OECD Economic Surveys
INDONESIA

MARCH 2021

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OECD Economic Surveys: Indonesia 2021

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Please cite this publication as:
OECD (2021), *OECD Economic Surveys: Indonesia 2021*, OECD Publishing, Paris, *https://doi.org/10.1787/fd7e6249-en*.

ISBN 978-92-64-96416-7 (print)
ISBN 978-92-64-63503-6 (pdf)

OECD Economic Surveys
ISSN 0376-6438 (print)
ISSN 1609-7513 (online)

OECD Economic Surveys: Indonesia
ISSN 2072-5116 (print)
ISSN 2072-5108 (online)

Photo credits: Cover © @Kalilipatvideoart/Shutterstock.

Corrigenda to publications may be found on line at: *www.oecd.org/about/publishing/corrigenda.htm*.

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This Survey was prepared in the Economics Department by Andrea Goldstein and Patrice Ollivaud under the supervision of Vincent Koen. Alexander Hijzen and Sébastien Martin, from the Directorate for Employment, Labour and Social Affairs (ELS), contributed to the second chapter. Cecilia Tam, from the Environment Directorate (ENV), provided the box on clean energy financing. Yvan Guillemette also contributed to the report; research assistance was provided by Natia Mosiashvili, and editorial support by Sisse Nielsen and Michelle Ortiz. The previous Survey of Indonesia was issued in October 2018. The Survey was discussed at a meeting of the Economic and Development Review Committee on 25 January 2021 with participation of representatives of the Indonesian government and of Italy and New Zealand as lead speakers.
The Survey is published under the responsibility of the Secretary-General of the OECD.
Information about the latest as well as previous Surveys and more details about how Surveys are prepared is available at www.oecd.org/eco/surveys.

BASIC STATISTICS OF INDONESIA, 2019*

(Numbers in parentheses refer to the OECD average)**

LAND, PEOPLE AND ELECTORAL CYCLE					
Population (million)	270.2		Population density per km² (2018)	147.8	(38.0)
Under 15 (%)	26.2	(17.9)	Life expectancy at birth (years, 2018)	71.5	(80.1)
Over 65 (%)	6.1	(17.1)	Men (2018)	69.4	(77.5)
International migrant stock (% of population, 2015)	0.1	(9.7)	Women (2018)	73.7	(82.8)
Latest 5-year average growth (%)	1.2	(0.6)	Latest general election		April 2019
ECONOMY					
Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	1 118.9		Agriculture, forestry and fishing	13.3	(2.6)
In current prices (trillion IDR)	1 583.5		Industry including construction	40.6	(26.8)
Latest 5-year average real growth (%)	5.0	(2.2)	Services	46.1	(70.5)
Per capita (000 USD PPP)	12.3	(48.9)			
GENERAL GOVERNMENT					
Per cent of GDP					
Expenditure (2018, OECD: 2019)	18.2	(40.6)	Gross financial debt (2018)	33.7	(107.5)
Revenue (2018, OECD: 2019)	16.6	(37.5)	Net financial debt (2018, OECD: 2017)	6.6	(67.9)
EXTERNAL ACCOUNTS					
Exchange rate (IDR per USD)	14 149.9		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	4 743.3		Mineral fuels, lubricants and related materials	20.2	
In per cent of GDP			Manufactured goods	15.8	
Exports of goods and services	18.4	(54.2)	Machinery and transport equipment	13.3	
Imports of goods and services	19.0	(50.6)	Main imports (% of total merchandise imports)		
Current account balance	-2.7	(0.4)	Machinery and transport equipment	32.5	
Net international investment position	-30.3		Manufactured goods	17.5	
			Chemicals and related products, n.e.s.	14.0	
LABOUR MARKET, SKILLS AND INNOVATION					
Employment rate (aged 15 and over, %)	65.7	(57.6)	Unemployment rate (aged 15 and over, %)	6.0	(5.4)
Men	79.3	(65.6)	Youth (aged 15-24, %)	13.5	(11.7)
Women	52.2	(50.0)	Long-term unemployed (1 year and over, %)	0.6	(1.4)
Participation rate (aged 15 and over, %)	67.5	(61.1)	Tertiary educational attainment (aged 25-64, %, 2017, OECD: 2019)	11.9	(38.0)
Mean weekly hours worked	38.2	(37.4)	Gross dom. spending on R&D (% of GDP, 2018)	0.2	(2.6)
ENVIRONMENT					
Total primary energy supply per capita (toe, 2017, OECD: 2018)	0.9	(4.0)	CO_2 emissions from fuel combustion per capita (tonnes, 2017, OECD: 2018)	1.9	(8.6)
Renewables (%, 2017, OECD: 2018)	33.2	(10.5)	Renewable internal freshwater resources per capita (1 000 m³, 2014)	7.9	
Exposure to air pollution (more than 10 µg/m³ of PM 2.5, % of population, 2017)	94.8	(58.7)			
SOCIETY					
Income inequality (Gini coefficient, 2018, OECD: 2017)	0.378	(0.332)	Education outcomes (PISA score, 2018)		
Poverty gap at USD 3.20 a day (2011 PPP, %, 2018)	5.1		Reading	371	(487)
Public and private spending (% of GDP)			Mathematics	379	(489)
Health care (2016, OECD: 2018)	3.1	(8.8)	Science	396	(489)
Education (% of GNI, 2018)	3.3	(4.5)	Share of women in parliament (%)	17.4	(30.7)

