough food to feed for the whole household. Ate less is defined when a family eats less than before the pandemic but does not necessarily lack of food consumption.

Social and gender norms prescribe the burden of responsibility for household and family care to women

Working from home or flexible working arrangements have been promoted as a way to help both men and women to balance work and family needs and keep married women with children in the workforce. Companies, including in Indonesia, that may have been slow to introduce formal procedures for flexible work have had to make this change due to the COVID-19 outbreak. While this may herald a positive change for promoting gender equality in the workforce in the longer term, it has come at a time when schools are closed and women are picking up the burden of the additional domestic work, home school supervision, and childcare responsibilities at home. From around the world, there is evidence of an unequal distribution of the additional work, and the additional stress that women are bearing.[13] The same pattern is observed in Indonesia. Although only 18 percent of households in the HiFy survey who have school-aged children required adults to quit their jobs or work less in order to supervise their children who are continuing their studies at home, in most of them (66 percent), this responsibility falls on the mother. This will potentially reverse some of the progress made in narrowing the gender wage gap over recent decades and disrupt the career progression and earnings prospects of mothers more than of fathers.[14]

[1] There are substantial uncertainties in this crisis that depend a lot on the epidemiology of the virus. See IMF (2020). The Great Lockdown: Worst Economic Downturn Since the Great Depression by Gita Gopinath, IMF Blogs, April 14 2020
[2] Why the coronavirus crash is hurting women more than men, CBS News (May 28, 2020)
[3] R. Joyce, X. Xu, 2020, 'Sector shutdowns during the coronavirus crisis: which workers are most exposed'
[4] Detik (May 12, 2020)
[5] Net job loss is calculated as the difference between job losses and job gains as workers transitioned between sectors during the pandemic. Poverty and Distributional Impact of COVID-19 Shock in Indonesia, an internal modelling exercise as of June 2020.
[6] Ibid
[7] Low-income, self-employed, and informal workers are less likely to be able to work from home and to have income protection schemes. Hayatama M., Mariana V., and Hernan W., Jobs' Amenability to Working From Home: Evidence from Skills Surveys for 53 countries, World Bank Policy Research Working Paper 9241, May 2020.
[8] There are many MSMEs unregistered in the banking system, tax system and social assistance system as these MSMEs have no National Identity Number (Nomer Induk Kependudukan) and therefore will not be able to receive certain benefits from the Government.
[9] Increasing the participation of Indonesian women in the labor market means that Indonesia will have more skills and more talent available to support economic growth. Gender Equality and Development, World Development Report, 2012.

[10] Higher earnings from working women also tends to lead to several channels of productivity growth. These include increased household savings and higher expenditures on human capital investments through better education and health care. Agenor, Pierre-Richard, O. Canuto, Gender Equality and Economic Growth in Brazil, World Bank Policy Research Working Paper 6348, 2013

[11] The number of male-headed households that stop receiving remittances is marginally lower than that of female-headed households.

[12] Fawole, Olufunmilayo & Nguku, PatrickM & Adewuyi, PeterA & Bamiselu, OlufunmiF. (2015). Gender dimensions to the Ebola outbreak in Nigeria. Annals of African Medicine. 15. 10.4103/1596-3519.172554

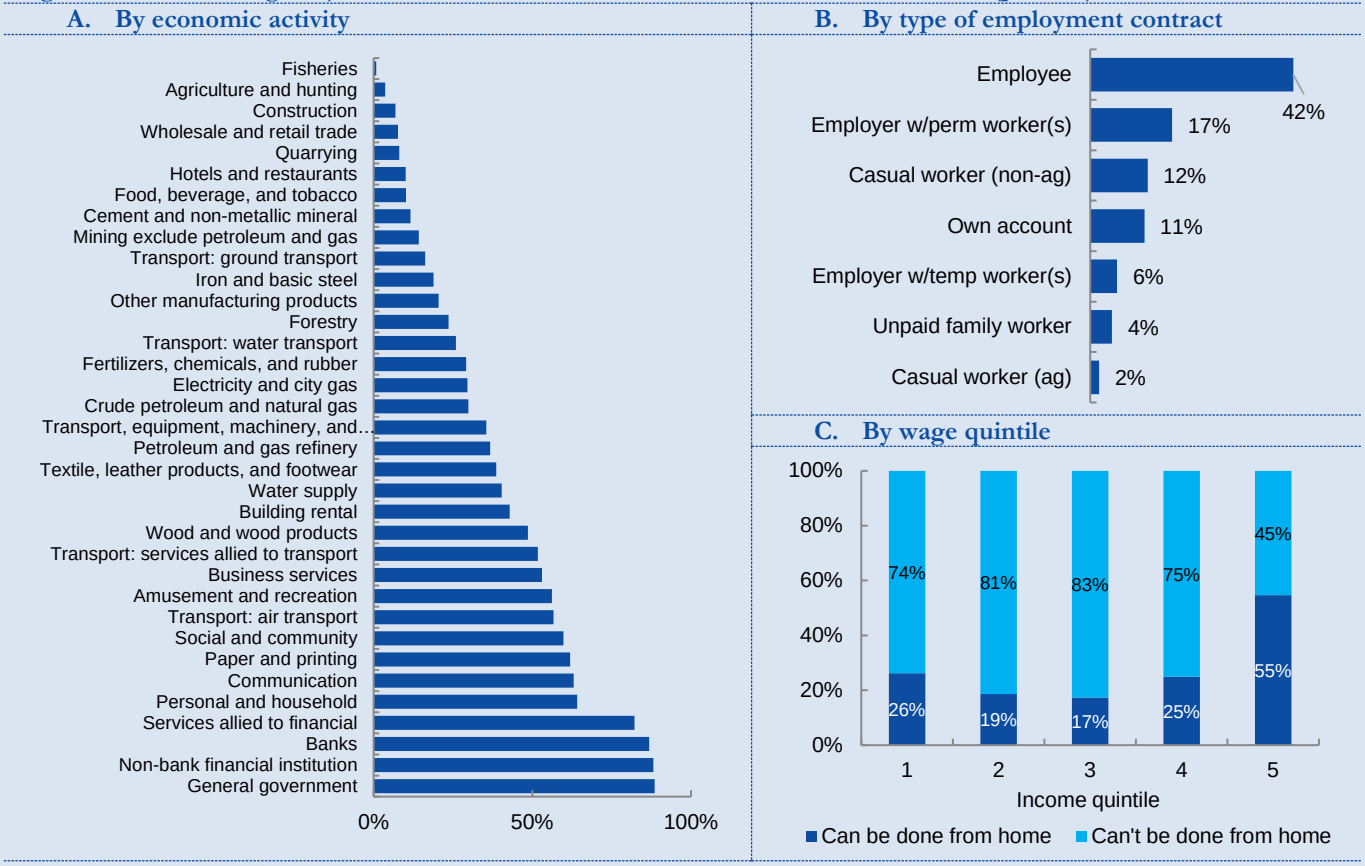
[13] See for example evidence from the UK in : A. Andrew, S. Cattan, M. Costa Dias, C. Frarquharson, L. Kraftman, S. Krutikova, A. Phimister, and A. Sevilla, 2020, 'How are mothers and fathers balancing work and family under lockdown', The Institute for Fiscal Studies

