# Indonesia's Digital Divide

## A Sub-national Competitiveness Analysis

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Lee Kuan Yew School of Public Policy
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Indonesia's Digital Divide – A Sub-national Competitiveness Analysis

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# About ACI

The Asia Competitiveness Institute (ACI) was established in August 2006 as a Research Centre at the Lee Kuan Yew School of Public Policy (LKYSPP), National University of Singapore (NUS). It aims to build the intellectual leadership and network for understanding and developing competitiveness in the Asia region. ACI seeks to contribute to the enhancement of inclusive growth, living standards, and institutional governance through competitiveness research on sub-national economies in Asia. It identifies mitigating issues and challenges for potential public policy interventions through close collaboration with regional governments, business corporations, policy think-tanks, and academics. ACI's three key research pillars include (I) Sub-national economies level competitiveness analysis; (II) The development of digital economy and its implications in 16 Asia economies; and (III) Singapore's long-term growth strategies and public policy analysis.

ACI's value propositions may be encapsulated in its acronym:
**A**nalytical inputs to initiate policies for policy-makers and business leaders in Asia
**C**apacity building to enable others through improvement in productivity and efficiency
**I**ntellectual leadership to create pragmatic models of competitiveness and inclusive growth

# Vision and Mission

- ACI's over-arching vision is to build up its research credibility with policy impact, contributing as a professional, world-class think-tank.
- ACI's mission is to establish our niche as a leading policy think-tank by identifying development trends, opportunities, and challenges among Asian economies and business corporations.
- ACI endeavours to articulate sound recommendations, promote discussion, and shape research agenda in the arena of public policy amongst Asian governments.
- ACI undertakes evidence-based analysis of public policy issues and decisions, in order to provide assessment of their effectiveness as well as economic and societal impact.

# Preface

Amidst global uncertainties stemming from the aftermath of the COVID-19 pandemic and disruptions in energy and food markets due to geopolitical conflicts, Indonesia's economy showed remarkable resilience in 2023. With stable growth reaching 5.05%, the nation's economic trajectory remained robust despite the challenges. This resilience was underpinned by robust domestic demand, particularly in key sectors such as wholesale and retail, transportation, tourism, and communications. The Indonesian government's concerted efforts to stabilise prices and safeguard consumer welfare through inflation management yielded significant declines in both headline and core inflation rates in 2023.

Recognising the need for greater focus on Indonesia's sub-national level, the Asia Competitiveness Institute (ACI) at the Lee Kuan Yew School of Public Policy (LKYSPP), National University of Singapore (NUS), has conducted annual empirical studies analysing and ranking the competitiveness of Indonesia's 34 provincial economies. This study aims to assist policymakers in understanding the provinces' strengths and weaknesses to enhance competitiveness at the provincial and regional levels.

The 11th edition of this book continues to assess the competitiveness of Indonesia's sub-national economies and includes ACI's examination of efforts to bridge the digital divide, fostering an inclusive digital economy. Indonesia's digital economy is expected to be among the fastest growing and largest within the ASEAN region, with significant increases in Gross Merchandise Value (GMV) over the next two years, particularly in e-commerce and food delivery platforms. However, disparities persist in digital access and usage, with remote regions like Papua facing lower levels of access and utilisation. Enhancing digital skills and literacy is crucial in bridging this divide and fostering an inclusive digital economy.

This book provides timely insights into sub-national competitiveness, aiding local governments in addressing unequal digital development early on. I am confident that the findings presented in this edition will offer valuable guidance to policymakers and contribute to the enhancement of overall economic development in Indonesia.

**Professor Paul Cheung**
Director, Asia Competitiveness Institute
Lee Kuan Yew School of Public Policy
National University of Singapore

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# Executive Summary

In 2023, the global economic landscape was marked by significant challenges, including high inflation, a notable rise in interest rates, and forecasts suggesting they would remain high for a prolonged period. This period of high inflation was compounded by the ongoing impact of global climate change, which remained a pressing concern for Indonesia throughout the year. Despite these obstacles, Indonesia effectively managed inflation through the implementation of tightened monetary policies and other measures aimed at safeguarding consumers' purchasing power. These measures encompassed various initiatives such as El Niño social assistance, enhancements to the MSME loan (KUR) facility, provision of housing incentives for low-income groups, and a commitment to refrain from adjusting electricity tariffs.

As a result of these efforts, there were significant reductions in both headline and core inflation rates, declining from 5.51% and 3.36% in 2022 to 2.61% and 1.80% in 2023, respectively. Additionally, economic growth remained stable at 5.05% year-on-year, supported by robust domestic demand. The labour market also showed signs of recovery, reverting to pre-pandemic levels with a 5.32%unemployment rate in August 2023, while poverty rates decreased from 10.19% in September 2021 to 9.36% in March 2023.

The study by ACI delves into the competitiveness of Indonesia's 34 sub-national economies, examining them both at the provincial and regional levels. **Chapter 1** of the book offers a concise overview of the country's socio-economic performance amidst global economic uncertainties. It describes how the Indonesian government proactively addressed these challenges and outlines the economic trajectory for 2024. This chapter serves as a guide for readers to identify the main sectors that contribute to Indonesia's growth and to discern which sectors are affected by global challenges. The information and communications sector continued to exhibit the fastest growth rate since the pandemic period, while the agriculture, forestry, and fishery sectors recorded the slowest growth rates, primarily due to the adverse impact of extreme climate conditions on agriculture and food supply.

**Chapter 2** provides an annual update on Indonesia's provincial competitiveness analysis. According to the annual competitiveness ranking of the country's 34 provinces, the majority of the provinces retained their rankings from the previous year, with East Kalimantan being a notable exception as it climbed to the third position. This upward movement suggests a favourable socio-economic trajectory for East Kalimantan, especially given its status as Indonesia's prospective new capital. The disparity between the western and eastern provinces persisted, with Java's provinces dominating the top 10 positions in the overall rankings, while the bottom five positions remained largely occupied by the eastern provinces. This divide is particularly conspicuous within the Government and Institutional Settings domain, where the disparity between the highest and lowest performers is starkly evident.

**Chapter 3** delves into a discussion on the competitiveness of different regions in

Indonesia. In line with the findings at the provincial level, the overall rankings of Indonesian regions remained relatively stable in 2023, compared to the preceding year. Java, Kalimantan, and Sumatra retained their top positions, while the eastern regions, including Sulawesi, Bali-Nusa Tenggara, and Maluku-Papua, maintained lower rankings. Notably, Maluku-Papua consistently held the sixth or last position over the past decade, indicating persistent challenges in this region, particularly in Quality of Life and Infrastructure Development. Both Java and Kalimantan, serving as the current and future capital cities of Indonesia respectively, showcased comparable strength in terms of Macroeconomic Stability. However, Kalimantan exhibited superior performance in the realm of Government and Institutional Settings.

A thematic research for this edition is presented in **Chapter 4**, which highlights the importance of digital skills and literacy in bridging the digital gap to achieve an inclusive digital economy in Indonesia. Despite government efforts to enhance the digital economy, the study highlights persistent challenges such as disparities in digital literacy, access, and usage across geographical and socio-economic lines. These challenges include a lack of digital skills and innovation among the workforce, differences in internet access pricing, under-utilisation of digital services for productivity, and insufficient skills and awareness in data security. The chapter concludes by offering several policy recommendations to foster an inclusive digital economy. These include integrating essential digital skills into school curriculum, improving financial literacy to combat online scams, and creating a safe and affordable digital environment to encourage greater digital inclusion.

# Acknowledgements

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In this book, we have updated previous sub-national and regional competitiveness indices with the latest available data. Our comprehensive approach to measuring competitiveness takes into account different factors that collectively shape the ability of a nation or region to achieve substantial and inclusive economic development over a sustained period of time. In addition, we apply a novel approach to assigning weights in the form of Shapley values to test the robustness of the findings. Furthermore, we added digital competitiveness analysis of the 34 provinces to the book. We examine how each provinces performed in terms of digital outputs, digital infrastructutre, core inputs, and digital utilisation.

This book would not have been possible without the support of our research and administrative colleagues. In particular, we would like to extend our sincere thanks to the competent and dedicated administrative team at ACI, including Cai Jiao Tracy, Lyne Po Lai Yin, Dewi Jelina Ayu Binte Johari, and Atiqah Binte Rahmat. We also would like to note with great appreciation the contributions from ACI Director Professor Paul Cheung and the research staff – Dr Xie Taojun, Dr Ammu George, Dr Banh Thi Hang, Dr Liu Jingting, Dr Yi Xin, Faith Tan Shih Yun, Ge Yixuan, Ng Wee Yang, Rohanshi Vaid, Shubhangi Gupta, Ulrike Sengstschmid, and Yan Bowen.

