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*Global Health Security  
COVID-19 & Its Impacts*

## **Indonesia's Budget 2022: Too Ambitious?**

*By Richard Borsuk*

### **SYNOPSIS**

*On top of all the other damage it has done in Indonesia, COVID-19 has hurt tax collection. That's a problem, as the country needs to collect more tax to help fund spending and reduce borrowing needs. Is the next budget too ambitious?*

### **COMMENTARY**

AS INDONESIA tries to get back to solid growth and significantly reduce budget deficits that ballooned because of COVID-19, the country faces a taxing challenge — literally. Meeting that challenge, which has been made harder by the pandemic, depends on having good policy and good governance plus good luck.

For many years predating COVID-19, Indonesia has been weaker in tax collection than other main Southeast Asian economies and many other developing countries. For 2019, the last year before the coronavirus started battering Southeast Asia's biggest economy, Indonesia had a tax-to-GDP (gross domestic product) ratio of 11.6%, according to the Organisation of Economic Cooperation and Development (OECD) — below the Philippines (18%) and Papua New Guinea (12.4%) and far below OECD's average 33.8%.

### **Winning Good Sovereign Ratings**

Many economists say Indonesia's tax-to-GDP ratio, which now is 10% or less, needs to be double that to help support the kind of spending it needs for long-term

development. Low tax collection is a short-term as well as long-term problem, due to COVID-19. The core issue is the size of the government's budget deficit, which is much larger than pre-COVID-19 and is a pivotal variable monitored closely by rating agencies that grade countries' sovereign debt.

When it became obvious that COVID-19 would seriously damage the economy, the Indonesian government in 2020 took the big step of suspending for three years a rule that the state's budget deficit could not exceed 3% of GDP. That legal limit was important for keeping state finances prudent and had helped Indonesia win back "investment grade" sovereign ratings from all three major global agencies S&P, Moody's and Fitch.

The government spent heavily on social safety nets for poor Indonesians hurt by COVID-19, and the deficit for 2020 ended up being 6.14%, more than double the temporarily-abandoned 3% ceiling.

Indonesia was able to spend heavily, while keeping its investment-grade ratings, because years of prudent economic management meant it could borrow substantially overseas and get help financing its big budget deficit from the central bank that, in an unorthodox move, last year bought government bonds in the primary market. On 23 Aug 2021, Bank Indonesia announced it would again make such purchases this year and in 2022, to help the government handle increased spending on countering COVID-19.

### **Targets Too Ambitious?**

But Indonesia can't maintain big deficits. With the increased overseas loans, the debt-service ratio is topping 40%, compared with around 30% at the start of COVID-19, which remains manageable but means interest payments will take a bigger bite of coming budgets. And Indonesia aims to not keep getting help from the central bank, as too much of that could worry the ratings agency and the market.

Meantime, the government faces a struggle getting the budget deficit back down to 3% in 2023. The government expects this year's level to be 5.82 percent. And last week (16 Aug), President Joko Widodo presented a proposed budget for 2022 that targets a reduction to 4.85%. Even if Indonesia can lower the deficit that much, a big drop would be needed the following year to get back to 3%.

For tax-takings, the president has set a target of a 10.5% rise in 2022, which many economists find too ambitious. Indonesia had trouble meeting its tax collection targets long before COVID-19 came, and the pandemic has made things harder.

Tax collections would be helped if the economy can grow 5.0-5.5% next year, as Widodo targeted. And Indonesia moved out of recession it suffered last year, with a 2.1% contraction, with 7.1% annual growth in April-June. But that size gain was in comparison to serious shrinkage a year earlier. If COVID-19's Delta variant continues to wreak havoc, growth this year might be marginal.

### **Obstacles to 2022 Tax Target**

Even if Indonesia (and the world) manages to get on top of COVID-19, there are multiple obstacles to meeting the 2022 tax target. First, before COVID-19, the corporate tax rate was reduced in stages; in 2022 it will be 20%, compared with 25% earlier. Indonesia is hoping that the lower rate will help attract foreign investment that has been going to Vietnam and other countries.

Indonesia plans a series of tax reforms, and they potentially could help raise takings – in the longer-run. Among the proposed measures is raising value-added taxes, increasing the rate on well-off Indonesians earning more than five billion rupiah (about US\$346,000) a year to 35% from 30% and introducing a carbon tax.

In June, Finance Minister Sri Mulyani Indrawati told parliament the battle against COVID-19 “does not divert our attention from the medium and long-term need to build a fair, healthy, effective and accountable tax system”.

But even though Widodo has a big majority in parliament, there’s no guarantee tax reforms will be approved any time soon, especially as there could be resistance to raising any taxes before there is sustainable economic recovery from COVID-19.

### **Weak Tax Administration**

An obstacle to collecting more tax is weakness in tax administration. Traditionally, some companies report losses when they have gains, but with the hit from COVID-19, many may genuinely have losses this year. Indonesia is making gains in digitalisation that should cut abuse, but it will be hard to eliminate cases where some taxpayers and collectors play “let’s make a deal”.

In 2013, the Jakarta Post quoted then-director of taxation Fuad Rahmany saying it was hard for him to find “just 200 honest officials” in a department employing thousands.

A World Bank report in 2020 said Indonesia needed clear, simple rules that “reduce opportunities for corruption, reduce taxpayer errors and make it quicker and easier to pay”. On the importance of having good people on a tax team, the Bank asked: “Is a strong anti-corruption culture engrained as part of the DNA of tax officials?”

COVID-19 has painfully shown how Indonesia needs to spend more on healthcare, and it still has many other needs. To afford the spending, it must find ways to collect more tax, and raise its low level of tax-to-GDP ratio.

It is “very difficult to run a modern state” with a ratio of anything less than 20% of GDP, asserts Peter McCawley, an economist who has worked in Indonesia and now is a visiting fellow for the Indonesia Project of Australian National University. “You can’t do it on 10%.”

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