[14] A. Andrew, S. Cattan, M. Costa Dias, C. Frarquharson, L. Kraftman, S. Krutikova, A. Phimister, and A. Sevilla, 2020, 'How are mothers and fathers balancing work and family under lockdown', The Institute for Fiscal Studies.

Box A.4: The dynamics of working from home

Academics are developing classifications to evaluate which jobs can be done at home based on the skills needed to successfully complete the tasks.[1] According to this classification, close to half of the jobs in high-income countries can be done at home, but this is true for less than a quarter of jobs in low- and middle-income countries. Using a common methodology, 37 percent of jobs can be done at home in the United States, but only 21 percent in Indonesia.[2] How amenable jobs are to be done from home varies enormously across economic sectors and based on what are considered essential services. In Indonesia, while 88 percent of government jobs are estimated to be amenable to be done at home, this is true for only about 40 percent of key manufacturing jobs (textile, leather products and footwear; wood and wood products), and for only 10 percent or less of jobs in hotels and restaurants, construction, wholesale, or agriculture (Figure A.4.1).

Figure A.4.1: Percentage of jobs that are estimated to be amenable to be done at home (percent)

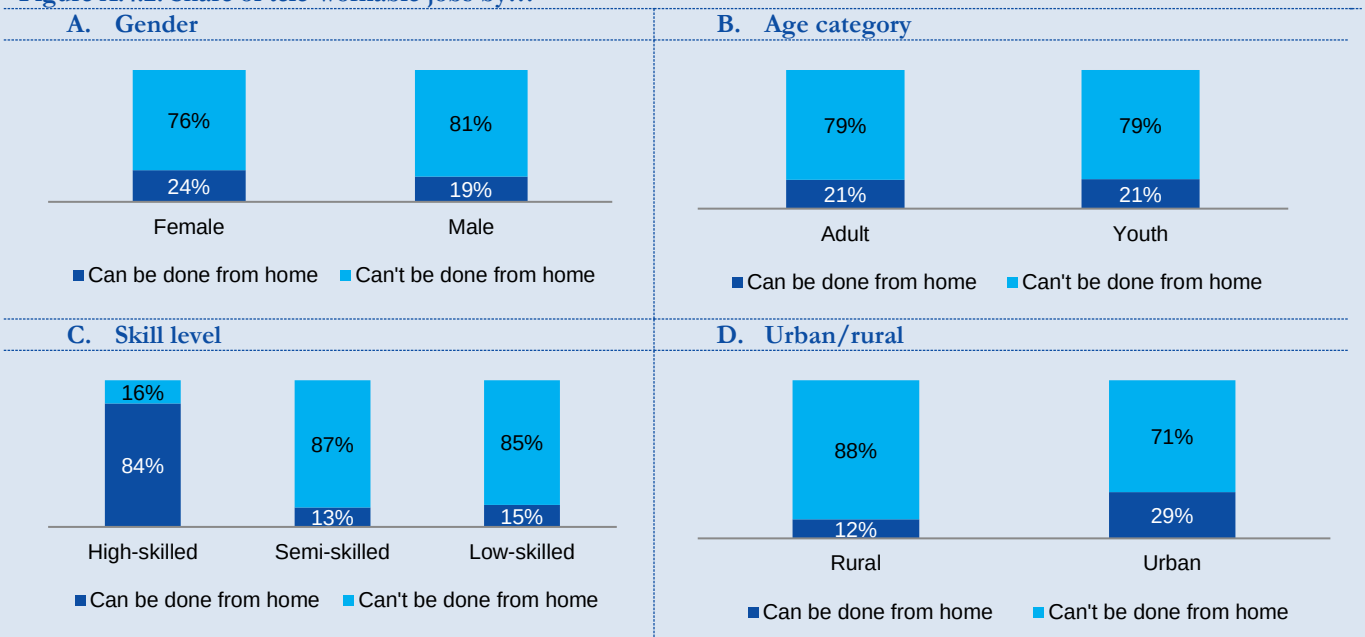


Note: Estimates based on Sakernas and Dingel and Neiman's (2020) methodology

Not surprisingly, workers in jobs that can be done at home are also more likely to be wage workers. Overall, 42 percent of wage jobs are estimated to be possible to complete from home, 17 percent of employers with permanent workers will be able to do so, and only 11 percent of own-account workers will be able to do so (Figure A.4.1B). Half of the workforce with high wages is estimated to be able to work from home; while, interestingly, a higher share of those with the lowest wages are able work from home (26 percent) than those with wages placing them in 2nd, 3rd, and 4th income quintiles (Figure A.4.1C).

Men, low-skilled workers, and workers living in rural areas are more likely to have jobs that cannot be done at home (see Figure A.4.2). The difference is most striking for low-skilled workers, for whom 85 percent of the jobs require physical presence. Higher education is also highly correlated with a higher proportion of jobs that can be done at home, as almost 80 percent of people with university education have jobs that can be done remotely at home.