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# List of Abbreviations

| | |
|---|---|
| 3D | Density, Distance, and Division |
| 3T | Disadvantaged, Frontier, Outermost Areas (*Daerah Tertinggal, Terdepan, dan Terluar*) |
| ACI | Asia Competitiveness Institute |
| AFI | Attractiveness to Foreign Investors |
| AI | Artificial Intelligence |
| APBN | State Budget (*Anggaran Pendapatan dan Belanja Negara*) |
| ARPU | Average Revenue Per Unit |
| ASEAN | Association of Southeast Asian Nations |
| BARESKRIM | Criminal Investigation Agency of the Indonesian National Police (*Badan Reserse Kriminal*) |
| BBM | Refined Fuel Oil (*Bahan Bakar Minyak*) |
| BI | Central Bank of Indonesia (*Bank Indonesia*) |
| BI7DRR | BI 7-Day Reverse Repo Rate |
| BLK | Technical and Vocational Education and Training (TVET) Center (*Balai Latihan Kerja*) |
| BLT | Village Fund Direct Cash Assistance (*Bantuan Langsung Tunai*) |
| BPS | Indonesia's Bureau of Statistics (*Badan Pusat Statistik*) |
| BRICS | Brazil, Russia, India, China, and South Africa |
| BSSN | National Cyber and Crypto Agency (*Badan Siber dan Sandi Negara*) |
| BTS | Base Transceiver Stations |
| CI | Competitiveness Index |
| CLMV | Cambodia, Laos, Myanmar, and Vietnam |
| CPO | Crude Palm Oil |
| CRSRL | Competition, Regulatory Standards and Rule of Law |
| DI | Digital Infrastructure |
| DI | Special Region (*Daerah Istimewa*) |
| DKI | Special Capital (*Daerah Khusus Ibukota*) |
| DKI | Special Capital Region (*Daerah Khusus Ibukota*) |
| FBMC | Financial, Businesses and Manpower Conditions |
| FDBE | Financial Deepening and Business Efficiency |
| FDI | Foreign Direct Investment |
| FRAND | Fair Reasonable and Non-Discriminatory |
| GCI | Global Competitiveness Index |
| GDP | Gross Domestic Product |
| GIS | Government and Institutional Setting |
| GIS | Geographical Information Systems |

| | |
|---|---|
| GMV | Gross Merchandise Value |
| GOI | Government of Indonesia |
| GPFS | Government Policies and Fiscal Sustainability |
| GRDP | Gross Regional Domestic Product |
| IDR | Indonesian Rupiah |
| ICT | Information and Communications Technology |
| IGL | Institutions, Governance and Leadership |
| IKN | Nusantara Capital City (*Ibu Kota Negara*) |
| IMD | International Institute for Management Development |
| IMF | International Monetary Fund |
| INDO-DAPOER | Indonesia Database for Policy and Economic Research |
| IOT | Internet of Things |
| JKN | National Health Insurance (*Jaminan Kesehatan Nasional*) |
| KOMINFO | Ministry of Telecommunications and Information (*Kementerian Komunikasi dan Informatika Republik Indonesia*) |
| KUR | People's Business Credit (*Kredit Usaha Rakyat*) |
| LMF | Labour Market Flexibility |
| LPG | Liquefied Petroleum Gas |
| LKYSPP | Lee Kuan Yew School of Public Policy |
| MINT | Mexico, Indonesia, Nigeria, and Turkey |
| MP3EI | Masterplan for Acceleration and Expansion of Indonesia's Economic Development 2011-2015 |
| MS | Macroeconomic Stability |
| MSMEs | Micro, Small, and Medium Entreprises |
| NCSI | National Cyber Security Index |
| NTB | West Nusa Tenggara (*Nusa Tenggara Barat*) |
| OECD | Organisation for Economic Co-operation and Development |
| OTS | Openness to Trade and Services |
| PAUD | Pre-school Education (*Pendidikan Anak Usia Dini*) |
| PBB | Land and Building Tax (*Pajak Bumi Bangunan*) |
| PC | Personal Computer |
| PI | Physical Infrastructure |
| PISA | Programme for International Student Assessment |
| PKH | Family Hope Program (*Program Keluarga Harapan*) |
| PNBP | Non-tax State Revenue (*Penerimaan Negara Bukan Pajak*) |
| PP | Productivity and Performance |
| PPh | Income Tax (*Pajak Penghasilan*) |
| PPN | Value-added Tax (*Pajak Pertambahan Nilai*) |
| PPP | Public-Private Partnerships |
| PPU | Penajem Paser Utara |
| PSN | National Strategic Project (*Proyek Strategis Nasional*) |
| QLID | Quality of Life and Infrastructure Development |

| | |
|---|---|
| REV | Regional Economic Vibrancy |
| RPJMN | National Medium-Term Development Plan (*Rencana Pembangunan Jangka Menengah Nasional*) |
| SAKERNAS | National Labour Survey (*Survey Angkatan Kerja Nasional*) |
| SBN | Government Bond Issuance (*Surat Berharga Negara*) |
| SDLC | Software Development Life Cycle |
| SLESS | Standard of Living, Education and Social Stability |
| STEM | Science, Technology, Engineering, and Mathematics |
| TI | Technological Infrastructure |
| TPAK | Labour Force Participation Rate (*Tingkat Partisipasi Angkatan Kerja*) |
| USD | United States Dollar |
| USO | Universal Service Obligation |
| VAT | Value-added Tax |
| WCY | World Competitiveness Yearbook |
| WEF | World Economic Forum |
| y-o-y | year-on-year |

# List of Provinces

| | Name of Province in English | Name of Province in Bahasa | Region |
|---|---|---|---|
| 1 | Aceh | Aceh | Sumatra |
| 2 | Bali | Bali | Bali-Nusa Tenggara |
| 3 | Bangka Belitung Islands | Kepulauan Bangka Belitung | Sumatra |
| 4 | Banten | Banten | Java |
| 5 | Bengkulu | Bengkulu | Sumatra |
| 6 | Central Java | Jawa Tengah | Java |
| 7 | Central Kalimantan | Kalimantan Tengah | Kalimantan |
| 8 | Central Sulawesi | Sulawesi Tengah | Sulawesi |
| 9 | DI Yogyakarta | DI Yogyakarta | Java |
| 10 | DKI Jakarta | DKI Jakarta | Java |
| 11 | East Java | Jawa Timur | Java |
| 12 | East Kalimantan | Kalimantan Timur | Kalimantan |
| 13 | East Nusa Tenggara | Nusa Tenggara Timur | Bali-Nusa Tenggara |
| 14 | Gorontalo | Gorontalo | Sulawesi |
| 15 | Jambi | Jambi | Sumatra |
| 16 | Lampung | Lampung | Sumatra |
| 17 | Maluku | Maluku | Maluku-Papua |
| 18 | North Kalimantan | Kalimantan Utara | Kalimantan |
| 19 | North Maluku | Maluku Utara | Maluku-Papua |
| 20 | North Sulawesi | Sulawesi Utara | Sulawesi |
| 21 | North Sumatra | Sumatera Utara | Sumatra |
| 22 | Papua | Papua | Maluku-Papua |
| 23 | Riau | Riau | Sumatra |
| 24 | Riau Islands | Kepulauan Riau | Sumatra |
| 25 | South Kalimantan | Kalimantan Selatan | Kalimantan |
| 26 | South Sulawesi | Sulawesi Selatan | Sulawesi |
| 27 | South Sumatra | Sumatera Selatan | Sumatra |
| 28 | Southeast Sulawesi | Sulawesi Tenggara | Sulawesi |
| 29 | West Java | Jawa Barat | Java |
| 30 | West Kalimantan | Kalimantan Barat | Kalimantan |
| 31 | West Nusa Tenggara | Nusa Tenggara Barat | Bali-Nusa Tenggara |
| 32 | West Papua | Papua Barat | Maluku-Papua |
| 33 | West Sulawesi | Sulawesi Barat | Sulawesi |
| 34 | West Sumatra | Sumatera Barat | Sumatra |

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# Chapter 1
# Year in Review: Indonesia in 2023

## 1.1 Structure and Content of the Book

This book consists of an update on Indonesia's recent socioeconomic development and the results of ACI's annual studies on Indonesia's economy. Apart from its annual competitiveness analysis and simulation studies for Indonesia's provinces and regions, this book also delivers insights on ACI's thematic research on overcoming the digital divide for an inclusive digital economy. Our studies adopt descriptive analysis to elaborate on highlighted insights in each chapter.

This book comprises four chapters. It begins with the introductory chapter, which provides an overview of the structure and content of the book. The remainder chapters are summarised as follows. As part of the flagship research project of ACI, Chapter 2 presents an annual update of Indonesia's provincial competitiveness analysis. The index evaluates competitiveness as a composite of four environments: (i) Macroeconomic Stability (MS), (ii) Government and Institutional Settings (GIS), (iii) Financial, Businesses and Manpower Conditions (FBMC), and (iv) Quality of Life and Infrastructure Development (QLID).

As shown in Chapter 2, most provinces maintained their rankings from the previous year. Only East Kalimantan and West Java swapped positions this year, placing East Kalimantan third and West Java fourth. This shift suggests a promising socio-economic outlook for East Kalimantan as Indonesia's new capital. The dominance of Java's provinces can be clearly seen in the overall rankings, with all six of them securing positions in the top 10. Conversely, the provinces in the bottom five rankings remained unchanged from the previous year. They are primarily concentrated in the eastern region of Indonesia. This disparity is particularly evident in the Government and Institutional Settings environment, where the wide gap between the top and bottom performers is more pronounced.

