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February 10, 2021

Statement by Mr. Huh and Ms. Johnson on Indonesia
(Preliminary)
Executive Board Meeting
February 12, 2021

We thank staff for the informative set of reports, and Ms. Mahasandana, Mr. Mochtar, Ms. Susiandri for their comprehensive Buff statement. The Indonesian economy, which is the seventh largest economy in the world, has not been spared the impacts of the pandemic recording its first recession in 22 years. The strong policy response by authorities supported economic activity, reduced unemployment and bankruptcies and preserved macro-financial and external stability. Looking ahead, we concur with the overall staff assessment that the policy mix should remain focused on protecting macroeconomic and financial stability, including by implementing a medium-term fiscal strategy and increasing structural reform efforts. We broadly agree with the staff report and offer the following comments.

An explicit medium-term fiscal strategy will be needed to anchor debt sustainability and preserve policy credibility. We note the planned expansionary fiscal policy settings for 2021 and the authorities' commitment to return to the budget ceiling in 2023. But meeting the budget ceiling will not be easy and will require ambitious fiscal consolidation in 2022 and 2023. The challenge for the authorities will be to ensure fiscal support expenditure is unwound when economic conditions allow, and revenue is boosted sufficiently to support much needed development in education, infrastructure and social safety nets. We therefore agree with staff that implementing a medium-term fiscal strategy is imperative to build credibility, anchor expectations, plan for and guide contingency plans and reduce the need for further monetary financing.

The longstanding revenue challenge in Indonesia persists and a medium-term revenue strategy is needed to boost growth potential and drive inclusive growth. The passing of the omnibus bill on job creation is a welcome step towards tackling labor and product market challenges which will boost potential growth and inclusion. We welcome the authorities' recognition of the importance of revenue mobilization to support medium-term adjustment but note that Indonesian revenues are weak relative to ASEAN peers, and expenditure needed to meet development goals is sizeable. We agree with the staff assessment that the authorities should carefully design a medium-term revenue strategy (MTRS) now and plan for well-timed implementation of tax reforms when economic conditions allow. To this end, we welcome the inclusion of Appendix IV in the staff report. But the political and implementation difficulties with broad based tax reform should not be underestimated, and in this regard, we wonder what further efforts might be needed from the Fund or other partners to provide ongoing technical assistance to the authorities. *Staff comments are welcome.*

Amid capital flow volatility, the policy mix should continue to preserve macroeconomic and financial stability. We take note of the authorities' assurance that monetary budget financing was an exceptional and temporary measure to support the recovery. We agree with staff that monetary financing should be a backstop that is guided by a framework to avoid unnecessary risks, and as staff note, the objective should not be determined primarily by fiscal considerations to ensure ongoing central bank independence. This would have added benefits for market confidence and stability. As the Indonesian economy relies heavily on foreign capital for financial stability, we welcome the authorities' efforts to promote domestic financial deepening. However, we note that while developing the domestic capital market would bring significant benefits, it is unlikely to be a straightforward or a linear process and will take time to implement.