Indonesia: making the economic recovery sustainable and inclusive

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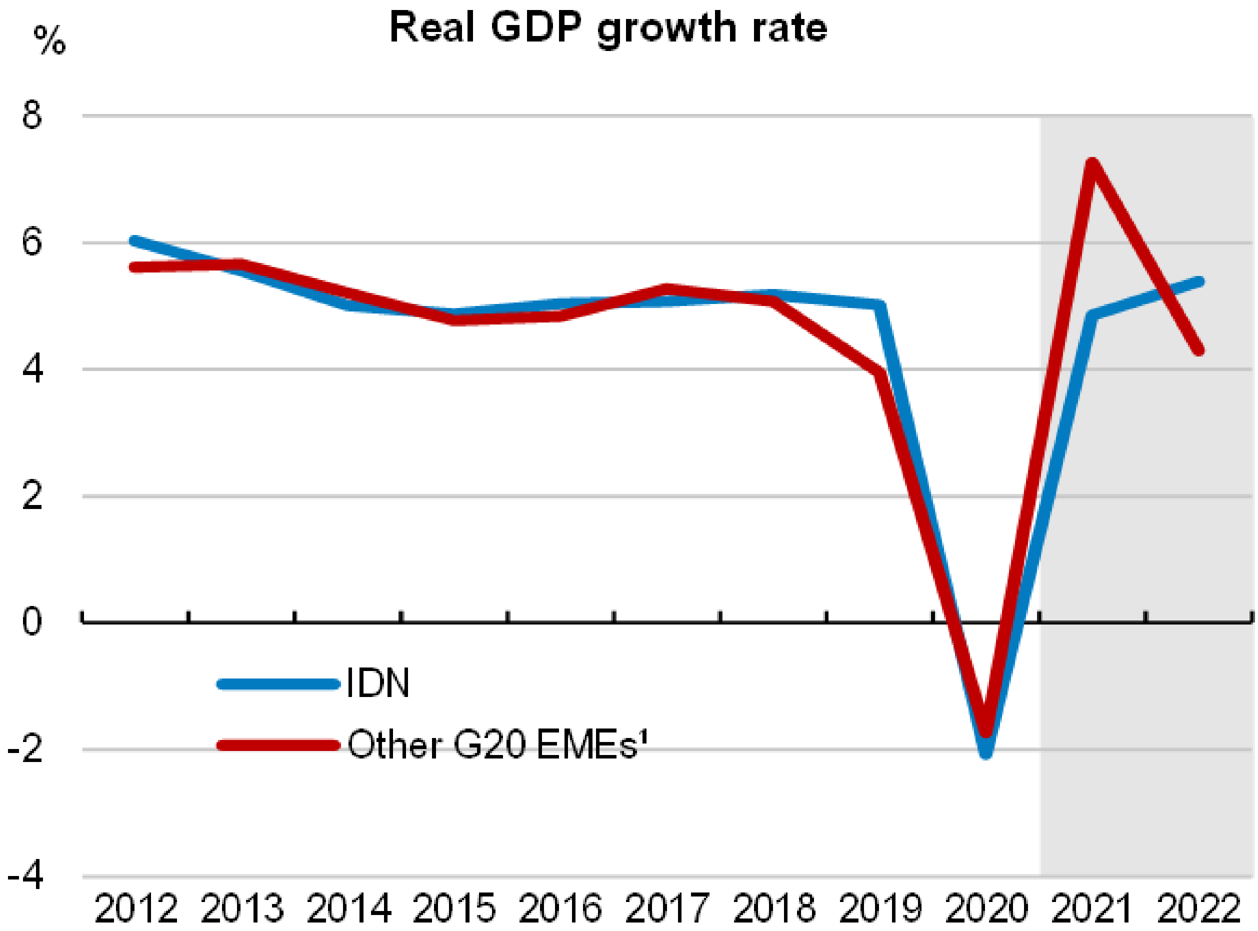
Despite the recession, the first in 20 years, Indonesia avoided an even larger downturn in 2020 thanks to a credible economic policy response. The latest *OECD Economic Survey of Indonesia* acknowledges that the size of the support was constrained by low tax revenue and underscores that disbursing the package proved initially difficult and slow. But it was accompanied by economic reforms, showing that meaningful efforts at improving market functioning can be made even in the midst of a severe crisis.

The economy is recovering. GDP shrunk by 2.1% in 2020 and the *Survey* sees growth of 4.9% for 2021 and 5.4% in 2022. The rebound is sustained by pent-up demand for consumer goods and capital goods and will gain momentum as containment measures are phased out and vaccination progresses to the entire archipelago of 17 000 islands.



1. Other G20 EMEs include Argentina, Brazil, China, India, Mexico, Russia, Saudi Arabia, South Africa, and Turkey.
Source: OECD Economic Outlook 108 database updated.

The economic outlook is surrounded by substantial risks and uncertainties

- Most Indonesians work in the informal sector and their limited savings were used to guarantee basic necessities during lockdowns. The emerging middle class that was celebrated in the 2010s found itself much more vulnerable than expected – how fast will it regain confidence and therefore access finance to resume spending, especially in consumer durables?
- On the upside, the global recovery could be stronger than expected and boost demand for Indonesian goods and services.
- On the downside, Indonesia, which will chair the G20 in

2022, is subject to the same investors' fickleness as other emerging markets and may suffer from contagion effects if a peer, no matter how distant and different, falls into crisis. An additional risk is that international travellers may stay away from far-flung destinations where medical services are deemed poor.