From Chapter 2, we can also observe that despite DKI Jakarta's leading performance, the COVID-19 pandemic has increased the province's unemployment rate. Specifically, the pandemic has affected the tertiary industry with a decline of over 100,000 employments in 2020. As a result, the province's score in the Labour Market Flexibility sub-environment decreased significantly, pushing DKI Jakarta to 33rd place. It should be noted, however, that the pandemic's impact on regional development varied. Significant setbacks have been experienced by tourism-dependent provinces, such as Bali.

Meanwhile, Chapter 3 applied a competitiveness framework akin to that of Chapter 2, with a focus on regional competitiveness. This framework classifies each region into an aggregation of several provinces based on their major island groupings, offering a comprehensive analysis of the competitive dynamics within the six regions of Indonesia. In this chapter, it is noted that, despite the occurrence of the COVID-19 outbreak in 2020, the overall rankings of the Indonesian regions remained consistent in 2023 compared to the 2022 ranking. Java, Kalimantan, and Sumatra continued to occupy the top three positions, while the eastern regions (Sulawesi, Bali-Nusa Tenggara, and Maluku-Papua) retained their lower positions. Notably, Maluku-Papua has consistently held the sixth position over the past decade.

Throughout Chapter 3, disparities are explored between western and eastern Indonesia as well as among the top-ranked regions. Java demonstrated significant strengths, leading in Macroeconomic Stability but facing challenges in Government and Institutional Settings. While Kalimantan exhibited stability and excellence in both Macroeconomic Stability and Government and Institutional Settings, Sumatra experienced declines in the latter, attributed to the negative effects of COVID-19. Sulawesi and Bali-Nusa Tenggara have shown progress in distinct areas, with advancements in Financial, Businesses, and Manpower Conditions, and Government and Institutional Settings, respectively. In contrast, Maluku-Papua requires significant improvements in Quality of Life and Infrastructure Development. The findings at the regional level highlight the existing disparities among Indonesian regions. The ongoing plan to relocate the capital city is expected to address these discrepancies and boost regional competitiveness.

In Chapter 4, ACI presents its new thematic research on the importance of digital skills and literacy in bridging the digital divide to achieve an inclusive digital economy in Indonesia. The chapter highlights various prospects and challenges facing Indonesia in its digital economy. Despite the Indonesian government's efforts to enhance the digital economy, disparities in digital literacy, access, and usage persist across geographical and socio-economic lines. These include a lack of creativity and digital innovation among Indonesia's labour force, disparities in internet access pricing, under-utilisation of digital services for productivity, and inadequate skills and awareness in data security.

The chapter also offers several policy recommendations to foster an inclusive digital economy in Indonesia. These recommendations include integrating core digital skills into the school curriculum, such as literacy in information and data, sharing and creation, and knowledge of historical and cultural contexts, especially regarding digital knowledge about data privacy and identity. Additionally, the government could raise awareness of financial literacy to combat online financial scams, not only by incorporating relevant materials into the school curriculum but also by providing digital and financial training to teachers and improving the quality of vocational schools and training programs. The chapter concludes by emphasising the recommendation for the government to establish a safe and affordable digital environment, particularly in Eastern regions, and to address security concerns to promote greater digital inclusion.

The insights derived from this book underscore the multifaceted nature of Indonesia's socio-economic landscape, revealing both strengths and challenges across provinces and regions. As the nation strives to address disparities and enhance competitiveness, it is recommended that policymakers prioritise targeted investments in higher education, encourage innovation at sub-national levels, and improve accessibility to seaports for efficient economic connectivity. Embracing tailored strategies and holistic approaches will be key to navigating the complexities of Indonesia's diverse regional dynamics and fostering sustainable development.

## 1.2 Indonesia in 2023

### 1.2.1 Indonesia's Economic Resilience Amid Global Uncertainty

The global economy demonstrated remarkable resilience throughout 2023, projecting a growth of 3% for the year. This performance was surprising, considering earlier projections anticipated lower growth due to disruptions in energy and food markets, resulting from geopolitical conflicts in previous years. The unexpected strength of the global economy in 2023 was attributed to the reopening of China, a reduction in energy prices and a more gradual inflationary trend. Although headline inflation exhibited a commendable decline from 9.2% in 2022 to 5.9% in 2023, core inflation generally decreased more gradually. This was driven by the services sector and the ongoing tightness in labour markets (OECD (2023)). The prevailing uncertainty post-COVID-19 and Ukraine-Russia war was further exacerbated by the unexpected Israel-Palestine conflict in October 2023, introducing additional geopolitical complexities to the global situation.

Asia Pacific's emerging economies, including Indonesia's, are a driving force in the global economy. Indonesia's resilience is marked by seven consecutive quarters of growth above 5% (year-on-year), driven by strong private consumption in various sectors (The World Bank (2023)). The nation's economic strength is based on strong domestic demand, particularly in sectors such as wholesale and retail trade, transportation, tourism, and information and communications. Increased community mobility during religious holidays, school vacations and foreign tourist arrivals contributed to this growth (PWC (2023)). Recent completion of major infrastructure projects in 2023 such as the Jakarta Light Rail Train and the Jakarta-Bandung high-speed train, coupled with the government's distribution of holiday allowances (*Tunjangan Hari Raya*/THR) and the 13th-month salary for civil servants also contributed significantly to domestic demand (Sipayung (2023)).

The labour market demonstrated improvement, evidenced by a decrease in the unemployment rate from 6.26% in February 2021 to 5.32% in August 2023. This reduction brought the rate back to pre-pandemic levels, falling within the range of 5%. Additionally, the labour force participation rate increased to 141.71 million workers in August 2023, a rise of 4 million workers since August 2022 (BPS (2024)). Likewise, positive trends were observed in poverty rates, as the rate decreased from a pandemic peak of 10.19%in September 2021 to 9.36% in March 2023.

Following energy price shocks in the preceding year, Indonesia effectively managed inflation in 2023. Both headline and core inflation witnessed substantial declines, dropping from 5.51% in 2022 to 2.61% in 2023 and from 3.36% in 2022 to 1.80% in 2023, respectively (BPS (2023a)). This is consistent with Bank Indonesia's target band of 3% with a margin of plus/minus 1%. The success can be attributed to ongoing initiatives to curb inflation such as Indonesia's tightened monetary policy. These efforts include providing fiscal incentives to local governments that successfully controlled their inflation and refraining from adjusting electricity tariffs. However, the price of essential food items, such as rice, sugar, and chicken, rose towards the end of 2023. This increase was attributed to supply and feed shortages, exacerbated by prolonged adverse climatic conditions, resulting from the impact of El Niño on staple crop production (The World Bank (2023)).

### 1.2.2 Indonesian Government Policy Focus in 2023

The majority of policies implemented by the Indonesian government in 2023 were primarily measures to address escalating inflation, with the aim of ensuring price stability and consumer welfare amidst global uncertainties. These initiatives align with the objectives of the State Budget (APBN) 2023, serving as a tool for stability to control inflation, extend social protection to vulnerable communities and contribute to ongoing global economic recovery and structural reform (Kemensetneg (2023)). In line with these objectives, the Indonesian government enacted a series of measures, including the El Niño social assistance, enhancement of the MSME loan (KUR) facility, provision of housing incentives for low-income groups, and a commitment to no electricity tariff adjustments.

#### 1.2.2.1 El Niño Social Assistance

In line with global economic challenges, inflation stemming from climate change remains a significant concern for Indonesia in 2023. One contributing factor is El Niño, a phenomenon characterised by an unusual, elevated sea surface temperature in the central to eastern Pacific Ocean. This occurrence intensifies cloud formation, leading to reduced rainfall in surrounding regions, including Indonesia. The consequential impact on Indonesia encompasses drought, water scarcity, crop failureand the risk of forest and land fires (Kemenko (2023)).

The crop failures induced by El Niño have resulted in diminished rice production, which has driven up inflation through already volatile food prices. In an effort to protect consumers' purchasing power, particularly among low-income groups, the government initiated the El Niño social assistance program in November and December 2023. This assistance was disbursed through two channels, namely direct cash assistance (*Bantuan Langsung Tunai*/BLT) and the distribution of 10 kg rice packages.

The BLT targeted 18.8 million families currently receiving food assistance, commonly referred to as *penerima sembako*[1]. Each beneficiary family received IDR 400,000 monthly from November to December 2023 (Setkab (2023)). This cash assistance was directly deposited into the beneficiaries' bank accounts, aligning with the government's broader initiative to promote financial inclusion. The total budget allocated for this program amounted to IDR 7.52 trillion and it was coordinated and distributed through the Ministry of Social Affairs (Kemenko (2023) Hidranto (2023)).

At the same time, the 10 kg rice assistance program extended the government's earlier food assistance initiatives, which had been carried out in three stages in March, April, and June 2023 (Bulog (2023)). The beneficiaries of this program included recipients of the food assistance and Family Hope Program (*Program Keluarga Harapan*/PKH)[2]. A total of 21.3 million families benefitted (Hidranto (2023)). Each family beneficiary received a monthly allocation of 10 kg of rice from September to December 2023, and this assistance will continue from January to March 2024 (Setkab (2023)).