Figure A.4.2: Share of tele-workable jobs by…



Note: Estimates based on Sakernas and Dingel and Neiman's (2020) methodology

While the exercise is interesting, it should be noted that more in-depth analysis should account for which services are considered essential (even if not amenable to be done from home, these occupations will not stop), that the same occupations might differ in their skills content in high and middle-income countries,[3] and that workers may be able to adjust their services and production functions to the new constraints.

[1] Dingel and Neiman (2020). "How many jobs can be done at home?" April 16, 2020. Mimeo.
[2] The estimation methodology for jobs that can be done at home is based on Dingel and Neiman (2020), which classifies the feasibility of working at home based on responses to two Occupational Information Network (O*NET) surveys covering "work context" and "generalized work activities" for each standard occupational classification (SOC) code. Given the many-to-many mapping from SOC code to KBJI (Indonesia Standard Job Title Classification, Klasifikasi Baku Jenis Pekerjaan Indonesia), when an SOC maps to multiple KBJIs, we allocate weights for each SOC code using the proportion of KBJI in The Intercensal Population Surveys (SUPAS).
[3] The World Bank is piloting an adjusted version of the US O*NET in Indonesia that will shed light on this question.

Box A.5: Indonesia, Trade Tensions, and the Phase One Trade Deal

Despite the endorsement of the Phase One Trade Deal in January this year, U.S.–China trade tensions and the threat of tariffs, while certainly pausing during the first few months of 2020, have not completely disappeared and have in fact seen some re-escalation in recent weeks.[1] In addition, given the continued move away from China as a production hub due to the aging of its labor force, higher wage bills, and recent major supply chain disruptions, it has become more important to understand the consequent trade and investment effects and their possible longer-term implications for Indonesia.

Prior to the Deal, trade tensions had been escalating for a period of two years. These tensions, along with the increases in tariffs and the ensuing increase in global policy uncertainty, have all weighed on world trade and investment. Global trade growth slowed to 0.8 percent in 2019, the weakest pace by far since the Global Financial Crisis[2]. At the same time, global investment growth also declined to 2.3 percent in 2019, the lowest since 2016.[3]

According to the Phase One agreement, China will increase its imports from the United States by an additional USD 77 billion in 2020 and USD 123 billion in 2021, totaling to USD 200 billion, compared to 2017 levels. China imported over USD 185 billion in total U.S. goods and services that year. The deal covers additional imports in agriculture (USD 32 billion), manufacturing (USD 77.7 billion), services (USD 37.9 billion), and energy (USD 52.4 billion) over the period February 14, 2020 to December 31, 2021.[4]

Trade and FDI Diversion Effects due to Heightened Trade Tensions

Slower global trade and the protracted heightened policy uncertainty have impacted the East Asia and Pacific (EAP) region. Regional exports growth is estimated to have slowed to 1.9 percent in 2019, after reaching 9.4 and 4.9 percent in 2017 and 2018, respectively. Regional fixed investment was also subdued, growing by 4.3 percent in 2019, lower than the 4.7 percent and 5.1 percent increase in 2017 and 2018, respectively.[5]

In the face of higher tariffs and increased uncertainty, the U.S.–China trade tensions are likely to have contributed to trade and Foreign Direct Investment (FDI) diversion effects, where companies operating in China relocated operations away from China, especially to neighboring countries in Southeast Asia.[6] A joint survey conducted by AmCham Shanghai and AmCham China in May 2019 showed that 40.7 percent of respondents were considering relocating manufacturing facilities outside China and that Southeast Asia was the preferred destination (24.7 percent), followed by Mexico (10.5 percent) (Table A.5.1).[7] Accordingly, USD 31 billion of U.S. manufacturing imports were diverted from China to other Asian countries in 2019, of which 46 percent were absorbed by Vietnam.[8] This diversion contributed to Vietnam exporting an additional USD 14 billion worth of manufactured goods to the United States in 2019 compared to 2018.[9]

Table A.5.1: Companies in China preferred relocation destination

Locations	Responses	Percentage
Southeast Asia	59	24.7
Mexico	25	10.5
Indian Subcontinent (India, Bangladesh, Pakistan, Sri Lanka)	20	8.4
Elsewhere	15	6.3
United States	14	5.9
East Asia	10	4.2
Europe	9	3.8
No plans to relocate manufacturing facilities	144	60.3

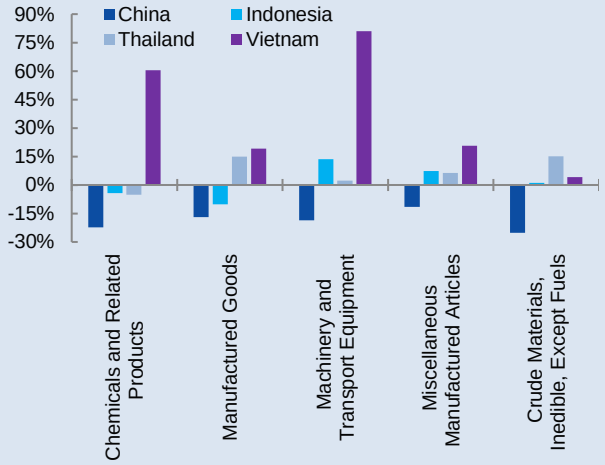
Source: American Chamber of Shanghai and China Joint Survey on Tariffs

Apart from Vietnam, there was also some evidence of trade diversion effects from China to Thailand and Indonesia. The specific goods categories for which U.S imports from China decreased but U.S. imports from Indonesia, Thailand, and Vietnam increased include inedible crude materials (excluding fuels), machinery and transport equipment, and miscellaneous manufactured articles (Figure A.5.1). At the same time, Vietnam saw a large increase in direct investment from China, growing by 64.8 percent to USD 4.1 billion of FDI inflows in 2019, up from USD 2.4 billion in 2018. Vietnam received large investments from China partly due to its trade liberalization efforts and favorable investment climate, which has supported Vietnam's relatively high integration into global value chains (GVCs).[10] Vietnam's GVC integration is found to be diversified across manufacturing sectors, including basic and fabricated metals, chemicals and chemical products, electrical and optical equipment, transport equipment, machinery, and rubber and plastics.[11]