* The year is indicated in parenthesis if it deviates from the year in the main title of this table.
** Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 80% of member countries.
Source: Calculations based on data extracted from databases of the following organisations: OECD, International Energy Agency, International Labour Organization, International Monetary Fund, World Bank.

Executive summary

COVID-19 interrupted a long and stable growth journey, causing a recession

After two decades of sustained, steady growth, the pandemic triggered a "perfect storm". GDP contracted in 2020 and some of Indonesia's vulnerabilities have come to the fore, although unprecedented policy interventions have circumscribed the damage.

The 2020 recession was widespread. Most sectors were hit, while uncertainty over the evolution of the pandemic and depressed confidence held back investment and consumption, with few exceptions such as ICT and healthcare services. Subdued global demand weighed on commodities sectors, notwithstanding improvement in the second half. Construction was also affected, with delays in infrastructure projects.

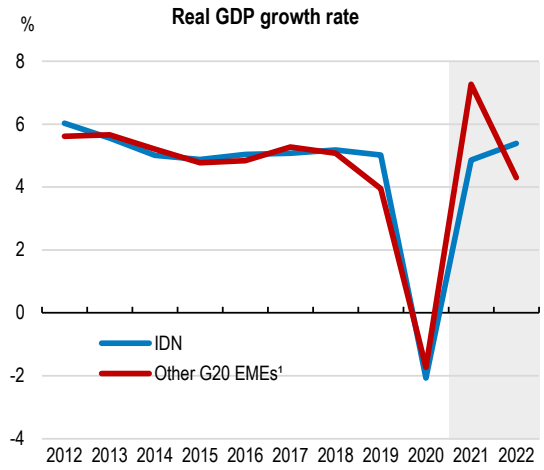
The social fallout is severe. Formal employment is shrinking, and the crisis is disproportionally hitting vulnerable groups such as informal workers, internal migrants, women and children. Government policies aim at reducing scarring effects and improving the skills of the population.

The healthcare system was put under stress but collapse was avoided. Extra efforts were made to deal with the COVID-19 outbreak and the system proved more resilient than expected, although the number of deaths for monitored patients, as well as among doctors and nurses, is high and the contract tracing system is still rudimentary. The migration of health professionals is also a cause of concern. Moving forward, it is important to continue the fight to eradicate other diseases like tuberculosis, dengue fever and malaria, which remain rampant.

The recovery will be gradual, with considerable downside risks. With no clear signals that the virus is receding, uncertainty surrounds the definitive withdrawal of all prevention and mitigation measures and the successful roll-out of the free vaccination programme. Despite the increasing reliance on e-commerce, private consumption will take time to return to pre-crisis levels due to income losses. Investment growth is set to remain soft, although the new Omnibus Bill for Job Creation is expected to improve the business climate. Sluggish global trade growth will also take its toll.