#### 1.2.2.2 MSME Loan Facility (KUR) Enhancement

The government has actively implemented the Micro, Small, and Medium Enterprise Loans (KUR) program. The KUR (*Kredit Usaha Rakyat*) is a credit facility providing working capital financing and/or investment for micro, small, and medium entrepreneurs (MSMEs) as well as cooperatives. It caters to businesses that are productive and viable but lack additional collateral or have insufficient additional collateral (OJK (nd)). The primary focus of the KUR program has been on the production sector (55.46%), with a special emphasis on the agricultural sector, which constituted 30.4%. This targeted allocation is in line with the government's proactive strategy to protect national food security by addressing challenges such as El Niño.

To enhance the protection of national food security in the agricultural sector against challenges posed by El Niño, the Ministry of Finance has implemented significant adjustments to expedite the distribution of the KUR in 2023 (Elena (2023)). This redesigned policy specifically aims at assisting MSMEs in the agriculture sector to navigate the impact of El Niño. The modifications include:

1. Removal of KUR access amounts.
2. Elimination of tiered interest rates for agricultural sector debtors for loans up to IDR 100 million.
3. Updated criteria for those eligible to qualify for investment credit and commercial working capital.

[1] Families qualifying as Food Assistance Beneficiaries (Penerima Sembako) are comprised of registered low-income families within a district or city. Their eligibility is determined by inclusion in the List of Beneficiary Families (KPM), a roster managed by the Ministry of Social Affairs (Banten (2020))

[2] The Family Hope Program is a conditional cash assistance initiative for registered low-income families, targeting vulnerable groups such as pregnant women, children, people with disabilities, and the elderly. Beneficiaries of this conditional cash assistance program are required to make use of nearby health and educational service facilities to qualify for the financial support (Kemensos (2019))

4. Debtors who previously accessed KUR with a ceiling below IDR 10 million and reapply for a loan above IDR 10 million, will face a fixed interest rate of 6% instead of a tiered interest rate.

Toward the end of 2023, the government further enhanced the implementation of Agricultural Machinery Business Credit (*Kredit Usaha Alsintan*/KUA) as another key initiative of its comprehensive strategy to address challenges arising from El Niño. This program is designed to provide financing for MSMEs in the agricultural sector to acquire essential agricultural tools and machinery (Purwanti (2023)). The program offers a subsidised low-interest rate or margin set at 3%, allowing farmers to access the credit with ceilings ranging from IDR 500 million to IDR 2 billion. Requiring only a minimal down payment of 10% and without the need for additional collateral, the program enhances accessibility for farmers to obtain credit (Kemenkeu (2023)).

#### 1.2.2.3 Housing Incentives for Low-Income Groups

In line with the goal of maintaining consumers' purchasing power, the Indonesian government introduced several policies specifically directed at the housing sector for low-income groups in 2023. These measures focused on strengthening the housing sector, promoting activities in the housing construction industry and simplifying access for low-income individuals to own homes (Noor (2023)). The implemented initiatives include the exemption of Value Added Tax (*Pajak Pertambahan Nilai Ditanggung Pemerintah*/PPN DTP) covered by the government for new houses priced under IDR 2 billion, financial assistance for administrative costs (*Bantuan Biaya Administrasi*/BBA), and the provision of integrated prosperous home (*Rumah Sejahtera Terpadu*/RST) assistance for low-income groups.

1. **VAT Exemption for New Houses (PPN DTP)**
   On November 2023, the government introduced Minister of Finance Regulation (PMK) No. 120 of 2023 (2023) on Value Added Tax (VAT) on the delivery of landed houses and flats, borne by the government for the 2023 fiscal year. This regulation aims to stimulate national economic growth by providing concrete incentives in the form of government-borne VAT. As outlined in Article 2, Paragraph (1) of the Minister of Finance Regulation (PMK) No. 120 of 2023 (2023), this VAT incentive is targeted at two types of houses — landed property and flats that meet specific requirements. The government provides incentives by exempting VAT for the sale of new houses with a maximum price of IDR 5 billion. According to the regulation, the VAT incentive is only applicable per individual for acquiring a landed house or apartment unit, with the condition that no down payment or instalment is made before 1 September 2023. The handovers of landed houses or flats must also be supported by a handover report from 1 November 2023 to 31 December 2024 (CNBC Indonesia (2023)).

2. **Assistance with administrative costs (BBA)**
   The government has expanded the capability of low-income groups to acquire

liveable and affordable housing through the Administrative Cost Assistance (BBA) scheme. In force for 14 months from November 2023 to December 2024, it provides a subsidy of up to IDR 4 million per house to cover partial or total administrative expenses linked to the financing of subsidised home ownership (*rumah subsidi*)PUPR Ministerial Regulation No. 11/2023 (2023b). These expenses encompass provision fees, appraisal fees, notary fees, sale and purchase deed fees, and other home ownership fees. The eligibility criteria for this incentive includes belonging to a low-income group that has been a debtor of subsidised home loans (KPR *Sejahtera*). The monetary value of BBA grant's is determined based on the acknowledgement letter indicating underpayment of administrative fees, with a maximum limit of IDR 4 million.

3. **Integrated Prosperous Home Assistance (RST)**
   Acknowledging that housing as a fundamental societal need, the government extended support to the low-income groups through the provision of Integrated Prosperous Home (RST) assistance. Under the scheme, 1,800 houses received IDR 20 million in November and December 2023. This commitment is aimed at progressively improving community access to decent, safe, affordable, inclusive, and liveable housing and settlements, aligning with a key policy direction outlined in the 2020-2024 National Medium Term Development Plan (RPJMN). The RST program is crafted to uplift the well-being of underprivileged families, focusing on the rehabilitation of habitable residences as well as micro and small businesses(Siswanto (2023)). The total budget allocated for this assistance is estimated to reach IDR 36.2 billion for 2023 and 2024.

#### 1.2.2.4 No Electricity Tariffs Adjustment

To protect consumers' purchasing power, towards the end of 2023, the Indonesian government decided not to make adjustments to electricity tariffs. The tariffs for October-December 2023, applicable to various consumer groups and classes, remained unchanged to ensure stability and affordability.

As outlined in PUPR Ministerial Regulation No. 11/2023 (2023a) concerning Electricity Tariffs Provided by the National Electricity Company (*Perusahaan Listrik Negara*/PT PLN), adjustments to electricity tariffs for non-subsidised customers may be reviewed every three months, based on changes in four key macroeconomic parameters. These include the exchange rate, Indonesian Crude Price (ICP), inflation, and the Reference Coal Price (HBA). Despite indications suggesting the necessity of increasing electricity tariff parameters, such as an exchange rate of IDR 14,927 per USD, an ICP of USD71.51 per barrel, inflation of 0.15%, and a Reference Coal Price (HBA) of USD70 per ton in the last quarter of 2024, the government has committed to maintain the current electricity tariffs (PLN (2023)).

This decision is motivated by the goal of protecting the purchasing power and maintaining the competitiveness of various industries. The commitment extends not only to impoverished households but also encompasses small businesses, small industries, and customers from micro, small, and medium enterprises (MSMEs). This approach aligns with PT PLN's commitment to providing a reliable electricity supply to all communities and to support the growth of the business and industrial sectors throughout the country.

## 1.2.3 Prospects and Challenges of Indonesia's Economy in 2024

### 1.2.3.1 Outlook and Challenges

The Indonesian economy is forecast to maintain its stability in 2024, despite uncertainties in the global economic landscape. The State Budget for 2024 projects a growth rate and inflation of 5.2% and 2.8%, respectively, reflecting a positive outlook (Table 1.1). However, The World Bank (2023), IMF (2024), and CORE Indonesia (2023) have slightly more conservative estimates, forecasting a growth range of 4.9 to 5% for the same period. Positive expectations also extend to development indicators, as outlined in Table 1.2. It is anticipated that the unemployment rate will decrease to its pre-pandemic level within a range of 5.0 to 5.7%, the poverty rate will be in the range of 6.5 to 7.5%, and the Gini ratio will fall within the range of 0.374 to 0.377.

The resilience of the Indonesian economy is supported by a rise in private consumption, primarily fuelled by election-related spending, as elections are scheduled for February 2024. A significant contribution of IDR 294.5 trillion to GDP is expected to be generated by the election (CORE Indonesia (2023)). This is based on historical data from the 2014 and 2019 elections, which showed an increase in household consumption and non-profit institutions leading up to and during the election period. It is anticipated that this pattern will continue for nine months following the election. Furthermore, a surge in domestic demand can be attributed to proposed salary hikes for civil servants and progress in relocating the capital city from DKI Jakarta to *Ibu Kota Nusantara* (IKN) in East Kalimantan (Rachman (2023)).