Aside from GVC integration, Vietnam also offers competitive costs and close geographical proximity to China, which helps the country to be a prominent option for companies in China to relocate their production bases to.[12] These factors have all contributed support for increased direct investment from China to Vietnam (Figure A.5.2). Likewise, Thailand experienced a similar FDI surge from China in 2019 with, in particular, the Thailand Plus relocation policy package contributing to luring firms from China to relocate their production to Thailand.[13] Similarly, China's FDI realization into Indonesia in 2019 almost doubled to USD 4.7 billion or 16.8 percent of total realized investment, from 2018.[14]

Figure A.5.1: Select categories of U.S. good imports from Vietnam, Thailand, and Indonesia increased in 2019

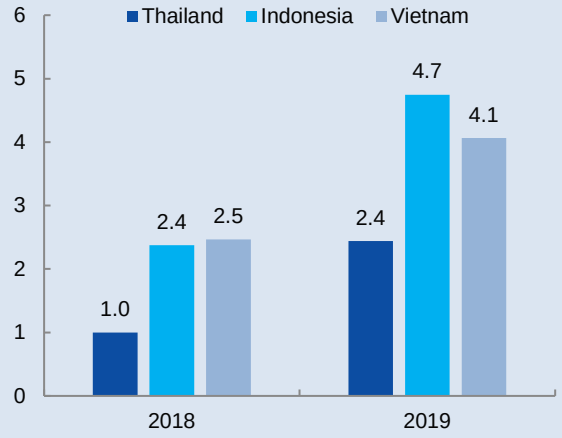
(U.S. goods import growth by source country and goods category, 2019, percent, yoy)



Source: CEIC, WB staff calculation

Figure A.5.2: Direct investment from China surged in 2019

(Realized direct investment from China into destination country, USD billion)



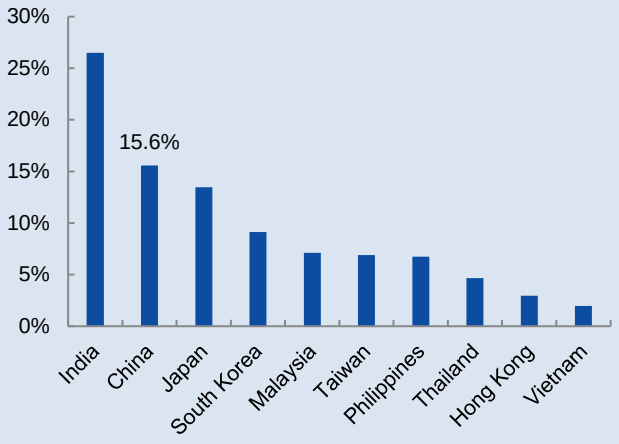
Source: CEIC, WB staff calculation

Trade and Investment Diversion Effects due to the Phase One Deal

The Phase One Deal requires China to import more manufacturing, agriculture, services, and energy products from the United States. As a commodity-exporting country, and with China being a major importer, Indonesia's exports to China are likely to be affected by this agreement. Coal and LNG are major commodity exports, which reached 53.7 percent and 15 percent of total mining exports, respectively, for the years 2014-2018. Over the same period, China imported 15.3 percent of its total coal imports from Indonesia, while coal imports from the United States constituted only 1.6 percent of total Chinese coal imports. Similarly, China imported 9.2 percent of its total liquefied natural gas (LNG) imports from Indonesia, while LNG imports from the United States only amounted to 2.6 percent. It is therefore plausible, if not likely, that China will divert a portion of its energy imports from Indonesia to the United States, particularly coal and natural gas, to meet the commitments of the trade deal, especially in the face of the COVID-related reduction in coal and natural gas domestic demand in China.[15]

Figure A.5.3: China is a major importer of Indonesian coal

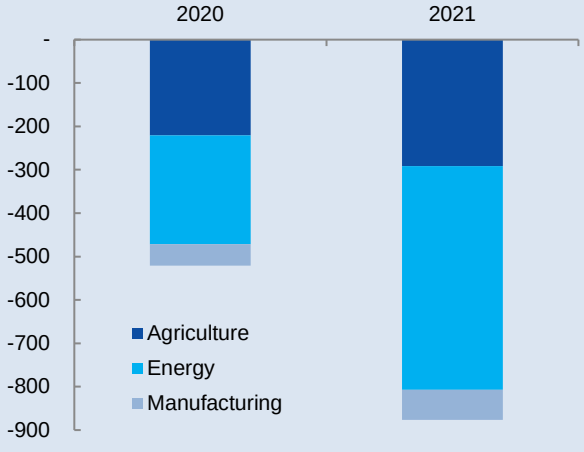
(Indonesia coal exports by destination country, 2015–2019, percent)



Source: CEIC, World Bank staff calculation

Figure A.5.4: Indonesia faces increasing export losses from the trade deal

(estimated drop in Indonesian exports to China from the trade deal, USD million)



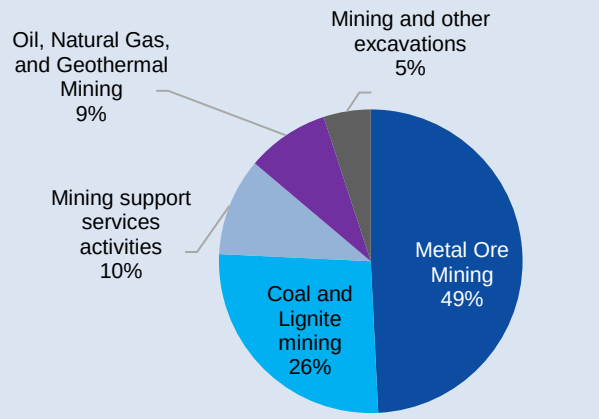
Source: Reproduced from Cali and Nabil (2020).