Figure 1. A sudden stop to a growth story

GDP growth, y-o-y % changes



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

StatLink https://stat.link/jr1hzt

Table 1. The economy suffered a contraction

(annual growth rates, unless specified)	2019	2020	2021	2022
Gross domestic product (GDP)	**5.0**	**- 2.1**	**4.9**	**5.4**
Private consumption	5.2	- 2.7	3.6	7.1
Government consumption	3.3	1.9	- 0.3	1.0
Gross fixed capital formation	4.5	- 4.9	2.0	6.0
Exports of goods and services	- 0.9	- 7.7	2.0	3.9
Imports of goods and services	- 7.4	- 14.7	1.8	7.4
Unemployment rate (% of labour force)	5.3	8.0	6.8	5.8
Consumer price index	3.0	1.9	2.1	3.0
Fiscal balance (% of GDP)	- 2.2	- 6.5	- 5.7	- 4.1
Public debt (% of GDP)	26.3	27.0	35.0	38.6

Source: OECD Economic Outlook 108 database updated.

Fiscal policy has been expansive despite formal constraints. The ceiling on the deficit (3% of GDP) has been temporarily suspended. Slow disbursements limited the initial impact of the 4.3% of GDP fiscal stimulus in 2020 but the situation later improved with an acceleration of spending. The OECD projects the deficit-to-GDP ratio to recede from 6.5% in 2020 to 5.7% in 2021. Further support in the medium term will depend on maintaining easy access to financial markets and raising tax revenue above current levels, which are insufficient.

Monetary policy remains accommodative. Bank Indonesia cut its policy rate five times in 2020 and then again in February 2021, by 150 basis points in total, while quantitative easing and a range of macro-prudential measures were activated to increase liquidity. Inflation is projected to remain low and accommodative monetary policy, accompanied by forward guidance, should continue.

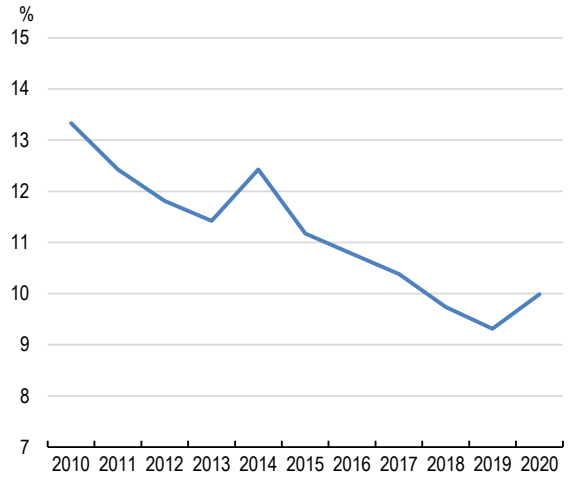
The central bank engaged in a "burden-sharing" scheme with the government. Bank Indonesia bought government bonds directly, bearing the interest cost. The action was consistent with the central bank's macroeconomic stabilisation mandate and appropriate safeguards were in place. Going forward, it will be important to maintain clarity regarding the boundaries between fiscal and monetary policy and preserve the independence of Bank Indonesia.

Some financial indicators warrant attention. Market stress was at its highest in March 2020. It has since receded but corporates' foreign currency debt is a risk to financial stability. Despite recent currency strengthening, the spreads over global benchmarks have yet to return to pre-crisis levels. The narrowing of the current account deficit is a positive signal insofar as reduces vulnerability, but investor sentiment towards emerging markets remains fickle and any sudden deterioration may trigger a vicious depreciation/inflation cycle and hinder market access.

Progress in reducing poverty is at risk. Poverty has declined since the turn of the century but started to edge up even before the pandemic hit (Figure 2). Consumption patterns, notably for durable goods, testify to the rise of the middle class. Nonetheless, only a third of Indonesians are economically secure and in urban areas three out of ten live in slums. Poverty remains widespread in rural areas and youth unemployment is the highest in Southeast Asia. Over 26 million people (9.8% of the population) were considered poor when the country started to suffer from the pandemic, which could push up to 10 million more individuals into poverty.

Figure 2. Poverty is on the rise again

Incidence of poverty as a share of total population



Source: BPS.