**Table 1.1:** Macroeconomic Indicators Forecast in 2024

| Macroeconomic Indicators | |
|---|---|
| **Indicator** | **2024 Forecast** |
| Economic Growth (%) | 5.2 |
| Inflation (%) | 2.8 |
| 10-Year Bond Yield (SBN) (%) | 6.7 |
| Exchange Rate (IDR/USD) | 15,000 |
| Crude Oil Price (USD/barrel) | 82.0 |
| Oil Lifting (rpbh) | 635 |
| Gas Lifting (rbsmph) | 1,033 |

*Source:* 2024 State Budget (APBN), Ministry of Finance

**Table 1.2:** Development Indicators Target in 2024

| **Development Indicators** | |
|---|---|
| **Indicator** | **2024 Target** |
| Unemployment Rate (%) | 5.0 - 5.7 |
| Human Development Index | 73.99 - 74.2 |
| Poverty Rate (%) | 6.5 - 7.5 |
| Gini Ratio | 0.374 - 0.377 |
| Extreme Poverty (%) | 0 - 1 |
| Farmer's Exchange Rate | 105 - 108 |
| Fisherman's Exchange Rate | 107 - 110 |

*Source:* 2024 State Budget (APBN), Ministry of Finance

However, Indonesia may encounter various global socio-economic challenges in 2024. These challenges include the uncertainties surrounding the political transition due to the presidential election, the economic slowdown in China, the potential for a global recession, and elevated benchmark interest rates in the United States and Europe. Geopolitical uncertainties and climate change-related shocks could disrupt global supply chains, impacting state revenues and tightening Indonesia's fiscal position (Ahdiat (2023)).

Among these risks, the most significant arises from China's role as Indonesia's primary trading partner. The ongoing property crisis in China, which contributes significantly to its GDP, is expected to have a consequential impact on Indonesia's economy (Purwowidhu (2024)). The projection suggests that a 1% decline in China's GDP could lead to a 0.3% decrease in Indonesia's economy (Rachman (2023)). Not only that, the downward trend in global commodity prices weakens the contribution of exports to GDP, and decreased demand from China may affect consumption and real wages.

#### 1.2.3.2 2024 State Budget Priorities

To achieve an inclusive and sustainable economic transformation, the Indonesian government is adopting a comprehensive fiscal policy that encompasses short-, medium- and long-term strategies. In the immediate term, the focus is on optimising the distribution function and stabilising the State Budget (APBN) through measures such as controlling inflation, eliminating extreme poverty, reducing stunting rates, and fostering increased investment (Kemenkeu (2024c)). In the medium- to long-term, the fiscal strategy shifts towards optimising the allocation function of the State Budget (APBN). This involves prioritising the enhancement of human resources (human capital), expediting infrastructure development (physical capital) and promoting downstream activities in natural resource utilisation (natural capital). Additionally, the strategy

**Table 1.3:** 2024 State Budget Expenditure by Sector and Main Priorities

| Sector | Main Priorities |
|---|---|
| **Education (IDR 665 trillion)** | 1. Enhancing accessibility to education across all educational levels through the improvement of mandatory education programs and education funds.<br>2. Optimising village funds to strengthen the quality and availability of kindergarten services (Pendidikan Anak Usia Dini/PAUD).<br>3. Expediting the improvement of educational infrastructure quality, particularly in disadvantaged, frontier, and outermost (*Tertinggal, Terdepan, Terluar*/3T) areas.<br>4. Elevating the quality of teachers and teaching staff.<br>5. Reinforcing the connection and alignment between vocational education and the industry within the labour market (link and match).<br>6. Augmenting investments in the education sector. |
| **Social Protection (IDR 496.8 trillion)** | 1. Enhancing data accuracy and objectives of social security programs.<br>2. Promoting synergies between programs to guarantee beneficiaries receive a diverse range of social security benefits.<br>3. Reinforcing poverty alleviation through empowerment programs.<br>4. Enhancing long-term social security by ensuring inclusivity for the elderly and people with disabilities.<br>5. Improving the design and implementation quality of social security programs. |
| **Infrastructure (IDR 423.4 trillion)** | 1. Accelerating the establishment of crucial economic infrastructure.<br>2. Prioritising the development of fundamental services and strategic projects in infrastructure.<br>3. Gradually and sustainably supporting the acceleration of the new capital city (Ibu Kota Nusantara/IKN) development.<br>4. Ensuring equitable and enhanced access to Information and Communication Technology (ICT) that facilitates digital transformation.<br>5. Promoting the involvement of business entities through the Public-Private Partnership (PPP) scheme in infrastructure development. |
| **Security, Law and Defence (IDR 331.9 trillion)** | 1. Strengthening security measures for the 2024 Election and the development of the new capital city (Ibu Kota Nusantara/IKN).<br>2. Executing the procurement and maintenance of defence equipment.<br>3. Carrying out legal and operational defence activities. |
| **Subsidy (IDR 286.0 trillion)** | 1. Sustaining the regular distribution of subsidies for diesel and kerosene.<br>2. Allocating electricity subsidies to specific beneficiaries.<br>3. Supplying subsidised fertiliser, including urea, NPK, and organic types, and implementing a phased direct fertiliser assistance scheme for farmers.<br>4. Improving the quality of public services in the transportation and information sectors.<br>5. Broadening MSME financing through interest rate subsidy facilities (KUR).<br>6. Offering diverse tax incentives, including income tax and business incentives. |
| **Health (IDR 187.5 trillion)** | 1. Accelerating efforts to reduce stunting through the expansion of locations and intervention.<br>2. Enhancing access and quality of primary and secondary healthcare services.<br>3. Improving the quality and distribution of healthcare workers.<br>4. Reinforcing technology in the healthcare sector and promoting the self-sufficiency of domestic pharmacies.<br>5. Strengthening the National Healthcare Insurance (*Jaminan Kesehatan Nasional*/JKN) by enhancing program benefits based on basic healthcare needs. |
| **Food Security (IDR 114.3)** | 1. Enhancing domestic product output by distributing production facilities, optimising land use, and maximising the capacity of farmers and fishermen.<br>2. Providing support to farmers through cooperative initiatives and financing.<br>3. Speeding up the development of food infrastructure.<br>4. Establishing Food Estate areas as centres for food production.<br>5. Reinforcing national food reserves. |

*Source:* 2024 State Budget (APBN), Ministry of Finance

aims to bolster institutional reform and streamline regulations (institutional reform) to cultivate a more conducive and efficient economic environment.

According to the State Bugdet 2024, the projected state budget expenditure in 2024 is anticipated to amount to IDR 3,325.1 trillion. This comprises central government spending of IDR 2,467.5 trillion and transfers to the regions amounting to IDR 857.6 trillion. The central government spending will be further categorised into institutional budget (IDR 1,090.8 trillion) and non-institutional budget (IDR 376.7 trillion). The institutional budget for 2024 will be directed towards four key priorities: supporting the construction of the new capital city (IKN) in East Kalimantan, conducting the

2024 elections, completing the National Strategic Projects (PSN), and strengthening law, security, and defence.

As shown in Table 1.3, the 2024 state expenditure will concentrate on seven sectors, with the highest allocations for education (IDR 665 billion), social protection (IDR 496.8 billion) and infrastructure (IDR 423.4 billion). This aligns with the primary objectives of the 2024 State Budget, namely emphasising prudent spending to bolster structural reforms and serving as a fiscal buffer against global uncertainties ((Kemenkeu (2024c)).

Meanwhile, budget financing aims to sustain economic growth momentum and protect consumers purchasing power. The government aims to keep budget financing at IDR 522.8 trillion or 2.29% of GDP. This includes debt financing (IDR 648.1 trillion), funded through government bond issuance (SBN) as needed, and investment financing (IDR 176.2 trillion), primarily directed toward realising government strategic programs, particularly in infrastructure, education, and the trade sector.

Lastly, the projected state revenue for 2024 is IDR 2,309.9 trillion, indicating a 6.3% increase from the 2023 state revenue. This total includes tax revenue (IDR 1,988.9 trillion), customs and excise (IDR 321 trillion), non-tax revenue (IDR 492 trillion), and grants (IDR 0.4 trillion). The government anticipates that 57.3% of tax revenue will come from income tax (PPh), followed by value-added tax (PPN and PPN BBM) (40.8%) as well as land and building tax (PBB), along with other taxes (1.9%).

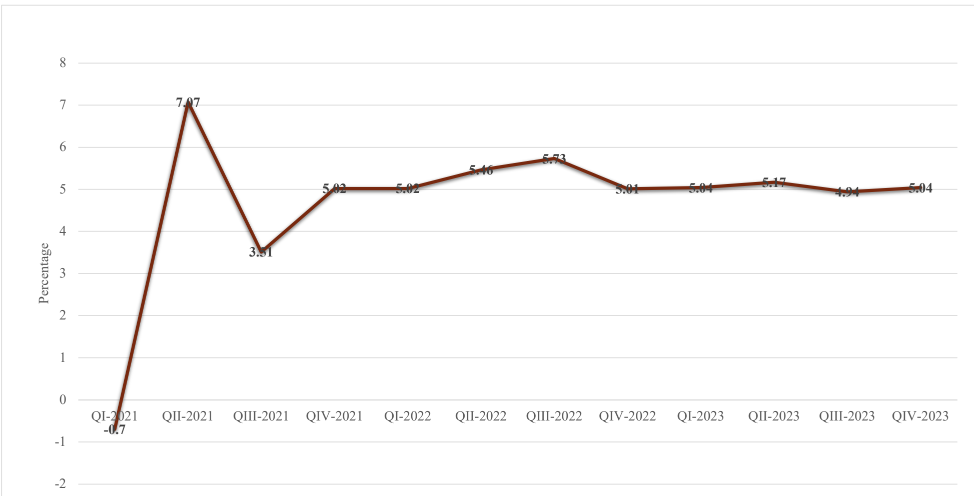
## 1.3 Overview of Indonesia's Recent Economic Developments

In this section, we will discuss Indonesia's growth trends and prospects, fiscal and monetary trends, trade performance, investment outlook, as well as the labour market and social development. An evaluation of Indonesia's performance during and after the COVID-19 pandemic will be presented.