China is the second-largest destination for Indonesia's coal exports after India, and account for 15.6 percent of Indonesia's total coal exports during 2015–2019 (Figure A.5.3). Similarly, China is the third most major destination country for Indonesia's natural gas exports, after Singapore and Japan. With the Phase One trade deal, recent estimates indicate that Indonesia's exports to China are expected to drop by USD 1.4 billion in 2020–21 as a direct result of the agreement and that gas and coal account for almost half of the expected export drop (Figure A.5.4).[16]

Apart from the trade diversion effects from Indonesia to the United States, the trade deal could also spark investment diversion effects. If China adheres to the imports from the United States stipulated in the trade deal for an extended basis beyond 2021, direct investment in Indonesia could be disrupted, especially for coal and LNG industries. Investment into the coal industry constitutes 26 percent of mining sector investment realization from 2015 to 2019 (Figure A.5.5).[17] Similarly, investment into the coal industry accounts for a quarter of Chinese investment in Indonesia over the same period.[18] In the face of potential lower Chinese demand for Indonesian coal and LNG products in the medium term, investors could decide to scale back investments in coal and LNG industries on profitability concerns, leading to dimmer prospects for Indonesia's coal and LNG industries, pending new substitute export destinations.

Figure A.5.5: Mining sector investment realization in Indonesia, 2015–2019

(percent)



Source: CEIC, World Bank staff calculation

[1] Aljazeera (June 29, 2020).
[2] World Bank (2020a).
[3] See World Bank (2020b) and Wall Street Journal (2020).
[4] In exchange, the United States agreed to reduce tariffs on Chinese products worth USD 120 billion from 15 percent to 7.5 percent, including flat-panel televisions, Bluetooth headphones, and footwear. However, the 25 percent U.S. tariffs put in place earlier on Chinese goods worth USD 250 billion will remain immediately unchanged and could be rolled back as part of a Phase 2 trade negotiation.
[5] World Bank (2020a).
[6] Nikkei Asian Review (2019), South China Morning Post (2020a).
[7] The survey received nearly 250 responses, with industry composition as follows: 61.6 percent from manufacturing-related industries, 25.5 percent from services, 3.8 percent from retail and distribution, and 9.6 percent from other industries. See Amcham Shanghai (2019).
[8] Amcham Shanghai (2020).
[9] Forbes (2020).
[10] Asian Development Bank (2017), World Bank (2020c).
[11] Anukoonwattaka, W and Lobo, R.S. (2019).
[12] See ASEAN Briefing (2019).
[13] The policy package includes a 50 percent corporate income tax reduction for an additional five years for firms with an investment of at least THB 500 million by 2020 or not less than THB 1 billion by 2021. See South China Morning Post (2020b) and Thailand Board of Investment (2019).
[14] According to the Indonesia Investment Coordination Board (BKPM) data. Badan Koordinasi Penanaman Modal (2020).
[15] With the slowdown in its economy this year, China would struggle to fulfill the deal on energy without displacing the energy imports from other exporters outside U.S. See Amcham Shanghai (2020), International Energy Agency (2020), Straits Times (2020), United States Trade Representative (2020).
[16] Indonesia's LNG exports to China could potentially be lowered by USD 434.8 million (about 12.3 percent of Indonesia's 2019 natural gas export to China), while coal exports could fall by USD 233.2 million (about 7.4 percent of Indonesia's 2019 coal export to China) in 2020–2021. WB staff calculation based on USTR, WITS, and IMF WEO. See Cali and Ryandiansyah (2020, forthcoming).
[17] Using KBLI (Klasifikasi Baku Lapangan Indonesia) 2015 data
[18] According to the American Enterprise Institute's China Global Investment Tracker data, about a quarter of China investment into Indonesia is allocated to the coal industry, totaling to USD 3.7 billion from 2015 to 2019.

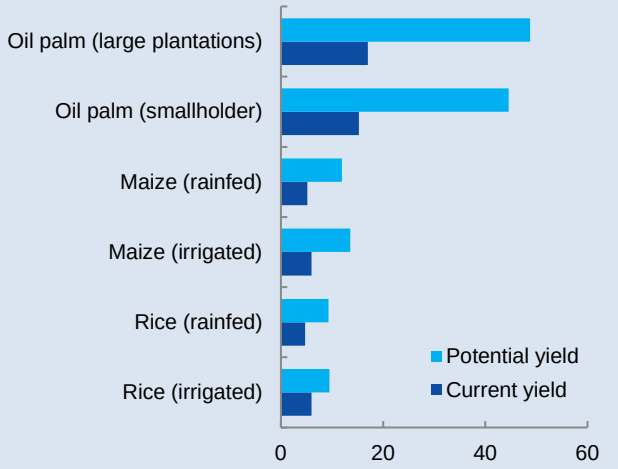
Box B.1: Minimizing externalities from post-crisis economic recovery policies

While far-reaching support is crucial for the economic recovery, it will be important to ensure that such support does not come at the expense of Indonesia's already over-stretched natural assets and local livelihoods. Instead, green industrial policy offers opportunities to leverage changing consumer demand that focuses on sustainability and places greater weight on health-consciousness.

The recently approved revisions to the 2009 Minerals and Coal Mining Law also illustrate this risk. The revisions introduce an obligation for mining companies to carry out more exploration activities and removes limitations to such activities aimed at protecting the natural environment.[1] While this strategy may generate short-term gains in economic activity nationally, it risks exacerbating pollution of land and water resources, massive deforestation and forest degradation[2], as well as conflict over access to land with local communities.[3] In addition, the expansion of coal production – the main mining product in Indonesia – would not bode well with the trends in global demand for clean energy and, if continued to be used for domestic energy production, will further contribute to the pollution problem in Indonesia.[4]

Figure B.1.1: Indonesia has high potential-to-actual yield ratios, underscoring the opportunity for expanding production in the current land base

(Indonesia crop potential vs actual yield, (ton/ha))



Source: Yield Gap Atlas; World Bank staff calculations

Pressure on land is also building. This is due to the need to accommodate the increasing shift of workers towards agriculture in response to the COVID-19 shock, and to the objective of achieving food self-sufficiency, particularly in rice, in response to possible global food shortages. This target is driving plans to convert additional land for agriculture, such as the Ex-Mega Rice Project (EMRP) area in Central Kalimantan, which includes between 250,000 and 300,000 hectares of peatland. Because peat areas are unsuitable for rice cultivation, the benefits are likely to be limited. On the other hand, deep peat areas are important carbon sinks and the conversion of peatland for agriculture generates large negative spillovers in Indonesia through forest and land fires, pollution, peatland degradation, and destruction of biodiversity.[5]

Preliminary World Bank estimates suggest that restoring peatland would have large multiplier effects associated with increased agricultural production and would also greatly reduce the risk of fires and related costs to the economy. The analysis estimates large economy-wide returns from such investments: an initial investment of USD 1 in restoration may yield a combined return of: a USD 1.61 increase in value added, a USD 2 sustained increase in value added resulting from the extra production in the restored peatlands, and a USD 0.85 reduction in the social cost of peat degradation, as lower fire risks would result in lower carbon emissions, lower loss of natural assets, and reduced impacts on health.