StatLink https://stat.link/pv2un4

Better performance of state-owned enterprises is key to unleash the benefits of globalisation

State-owned enterprises (SOEs) are assigned a central role in transforming Indonesia into a developed economy. SOEs enjoy favourable operational conditions, but their performance is uneven and their rising leverage represents a hidden fiscal risk.

Even short of large-scale privatisation, there is room for SOE reform. Corporate governance should be improved and boards and management shielded from government interference. The creation of holding companies at the sector level may bring benefits, provided operating companies are given a clear mandate and their financial reporting is transparent.

Trade intensity has diminished and exports remain concentrated in natural resources. Although commerce is increasingly with the rest of Emerging Asia, Indonesia only modestly participates in regional value chains and foreign investors are discouraged by high regulatory barriers and legal uncertainty.

Important and comprehensive agreements open new opportunities. The Regional Comprehensive Economic Partnership, the Indonesia-Australia Comprehensive Economic Partnership Agreement, and possible agreements with the European Union and EFTA will ease the flow of goods, services, investment and people

between Indonesia and some of its major partners. Preferential market access is a potential boon for exporters that must be complemented by progress in trade facilitation, product quality and other areas.

Despite progress in transport infrastructure, shortfalls in safety and logistics remain. Road and sea transport fatalities are among the highest in Asia and so are logistics costs. Filling infrastructure gaps to make the most of globalisation requires significant financial resources that should be increasingly sought from private investors, including from abroad. The new sovereign wealth fund can play a facilitating role.

Protecting the environment to the benefit of all

Achieving the Nationally Determined Contribution to the Paris Accord and the Sustainable Development Goals requires ambitious policies to mobilise additional financial and technological resources.

Land use and deforestation contribute to make Indonesia one of the world's largest emitters of greenhouse gases. The largest mitigation potential may come from extending the moratorium policy on the clearing and conversion of primary forest and peatlands and widening it to include secondary forests.

Decoupling greenhouse gas emissions from economic growth and fulfilling emission reduction targets for 2030 are tough challenges. They require investments in public transport and low-emission technologies and improvements in energy efficiency, to fight air pollution especially in Jakarta and its satellite cities. In many locations, inland and by the sea, pollution from plastic waste is a major challenge. In the post-crisis phase, government and business actions carry the potential to accelerate the green transition.

Building competencies for inclusive growth

Demography has been supportive but the window is about to close.

Indonesia has enjoyed a "demographic dividend", supporting the growth of GDP per capita. The share of the working age population is expected to peak in 2021, remain broadly stable for ten years, and then gradually decline.

Growth objectives for the next 25 years are particularly ambitious. Over the medium term, the 2020-24 Plan aims at achieving GDP growth between 5.4% and 6%, with the long-term goal of making Indonesia a developed country by 2045 – the centenary of Independence.

Educational attainment has improved considerably in the past two decades, but COVID-19 has increased the risk of absenteeism and drop-out. Improved public spending efficiency and starting school earlier could raise educational attainment and learning performance. Greater ICT investment would help reap the benefits of digitalisation.

Skills shortages are many and concern both current and future needs. The importance of securing adequate skills will increase as the economy becomes more knowledge-based. Vocational education and lifelong training should be further promoted to upskill and reskill the workforce, with an enhanced role for social partners.

Increasing employment is crucial to anticipate the end of the demographic dividend. Higher participation is needed from women, internal migrants, diaspora returnees, foreign workers, and disadvantaged groups.

Employment legislation reform aims at helping jobseekers. The recently-approved Omnibus Bill for Job Creation encourages hiring in the formal economy, diminishes firing costs and introduces a risk-based system for authorising environment-sensitive projects. Implementing regulation will be crucial to achieve desired outcomes and should be elaborated in consultation with relevant stakeholders.

Fostering competition, simplifying business regulations and modernising the financial sector would boost productivity. Many anti-competitive measures stymie entrepreneurship. There is scope to improve the regulatory framework, for instance by removing unnecessary restrictions on the entry of foreign multinationals.

Corruption remains a major issue. The overhaul of the national anti-corruption agency presents new challenges and its independence should be preserved. With considerable financial resources earmarked for the recovery, it is important to apply strict public procurement norms and practices.