### 1.3.1 Growth Trends and Prospects

Indonesia's GDP growth by quarter is depicted in Figure 1.1, showing a consistent positive trend throughout the observation period. Following the negative GDP growth in Q1 of 2021, due to the impact of the COVID-19 pandemic, there was a significant recovery in Q2 of 2021, reaching 7.07%. Despite experiencing a decline to 3.51% in Q3 of 2021, the GDP growth demonstrated steady improvement for seven consecutive quarters thereafter.

**Figure 1.1:** Quarterly GDP Growth (Y-o-Y), 2021–2023

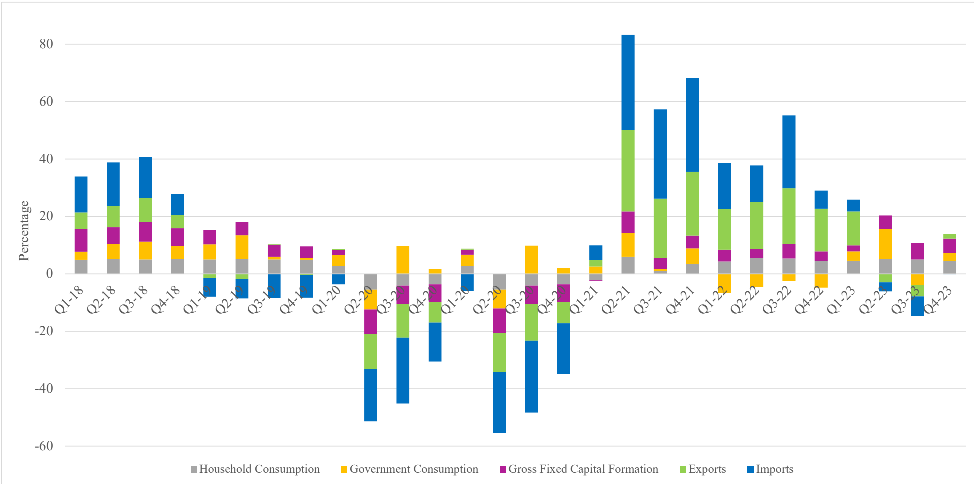



*Source:* Central Bureau of Statistics (BPS)

In 2023, the trend remained relatively stable within the range of 5%, resulting in an annual average growth of 5.05%. There was a slight increase from 5.04% in Q1 to 5.17% in Q2 of 2023, followed by a decrease to 4.94% in Q3 of 2023, due to disruptions in food supply caused by the El Niño phenomenon. However, GDP growth rebounded in the last quarter of 2023, reaching 5.04%.

As illustrated in the graph 1.2, household consumption emerged as the primary contributor to GDP growth by expenditure in 2023, accounting for the highest share. On average, it contributed 4.8% to the total GDP growth rate. The robust growth in household consumption was attributable to various factors, such as increased consumer confidence and social assistance generated from a carbon tax, together with an increase in the minimum wage (The World Bank (2023), Sipayung (2023)).

**Figure 1.2:** GDP Growth Rate by Expenditure (Year on Year Percentage), Q1 of 2018–Q4 of 2023



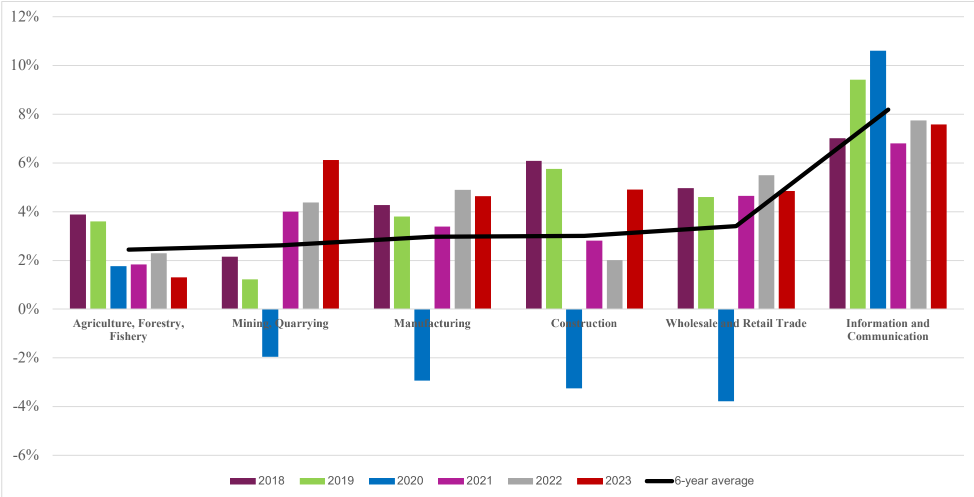

*Source:* Central Bureau of Statistics (BPS)

Following household consumption, gross fixed capital formation contributed 4.38%, while government consumption accounted for 3.17%. The substantial contribution of gross fixed capital formation to GDP growth was propelled by an increase in infrastructure projects and in social assistance programs initiated by the central government. Conversely, government consumption remained sluggish, due to slow budget execution and the government's efforts to reduce the budget deficit. In terms of international trade, both exports and imports made minimal contributions to GDP growth, averaging 1.6% and -1.5% respectively, for the year. The subdued performance of international trade in 2023 was influenced by global uncertainties and declining commodity prices (The World Bank (2023)).

Graph 1.3 illustrates the GDP growth rate for the top six largest industries in Indonesia. It is evident from the graph that the majority of these industries experienced negative growth in 2020, due to the COVID-19 pandemic, before rebounding in the subsequent years. Notably, the agriculture, forestry, and fishery sectors, as well as the information and communications sector, remained resilient during the pandemic period and beyond.

In 2023, the information and communications sector continued to exhibit the fastest growth rate at 7.6%, followed by mining and quarrying at 6.1%. Conversely, the agriculture, forestry, and fishery sector recorded the slowest growth rate at 1.3%, primarily due to the adverse impacts of extreme climate conditions on agriculture and food supply. The remarkable growth of the information and communications sector can be seen in its high six-year average growth rate of 8.2% from 2018 to 2023. This growth rate significantly surpassed that of other top industries, which ranged only between 2.4% and 3.4%.

**Figure 1.3:** GDP Growth Rate for Top-6 Largest Industries (Year on Year Percentage), 2018–2023




*Source:* Central Bureau of Statistics (BPS)

### 1.3.2 Fiscal and Monetary Trends

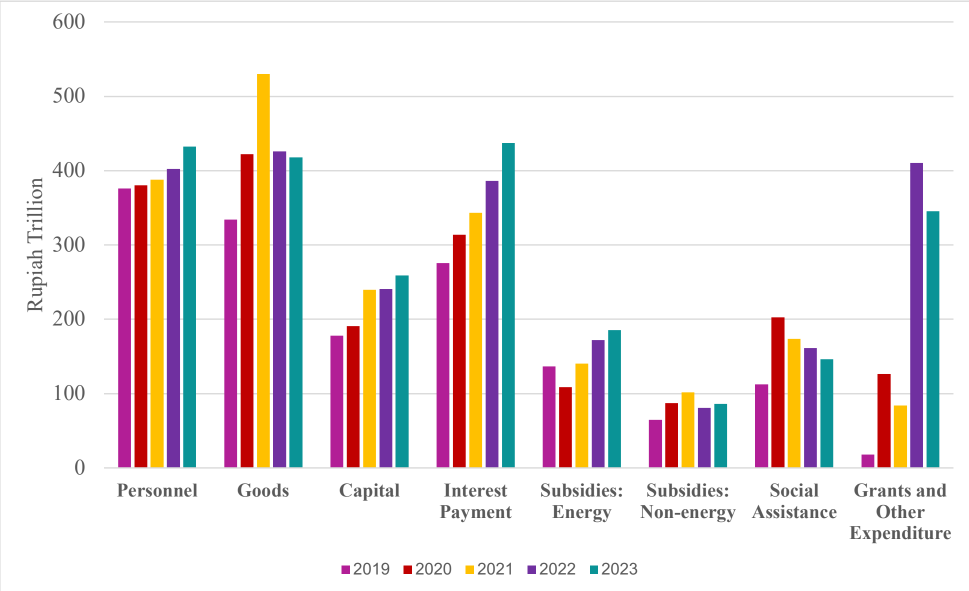
The previous sub-chapter described the growth trends and prospects for several macroeconomic indicators in Indonesia during and after the COVID-19 pandemic. By examining Indonesia's fiscal and monetary indicators, this sub-chapter attempts to analyse the country's recovery from the pandemic.

As illustrated in Figure 1.4, the majority of government expenditure components experienced an increase in 2023 compared to previous years, with the exception of goods, social assistance, grants, and other expenditure. The two largest components of government expenditure in 2023 were interest payments (IDR 437.5 trillion) and personnel expenditure (IDR 432.5 trillion).

