# Executive summary

- *Main findings*
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## Main findings

**Macroeconomic policy challenges.** Indonesia's economy performed exceptionally well over the decade following the Asian Crisis on the back of the prudent macroeconomic framework and solid policy reforms of the time, and from which dividends continue to flow. However, growth has moderated in recent years, reflecting weaker international demand and slow investment growth due to lower commodity prices but also heightened regulatory uncertainty and infrastructure bottlenecks. Indonesia is still in the catch-up phase of growth, but the pace of reform has slowed in recent years, and some protectionist measures have been adopted. Both internal and external factors will continue to challenge the implementation of monetary policy. Ensuring continued increases in living standards for all Indonesians will require maintaining macroeconomic stability, adopting a broad range of structural reforms, and creating fiscal space to expand government expenditures in priority areas such as education, health, poverty alleviation and infrastructure. The recent removal of most fuel subsidies was a laudable step in this direction. However, low commodity export prices and slower growth mean that further space will need to come from carefully designed increases in tax revenues from current low levels. There is also room to improve the efficiency and targeting of public spending at both central and sub-national levels.

**Implementing policies for inclusive and sustainable growth.** Indonesia has made impressive inroads into poverty, aided by strong per capita income growth and increasingly efficient and well-targeted poverty-reduction programmes. However, income inequality is high and even rose in the past decade. The current mix of social programmes, including cash transfers conditioned on school attendance and a subsidised rice programme, are not well targeted, although encouraging headway is being made in developing a single registry of vulnerable households. Transport congestion and logistics bottlenecks are preventing better integration with global value chains and inhibiting growth more generally. Investment in power generation and water treatment is also lagging. While PISA outcomes are in line with Indonesia's current stage of development, the education system still suffers from serious quality and access problems.

**Improving the regulatory framework and dealing with corruption.** Some institutional arrangements hinder economic and social development, inhibiting the formation of new firms and the investment plans of existing businesses. The lack of harmonisation and conformity between national and sub-national laws and regulations continues to be an issue. The authorities have been stepping up the fight against corruption, notably with the establishment and expansion of the Corruption Eradication Commission. The capacity of the civil service is inconsistent in some areas, impeding business and discouraging both domestic and foreign investment. Budget execution at all levels of government also remains a problem; measures have recently been taken to address this issue.

**Managing natural resources and combating environmental degradation.**
Indonesia has an abundance of natural resources, but its geography and underdeveloped transport infrastructure prevent it from taking full advantage of them for the benefit of all Indonesians. Under-exploitation and mismanagement are responsible for the decline in the energy sector. The efficiency of coal-fired power plants is low. The 2014 enforcement of the 2009 export ban on mineral ore (in order to foster onshore processing) has increased uncertainty. The agricultural sector suffers from lagging productivity, misplaced support for staple food crops (e.g. rice, maize and soybeans) and lack of diversification. Environmental outcomes, including greenhouse gas emissions and deforestation, are aggravated by the central role played by fossil fuels and uneven enforcement of existing laws and regulations.

## Key recommendations

### *Confronting macroeconomic policy challenges*

- Bank Indonesia should remain cautious with regards to monetary and macro-prudential policies, taking into account both external and internal factors.
- Raise government tax revenues in order to fund a needed longer-term increase in government spending. Revenue could be raised by bringing more self-employed into the tax net and by improving the effectiveness of tax collection.

### *Implementing policies for inclusive and sustainable growth*

- Raise public spending on infrastructure. Focus on transportation and logistics to support industry, as well as natural disaster prevention and water treatment.
- Avoid protectionist measures that inhibit openness to trade and foreign investment with uncertain development payoff.
- Increase, and further improve targeting of, spending on poverty alleviation and health measures.
- Direct more public resources to improving education access and outcomes. Continue regular teacher assessments and professional development, and link teacher salaries more closely to qualifications and performance.
- Increase financial inclusiveness by further developing branchless banking, drawing lessons from such countries as India, Mexico, the Philippines and Kenya.
- Tackle labour market informality by reducing rigidities in the formal sector, and by enhancing the effectiveness of the tax-transfer system for poverty alleviation and channelling other social benefits.

### *Dealing with corruption and improving the regulatory framework*

- Improve mechanisms to prevent corruption, while further increasing efforts to combat all forms of corruption.
- Expand support to sub-national governments for capacity building, including the provision of technical and administrative assistance by the central government.

### *Managing natural resources and combating environmental degradation*

- Refocus the mineral ore export ban based on an evaluation of the costs and benefits of onshore processing for each mineral. Provide infrastructure and electricity to the new smelters.
- Increase agricultural productivity by providing technical assistance and training, including through agreements between smallholders and large estates. Increase farmers' access to credit by accelerating land titling. Lower food prices by decreasing trade restrictions.
- Devote more resources to enforcing laws against illegal forest clearing, logging and mining.
- Reduce greenhouse gas emissions by further developing clean power, especially geothermal.


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