A more effective strategy to increase agricultural production both for commercial and food security purposes would be to increase the productivity of existing agricultural land. There is great potential to increase agricultural yields across both cash and food crops (Figure B.1.1). To that end, reallocation of wasteful fertilizer subsidies toward investments in extension services could ensure a better match of crop choice with land suitability, enhance seed quality, and reduce post-harvest loss. It would also build human capital in agriculture, helping to modernize this key sector.

Similarly, the increasing demand for clean energy sources along with the large untapped potential of the renewables make the sector another ideal target for the expansion of investments in Indonesia even in the short run. The Ministry of Energy and Mineral Resources estimates 168.6 GW of renewable energy potential in Indonesia (from solar, geothermal, wind, hydro and others), of which roughly 6.4 percent has been installed so far. Solar energy is a case in point. Technology advances in photovoltaic cells (PVC) have made solar power more competitive vis-à-vis fossil-fuel-derived energy globally[6] and new generations of batteries are making solar an increasingly more stable source of energy supply. Estimates suggest Indonesia may have close to 50 GW of potential solar capacity, the vast majority of which is untapped, with a potential to generate 325,000–515,000 jobs.[7] Considering the potentially healthy returns on investments, there is much appetite for private investments in the sector, which could help the economy in the near term. For that to happen, the Government needs to address a number of bottlenecks, including a revision of feed-in tariffs, which currently make investments in renewables including solar unviable. Local content requirements for PVC, as well as regulations dictate that private solar plants are to be transferred to PLN at the end of the power purchase agreements. In this context, the development of biomass energy, which the Government is pursuing through subsidies for B30 biodiesel, may not be an equally appealing solution given the possible environmental damage associated with forest conversion to increase palm oil production.

[1] These include the removal of the limit on offshore mineral explorations and the removal of the area limitations for special mining business license areas ("WIUPKs") for metal mineral production operation activities and coal production operations.
[2] One of the key drivers of deforestation/forest degradation in East Kalimantan was mining, which is highlighted in the Government's Emission Reductions Program Document (https://www.forestcarbonpartnership.org/system/files/documents/Revised%20ERPD.pdf).
[3] There is increasing evidence of the detrimental effects of mining activities in developing countries, including in Indonesia. On the health effect of mining in Indonesia, see Bose-O'Reilly et al. (2010). Health assessment of artisanal gold miners in Indonesia. *Science of the Total Environment, 408*:713-725. On land conflict generated by mining activities in Indonesia, see World Bank (2014). *Towards Indonesian Land Reforms: Challenges and Opportunities*. A Review of the Land Sector (Forest and Non-forest) in Indonesia. DOI: 10.13140/RG.2.2.16062.02883. On the negative pollution and economic impact of mining activities on local communities globally, see Aragon, F. and J.-P. Rud (2016). Polluting Industries and Agricultural Productivity: Evidence from Mining in Ghana, *The Economic Journal*, 126 (597): 1980 – 2011; and von der Goltz, Jan & Barnwal, Prabhat, 2019. Mines: The local wealth and health effects of mineral mining in developing countries, *Journal of Development Economics*, 139(C): 1-16.
[4] The heavy exploitation of coal for energy and exports has contributed to air pollution and respiratory diseases due to pollution, which could cause 238 premature deaths/million people per year and cost up to USD 805 billion between 2012 and 2030 (Bloom et al. (2015). *The economics of non-communicable diseases in Indonesia.* Geneva: World Economic Forum (WEF).
[5] Preliminary World Bank analysis suggests that the value added from the conversion of an additional hectare of peatland to agriculture could be 50 percent lower than the social costs in terms of loss of natural assets (forest, agricultural areas), carbon emission, and health impact.
[6] Various bottlenecks make solar production relatively costlier than global standards, but still cost-effective once positive spillovers such as reduced carbon emissions and lower health impacts from air pollution are accounted for (IISD, 2019).
[7] World Bank (2018). Indonesia: Creating Climate Markets, Nurturing Green Industries. Mimeo.

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APPENDIX: A SNAPSHOT OF INDONESIAN ECONOMIC INDICATORS

Appendix Table 1: Budget outcomes

(IDR trillion)

	2012 Actual	2013 Actual	2014 Actual	2015 Actual	2016 Actual	2017 Actual	2018 Actual	2019 Preliminary Actual
A. State revenue and grants	**1,338**	**1,439**	**1,550**	**1,508**	**1,556**	**1,666**	**1,944**	**1,957**
1. Tax revenue	981	1,077	1,147	1,240	1,285	1,344	1,519	1,545
2. Non-tax revenue	352	355	399	256	262	311	409	405
B. Expenditure	**1,491**	**1,651**	**1,777**	**1,807**	**1,864**	**2,007**	**2,213**	**2,310**
1. Central government	1,011	1,137	1,204	1,183	1,154	1,265	1,455	1,499
2. Transfers to the regions	481	513	574	623	710	742	758	811
C. Primary balance	**-53**	**-99**	**-93**	**-142**	**-126**	**-124**	**-11**	**-78**
D. SURPLUS / DEFICIT	-153	-212	-227	-298	-308	-341	-269	-353
(percent of GDP)	-1.9	-2.3	-2.1	-2.6	-2.5	-2.5	0.0	-2.2

Source: MoF; World Bank staff calculations
Note: Budget balance as percentage of GDP uses the revised and rebased GDP

Appendix Table 2: Balance of payments

(USD billion)