The dominance of interest payments in government expenditure remains pronounced, largely influenced by variables such as outstanding debt, current year's debt financing targets, and debt interest rates, particularly SBN yields. These elements are dynamic, responding to shifts in financial markets and both domestic and global economic trends (Kemenkeu (2024a)). In this case, the global economic landscape in 2023 was characterised by high inflation, a substantial increase in interest rates, and forecasts indicating a sustained period of rates being "higher for longer". This complex scenario is compounded by simultaneous ongoing climate change conditions and digital developments, necessitating proactive measures (Kemenkeu (2023)).

According to Figure 1.4, both energy and non-energy subsidies also experienced an improvement from 2022, showing an increase of 8% and 6%, respectively. In the context of energy subsidies, there was a significant adjustment in 2023. Specifically, subsidies for fuels and liquefied petroleum gas (LPG) experienced a reduction of 17.3% compared to the previous year (Rachman (2024)). This decline was a result of implementing more targeted distribution restrictions on fuel purchases. However, this reduction in

**Figure 1.4:** Components of Actual Government Expenditure by Type (Rupiah Trillion), 2019–2023




*Source:* Ministry of Finance

fuel-related subsidies was compensated by a substantial increase in electricity subsidies, which saw a notable growth of 22.2% during the same period. An illustrative example is the no electricity tariffs adjustment program aimed at preserving purchasing power, as discussed in Chapter 1.2.

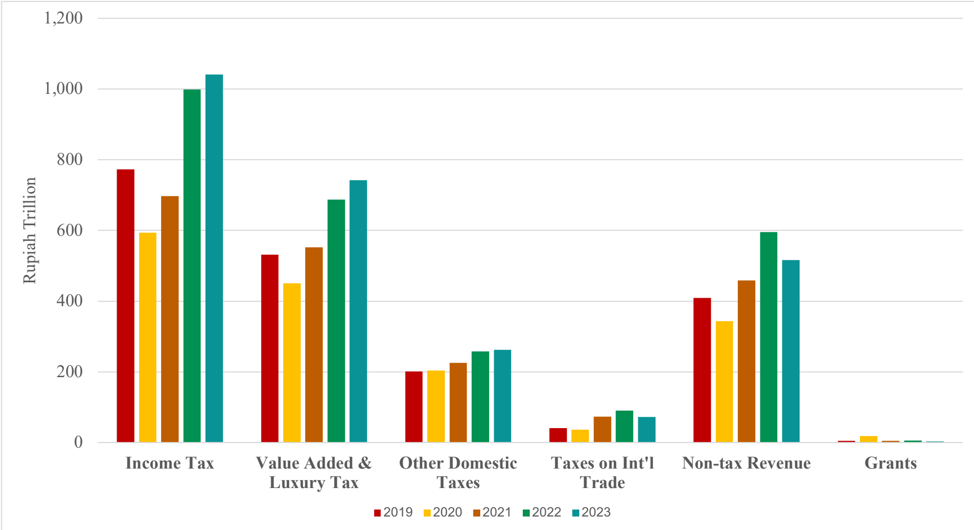
In the non-energy subsidy category, there were significant developments in 2023. Fertiliser subsidies and KUR interest, for instance, experienced notable growth throughout 2023, with increases of 41.3% and 60.8%, respectively (Rachman (2024)). These upward trends align closely with the government's strategic programs in 2023, particularly KUR enhancement initiatives aimed at addressing the impacts of El Nino.

As depicted in the Figure 1.5, government revenue has been steadily recovering since reaching its lowest point during the COVID-19 pandemic in 2020. In 2023, nearly all sectors of government revenue showed improvement, except for non-tax revenue and grants. Notably, the most significant growth from 2022 was observed in revenue from value-added (VAT) and luxury taxes (8%), as well as income tax (4%).

The positive trend in value-added and luxury tax revenue can be attributed to increased economic activities post-pandemic, coupled with adjustments in value-added tax tariffs, following changes to VAT rates under Law No. 7 of 2021 (2021) to harmonise tax regulations. The VAT rate, previously at 10%, was increased to 11% effective April 1, 2022, with a further increment to 12% expected no later than January 1, 2025. Furthermore, the consistent growth in 2023 may also be credited to robust domestic consumption throughout the year.

The growth in income revenue was primarily driven by non-oil income tax revenue, aligning with projected economic growth, increased labour utilisation, and wages. This

**Figure 1.5:** Sources of Actual Government Revenue (Rupiah Trillion), 2019–2023




*Source:* Ministry of Finance

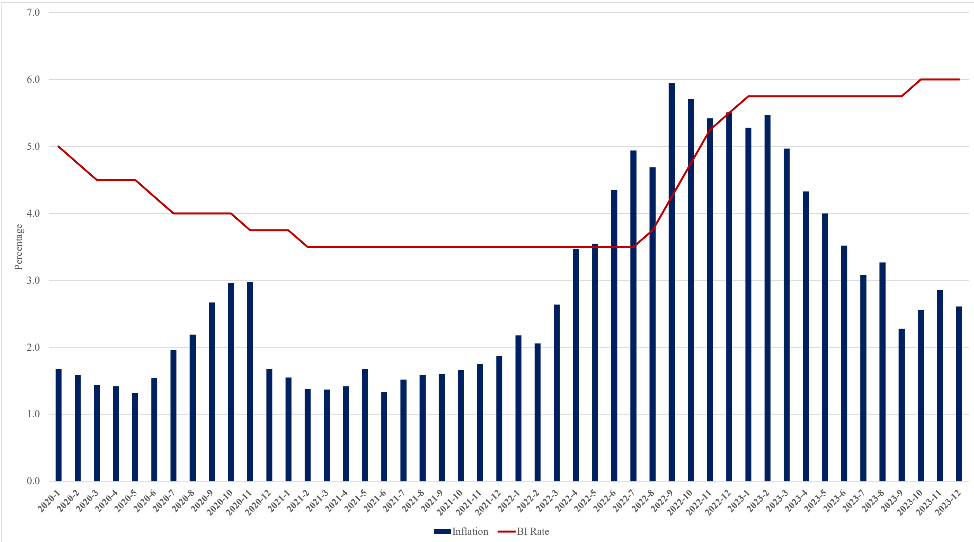
performance was further boosted by a matching program between the NIK on the Identity Card (KTP) and the Taxpayer Identification Number (NPWP), streamlining population and tax administration. Consequently, there was a significant increase in the number of taxpayers (WP) by 2023 (Kemenkeu (2024a)). However, oil and gas tax revenue did not significantly contribute to overall income tax revenue, owing to oil price moderation projected to continue until the end of 2023.

On the other hand, revenue from grants declined by almost half from IDR 5.7 trillion in 2022 to IDR 3.1 trillion in 2023, followed by a 20% decrease in taxes on international trade compared to the previous year. This decline was influenced by severalfactors, including reduced grants related to COVID-19 assistance, decreased tobacco production, lower CPO commodity prices affecting export duties, and a decline in the volume of mineral exports (Kemenkeu (2024a)).

Apart from the fiscal condition, the economic slowdown in 2020 also affected Indonesia's monetary situation, including inflation and the central bank policy rate (see Figure 1.6). Following a period of controlled inflation during 2020-2021, the persistent rise in global commodity prices, particularly energy and food commodities, alongside geopolitical tensions, led to inflation steadily increasing in 2022.

Throughout 2023, Indonesia continued to grapple with global challenges impacting domestic prices. These challenges encompassed supply shortages and feed scarcities, exacerbated by prolonged adverse climatic conditions stemming from the El Niño effect on staple crop production. Despite these obstacles, Indonesia effectively managed inflation in 2023 through the implementation of tightened monetary policies and other measures aimed at maintaining consumers' purchasing power. The inflation rate gradually declined from 5.28% in January 2023 to 2.61% in December 2023, consistent

**Figure 1.6:** Inflation and Central Bank Policy Rate (%), 2020–2023




*Source:* Central Bank of Indonesia

with Bank Indonesia's target band of 3% with a margin of plus/minus 1% (Figure 1.6).

As part of the government's tightened monetary policy to control the inflation rate, Bank Indonesia (BI) increased its policy rate (BI7DRR) twice throughout 2023. At the outset of the year, the BI7DRR was promptly raised from 5.5% in December 2022 to 5.75% in January 2023, before further increasing to 6% in October 2023. This policy aimed to fortify the stabilisation of the Rupiah exchange rate amidst escalating global uncertainties and served as a preemptive, forward-looking measure to mitigate its impact on imported inflation, thereby ensuring inflation remained within the target range of 3.0 plus/minus 1% in 2023 and 2.5 plus/minus 1% in 2024 (Bank Indonesia (2023)).

As depicted in Figure 1.7, the surge in inflation and commodity prices, along with disruptions in food supply, also influenced Indonesia's exchange rate against the dollar, particularly towards the end of 2023. The rupiah exhibited significant fluctuations throughout the year, commencing at IDR 15,572/USD in January 2023, peaking at IDR 15,946/USD in November 2023, and then gradually appreciating to IDR 15,439/USD by year-end. The improvement in the exchange rate observed at the close of 2023 could be attributed to the impact of the BI7DDR increase in October 2023.