While the economy is fragile, macroeconomic support is needed

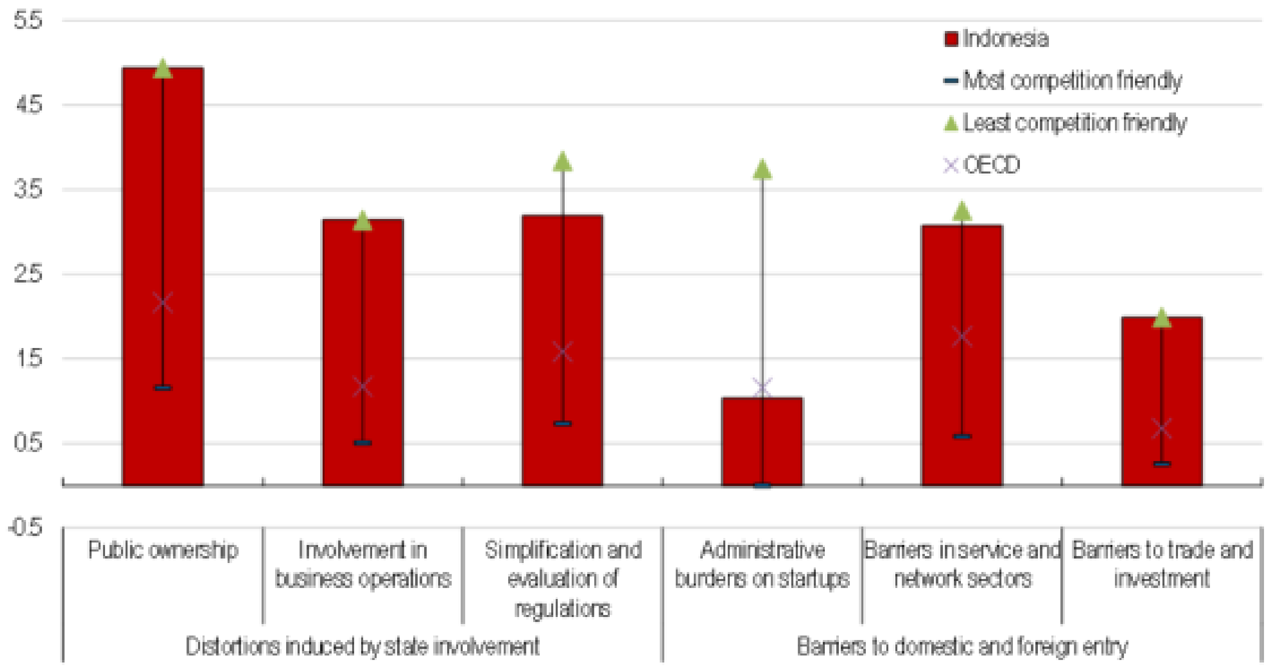
- The independent central bank should maintain its accommodative stance, geared towards supporting the recovery, while providing forward guidance regarding normalisation of monetary conditions.
- With so many households and firms suffering from the crisis and the risk of long-lasting scarring effects, it is sensible to maintain fiscal support to the economy. Additional efforts can be made to ensure that resources are directed at those most in need. Tax policy reforms should continue, to fight against evasion and erosion and make the system fairer with more people paying their due.

Structural reforms can contribute to make the recovery stronger, fairer and greener

Firms and households flourish and make forward-looking decisions when governments provide the right conditions to take calculated risks and policies are predictable and consistent.

- Indonesia is still characterised by a high number of restrictions that benefit selected and well-connected groups. This is true for labour market rules that protect employees and not jobs, as well as for product market regulations that make it difficult for new entrants to challenge incumbents. But where conditions are right, the results are impressive. Establishing a start-up is rather easy and affordable: it is no coincidence that Indonesia can boast five unicorns (i.e. high-tech firms valued USD 1 billion and more) versus three in Australia and four in Japan.

Regulatory barriers to competition are high



Sources: OECD Economic Outlook 108 database updated; OECD Product Market Regulation database.

- The Omnibus Bill on Job Creation, approved in late 2020, includes a large number of changes that will hopefully make it easier for domestic and foreign firms to operate and invest in Indonesia. And it will be fundamental that they do so in full respect of the rules of the game and of international best standards. This translates into respect for labour and environmental rights and determination in upholding business integrity. The government and parliament should play their part too: the post-pandemic period, for instance, will see many public works adjudicated, and there is no need to prefer direct awards over the transparency of open tenders.

The crisis has not been neutral. Informal workers who are not covered by social security, women who are either housewives or both work and take care of the family, people with disabilities, youngsters and migrants – these groups have suffered disproportionally from the crisis. But so did children who missed a good part of the school year, at least in terms of in-person education, and will suffer the consequences for the rest of their life. These developments add to pre-existing challenges in providing relevant and adequate skills to a population that remains young but will soon reach the peak of the demographic dividend.

These issues are covered in the *Survey*'s in-depth chapter on education and skills. There is no easy answer, but a combination of measures that would help. Early childhood education, for instance, has a lasting effect on educational performance, at the same time as it makes it easier for women to combine work and maternity. Vocational education and training should also be reinforced, removing any stigma it has compared to standard education. And foreign investment in tertiary education, as contemplated by the new economic cooperation agreement with Australia, would improve the quality of Indonesian universities.

Reference:

OECD (2021), *OECD Economic Surveys: Indonesia 2021*, OECD Publishing, Paris – OECD.Kappa