	2017	2018	2018		2019				2020
			Q3	Q4	Q1	Q2	Q3	Q4	Q1
Balance of payments	**11.6**	**-7.1**	**-4.4**	**5.4**	**2.4**	**-2.0**	**0.0**	**4.3**	**-8.5**
Percent of GDP	*1.1*	*-0.7*	*-1.7*	*2.1*	*0.9*	*-0.7*	*0.0*	*1.5*	*-3.1*
Current account	**-16.2**	**-30.6**	**-8.4**	**-9.5**	**-6.6**	**-8.2**	**-7.5**	**-8.1**	**-3.9**
Percent of GDP	*-1.6*	*-2.9*	*-3.2*	*-3.7*	*-2.5*	*-2.9*	*-2.6*	*-2.8*	*-1.4*
Trade balance	11.4	-6.7	-2.2	-4.1	-0.3	-1.3	-0.9	-1.7	2.5
Net income & current transfers	-27.6	-23.9	-6.2	-5.4	-6.3	-6.9	-6.6	-6.4	-6.4
Capital & Financial Account	**28.7**	**25.2**	**4.0**	**15.9**	**9.9**	**6.8**	**7.5**	**12.6**	**-2.9**
Percent of GDP	*2.8*	*2.4*	*1.5*	*6.2*	*3.7*	*2.4*	*2.6*	*4.4*	*-1.1*
Direct investment	18.5	12.5	4.5	0.9	6.0	5.8	5.2	3.2	3.5
Portfolio investment	21.1	9.3	-0.1	10.5	5.2	4.6	4.9	7.1	-5.8
Other investment	-10.7	3.3	-0.5	4.7	-1.4	-3.6	-2.7	2.4	-0.5
Errors & omissions	**-0.9**	**-1.7**	**0.0**	**-1.0**	**-0.8**	**-0.5**	**0.0**	**-0.3**	**-1.7**
Foreign reserves*	**130.2**	**120.7**	**114.8**	**120.7**	**124.5**	**123.8**	**124.3**	**129.2**	**121.0**

Source: Ministry of Finance, Republic of Indonesia; World Bank staff calculations
Note: *Reserve at end-period

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

	2000	2011	2012	2013	2014	2015	2016	2017	2018	2019
National Accounts (% change)[1]										
Real GDP	4.9	6.2	6.0	5.6	5.0	4.9	5.0	5.1	5.2	5.0
Real investment	11.4	8.9	9.1	5.0	4.4	5.0	4.5	6.2	6.6	4.4
Real consumption	4.6	5.1	5.4	5.7	4.7	4.9	4.3	4.6	5.1	4.9
Private	3.7	5.1	5.5	5.5	5.3	4.8	5.0	5.0	5.1	5.2
Government	14.2	5.5	4.5	6.7	1.2	5.3	-0.1	2.1	4.8	3.2
Real exports, GNFS	30.6	14.8	1.6	4.2	1.1	-2.1	-1.7	8.9	6.5	-0.9
Real imports, GNFS	26.6	15.0	8.0	1.9	2.1	-6.2	-2.4	8.1	11.9	-7.7
Investment (% GDP)	19.9	31.3	32.7	32.5	32.4	32.4	32.2	32.6	33.0	32.8
Nominal GDP (USD billion)	165	893	918	915	891	861	932	1,016	1,042	1,119
GDP per capita (USD)	857	3,688	3,741	3,668	3,532	3,368	3,605	3,886	3,945	4,193
Central Government Budget (% GDP)[2]										
Revenue and grants	13.9	15.5	15.5	15.1	14.7	13.1	12.5	12.3	13.1	12.4
Tax revenue	7.8	11.2	11.4	11.3	10.9	10.8	10.4	9.9	10.2	9.8
Non-tax revenue	6.0	4.2	4.1	3.7	3.8	2.2	2.1	2.3	2.8	2.6
Expenditure	15.0	16.5	17.3	17.3	16.8	15.7	15.0	14.8	14.9	14.6
Consumption	2.7	3.8	3.9	4.1	4.0	4.5	4.6	4.4	4.7	4.5
Capital	1.7	1.5	1.7	1.9	1.4	1.9	1.4	1.5	1.2	1.1
Interest	3.4	1.2	1.2	1.2	1.3	1.4	1.5	1.6	1.7	1.7
Subsidies	4.2	3.8	4.0	3.7	3.7	1.6	1.4	1.2	1.5	1.3
Budget balance	-1.1	-1.1	-1.8	-2.2	-2.1	-2.6	-2.5	-2.5	-1.8	-2.2
Government debt	97.9	23.1	23.0	24.9	24.7	27.5	28.3	29.4	29.8	30.2
o/w external government debt	51.4	11.7	11.9	11.8	13.3	16.0	16.6	17.5	17.6	17.9
Total external debt (including private sector)	87.1	25.2	27.5	29.2	32.9	36.1	34.3	34.7	36.0	35.9
Balance of Payments (% GDP)[3]										
Overall balance of payments	..	1.3	0.0	-0.8	1.7	-0.1	1.3	1.1	-0.7	0.4
Current account balance	4.8	0.2	-2.7	-3.2	-3.1	-2.0	-1.8	-1.6	-2.9	-2.7
Exports GNFS	42.8	23.8	23.0	22.5	22.3	19.9	18.0	19.1	20.3	17.9
Imports GNFS	33.9	21.2	23.2	23.2	22.7	19.3	17.1	18.0	21.0	18.3
Trade balance	8.9	2.7	-0.2	-0.7	-0.3	0.6	0.9	1.1	-0.6	-0.4
Financial account balance	..	1.5	2.7	2.4	5.0	2.0	3.1	2.8	2.4	3.3
Direct investment	-2.8	1.3	1.5	1.3	1.7	1.2	1.7	1.8	1.2	1.8
Gross official reserves (USD billion)	29.4	110	113	99	112	106	116	130	121	129
Monetary (% change)[3]										
GDP deflator[1]	20.4	7.5	3.8	5.0	5.4	4.0	2.4	4.3	3.8	1.6
Bank Indonesia benchmark policy rate (%)	..	..	..	..	..	6.3	4.8	4.3	6.0	5.0
Domestic credit (eop)	..	24.6	23.1	21.6	11.6	10.4	7.9	8.2	11.8	6.1
Nominal exchange rate (average, IDR/USD)	8,392	8,776	9,384	10,460	11,869	13,389	13,309	13,381	14,238	13,403
Prices (% change)[1]										
Consumer price Index (eop)	9.4	3.8	3.7	8.1	8.4	3.4	3.0	3.6	3.1	2.6
Consumer price Index (average)	3.7	5.3	4.0	6.4	6.4	6.4	3.5	3.8	3.2	4.8
Indonesia crude oil price (USD per barrel, eop)[4]	28	112	113	107	60	36	51	61	55	67