**Figure 1.7:** Indonesia's Exchange Rate against USD (IDR/USD), 2022–2023


*Source:* Central Bank of Indonesia

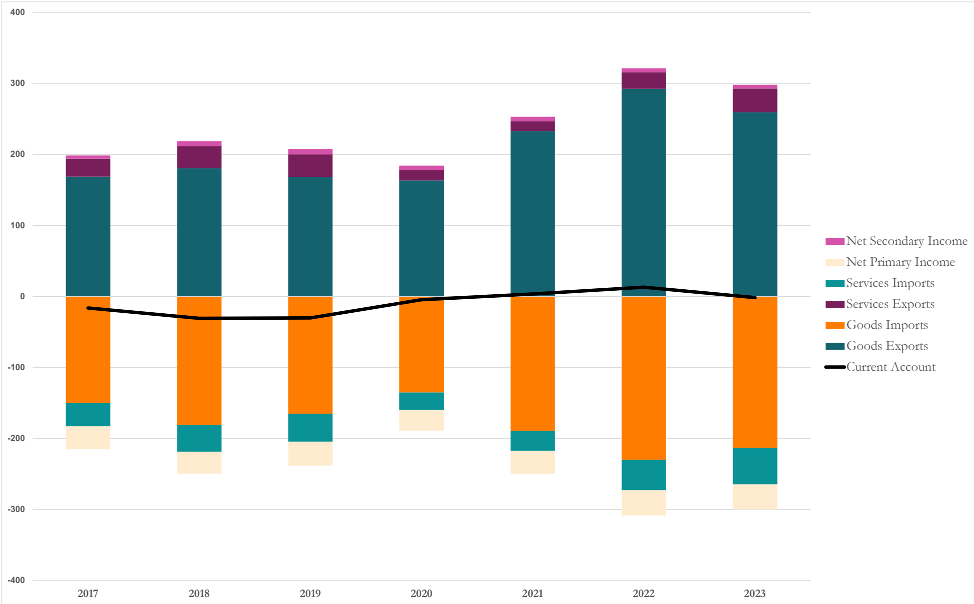
### 1.3.3 Trade Performance and Investment Outlook

As depicted in Figure 1.8, Indonesia's current account, after experiencing a surplus during the recovery period post-COVID-19 pandemic in 2020, registered a deficit of USD1.6 billion in 2023, equivalent to 0.1% of Indonesia's GDP for that year. This stands in stark contrast to the surplus of USD15.2 billion recorded in 2022. The current account deficit in 2023 can be attributed to a decline in the goods trade surplus, primarily influenced by sluggish global economic growth and low commodity prices throughout the year (CNBC Indonesia (2024)). Consequently, both goods exports and imports witnessed a decrease of 11 and 7% respectively.

However, it should be noted that the current account deficit remains below 1% of the GDP. Firstly, this is supported by the narrowing of Indonesia's services trade deficit from USD9.9 billion in 2022 to USD8.9 billion in 2023. This improvement stemmed from a significant increase of 44% in services exports, followed by a 19% rise in services imports. The recovery of Indonesia's tourism sector was facilitated by an increase in international tourist arrivals and the success of various national and international events, such as the 2023 ASEAN Summit in Jakarta and the MotoGP Mandalika in West Nusa Tenggara (Kemenkeu (2024b)).

Secondly, the manageable current account deficit is bolstered by the government's intensive efforts in implementing industry downstreaming policies, particularly in the natural resources commodities sector, such as bauxite, tin, and nickel (Elena (2024)). These policies aim to mitigate the risk of a decline in the trade surplus amidst global economic uncertainty by enhancing industries' access to infrastructure, providing fiscal incentives, and fostering a conducive business environment (Kemenko Perekonomian (2024)). As a result, regions with high industry downstreaming products, such as

**Figure 1.8:** Current Account Components of Indonesia (US$Billion$), 2017˘2023




*Source:* Central Bank of Indonesia

Sulawesi (6.37%) and Maluku-Papua (6.94%), have experienced higher growth rates than the national average (Kemenkeu (2024b)).

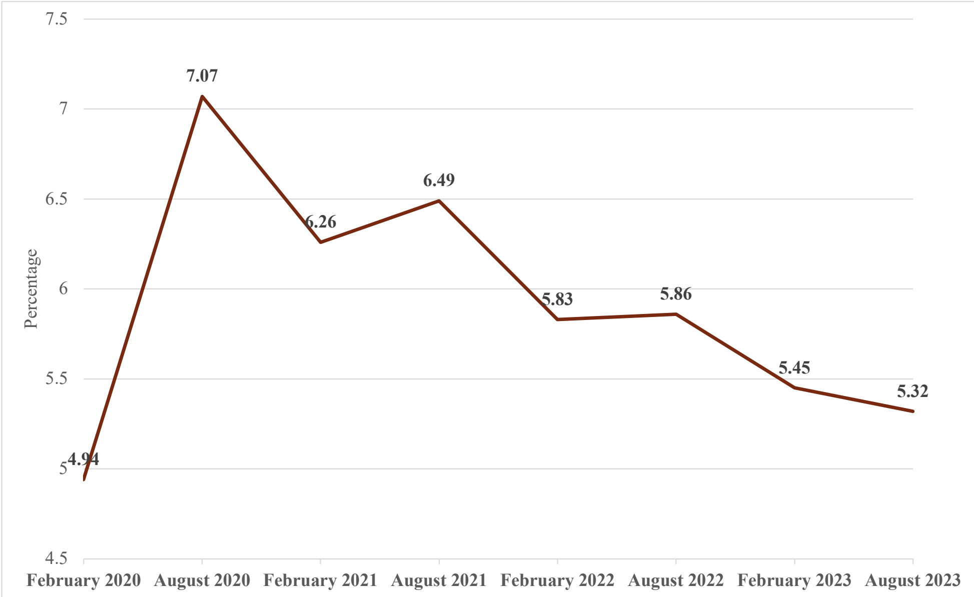
## 1.4 Labour Market and Social Development

Following the post-COVID-19 pandemic recovery, the Indonesian government has successfully reduced the unemployment rate from 7.07% in August 2020 to 5.86% in August 2022 (Figure 1.9). Throughout 2023, the unemployment rate continued to decline, reaching 5.45% in February and dropping to 5.32% in August 2023. This rate nearly returned to its pre-pandemic level of 5%.

The total workforce, according to the National Labour Force Survey (Sakernas) of August 2023, stood at 147.71 million people, reflecting an increase of 3.99 million individuals compared to August 2022. Additionally, the Labour Force Participation Rate (TPAK) rose by 0.85 percentage points compared to August 2022. The employed population reached 139.85 million people, indicating an increase of 4.55 million individuals since August 2022. Notably, the sector witnessing the most substantial growth is the provision of accommodation and food services, with an increase of 1.18 million people (BPS (2023b)).

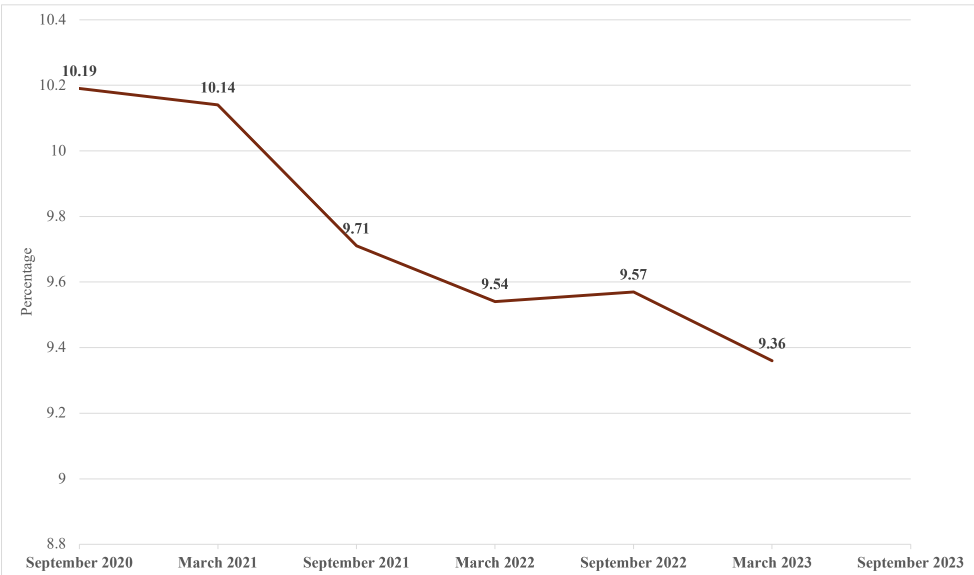
In line with the economic recovery, the poverty rate also declined significantly from 10.19% in September 2020 to 9.57% in September 2022 (Figure 1.10). This rate further declined to 9.36% in March 2023. This progress can be attributed to various government

**Figure 1.9:** Unemployment rate (Percentage), 2020–2023




*Source:* Central Bureau of Statistics (BPS)

**Figure 1.10:** Poverty Rate (Percentage), 2020–2023




*Source:* Central Bureau of Statistics (BPS)

measures implemented in 2023. They were aimed specifically at maintaining consumers' purchasing power amidst high inflation and food supply shortages. These measures included social assistance programs, tax reductions, and housing incentives for low-income groups, as previously mentioned. This commitment extended not only to impoverished households but also to small businesses, small industries, and customers from MSMEs.

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