Source: [1] BPS and World Bank staff calculations, using revised and 2010 rebased figures. [2] MoF and World Bank staff calculations, [3] BI, [4] CEIC

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

	2000	2011	2012	2013	2014	2015	2016	2017	2018	2019
Demographics[1]										
Population (million)	212	245	248	252	255	258	262	265	268	
Population growth rate (%)	1.4	1.3	1.4	1.3	1.3	1.3	1.2	1.2	1.1	..
Urban population (% of total)	42	51	51	52	53	53	54	55	55	..
Dependency ratio (% of working-age population)	55	51	50	50	49	49	49	48	48	..
Labor Force[2]										
Labor force, total (million)	98	117	120	120	122	122	125	128	131	134
Male	60	73	75	75	76	77	77	79	80	82
Female	38	44	46	45	46	46	48	49	51	51
Agriculture share of employment (%)	45	36	35	35	34	33	32	30	29	27
Industry share of employment (%)	17	21	22	20	21	22	21	22	23	23
Services share of employment (%)	37	43	43	45	45	45	47	48	48	49
Unemployment, total (% of labor force)	8.1	7.4	6.1	6.2	5.9	6.2	5.6	5.5	5.4	5.3
Poverty and Income Distribution[3]										
Median household consumption (IDR 000 per month)	104	421	446	487	548	623	697	765	835	..
National poverty line (IDR 000 per month)	73	234	249	272	303	331	354	375	402	441
Population below national poverty line (million)	38	30	29	28	28	29	28	28	26	25
Poverty (% of population below national poverty line)	19.1	12.5	12.0	11.4	11.3	11.2	10.9	10.6	9.8	9.2
Urban (% of population below urban poverty line)	14.6	9.2	8.8	8.4	8.3	8.3	7.8	7.7	7.0	6.6
Rural (% of population below rural poverty line)	22.4	15.7	15.1	14.3	14.2	14.2	14.1	13.9	13.2	12.6
Male-headed households	15.5	10.2	9.5	9.2	9.0	9.3	9.0	8.7	6.4	..
Female-headed households	12.6	9.7	8.8	8.6	8.6	11.1	9.8	9.3	6.6	..
Gini index	0.30	0.41	0.41	0.41	0.41	0.41	0.40	0.39	0.39	0.38
Percentage share of consumption: lowest 20%	9.6	7.4	7.5	7.4	7.5	7.2	7.1	7.0	7.0	..
Percentage share of consumption: highest 20%	38.6	46.5	46.7	47.3	46.8	47.3	46.2	45.7	45.4	..
Public expenditure on social assistance (% of GDP)[4]	..	0.5	0.5	0.7	0.6	0.8	0.7	0.7	0.7	0.7
Health and Nutrition[1]										
Physicians (per 1,000 people)	0.2	..	0.3	0.3	..	0.3	..	0.4	0.4	..
Under five mortality rate (per 1000 children under 5 years)	52	33	32	30	29	28	27	26	25	..
Neonatal mortality rates (per 1000 live births)	23	17	16	16	15	14	14	13	13	..
Infant mortality (per 1000 live births)	41	27	26	25	24	24	23	22	21	..
Maternal mortality ratio (modeled est., per 100,000 live births)	272	221	214	207	199	192	184	177	..	..
Measles vaccination (% of children under 2 years)	76	80	82	81	75	75	76	75	75	..
Public health expenditure (% of GDP)	0.7	0.9	1.0	1.0	1.1	1.2	1.4	1.4	1.4	..
Education[3]										
Primary net enrollment rate (%)	..	92	93	92	93	97	97	97	98	98
Female (% of total net enrollment)	..	49	49	50	48	49	49	49	49	49
Secondary net enrollment rate (%)	..	60	60	61	65	66	66	79	79	79
Female (% of total net enrollment)	..	50	49	50	50	51	51	49	49	50
Tertiary net enrollment rate (%)	..	14	15	16	18	20	21	19	19	19
Female (% of total net enrollment)	..	50	54	54	55	56	55	53	53	52
Adult literacy rate (%)	..	91	92	93	93	95	95	96	96	96
Public spending on education (% of GDP)[5]	..	3.3	3.3	3.3	3.3	3.5	3.4	3.1	3.0	..
Public spending on education (% of spending)[5]	..	18.9	17.9	17.3	17.4	19.3	20.0	20.0	20.0	..
Water and Sanitation[1]										
Access to at least basic drinking water services (% of population)	76	85	86	87	87	88	89	89	..	..
Urban (% of urban population)	90	93	94	94	94	95	95	95	..	..
Rural (% of rural population)	66	76	77	78	79	80	81	82	..	..
Access to at least basic sanitation facilities (% of population)	41	62	64	66	67	69	71	73	..	..
Urban (% of urban population)	63	74	75	76	77	78	79	80	..	..
Rural (% of rural population)	25	50	52	54	57	59	62	65	..	..
Others[6]										
Proportion of seats held by women in national parliament (%)	8	18	19	19	17	17	17	20	20	17

Source: [1] World Development Indicators; [2] BPS (Sakernas); [3] BPS (Susenas) and World Bank; [4] MoF and World Bank staff calculations. Social assistance includes spending on Raskin, health insurance for the poor, scholarship for the poor, family hope program (PKH), cash for work (PKT, 2018), and remaining MOSA and social protection function expenditures and actuals; [5] MoF; [6] Inter-Parliamentary Union.

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