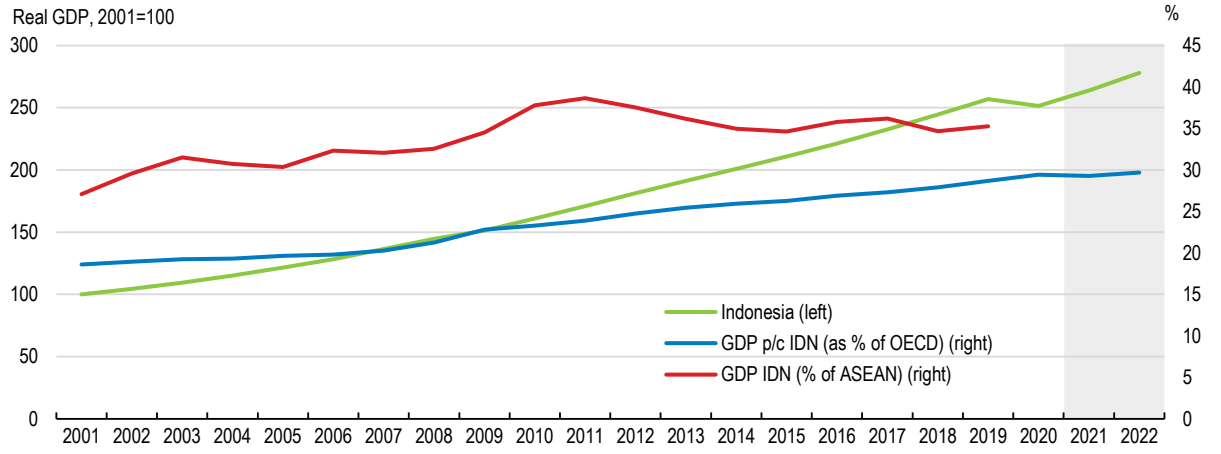
MAIN FINDINGS	KEY RECOMMENDATIONS
Moving from crisis management to achieving recovery	
A broad range of temporary measures has been adopted to succour vulnerable households and businesses.	Prolong measures directed at providing financial support to households and businesses to protect livelihoods and employment.
Disbursements in the context of the emergency fiscal package have been slow, but have accelerated in the latter part of 2020.	Improve inter-ministerial policy coordination and between government levels and ensure consistency between government accounting systems.
Past fiscal prudence has made room for fiscal expansion in the face of exceptional circumstances.	Authorities should plan for fiscal consolidation over the medium run but avoid a premature and abrupt removal of stimulus.
The economic crisis and the tax policy actions to mitigate its impact have further reduced tax revenue from already low levels.	Efforts to raise tax revenue should be stepped up, notably by: • improving compliance; • broadening the base; • increasing selected tax rates (e.g. on tobacco); • enhancing international cooperation; and • closing loopholes.
The "burden sharing" scheme is part of the unconventional apparatus, unlikely to generate inflationary pressures as long as demand stays compressed, and intended as temporary.	Phase out the "burden sharing" agreement, as envisaged.
The central bank has lowered the policy rate in steps during the crisis and inflation has drifted down to below target.	The monetary stance should remain accommodative as long as inflation is within target, with forward guidance on normalisation as conditions improve.
Central bank independence is key for the credibility of macroeconomic policy, especially in difficult times.	Bank Indonesia's independence should continue to be fostered.
Enhancing the effectiveness of government interventions	
SOEs' financial and operational performance has deteriorated during the crisis and some needed capital injections or restructuring.	Improve SOEs' corporate governance to align with global best practices.
A number of SOEs enjoy various competitive advantages and the lack of a level playing field may hamper private sector growth.	SOEs should always be subject to competition law and be held responsible when abusing their dominant market position.
Restrictions on FDI are amongst the highest in the G20.	Review existing restrictions, eliminate those that generate costs without producing benefits, and monitor the remaining ones.
Streamlined procedures and direct awards may be an efficient, but only temporary, solution for procuring specific goods, services and works in emergency situations like COVID-19.	Limit direct awards only to current, urgent and unforeseeable needs, when there really is only one qualified supplier, and terminate them as soon as possible.
The recent requirements to seek prior approval by the supervisory board before launching investigations and to turn staff into civil servants weaken the independence of the Corruption Eradication Commission (KPK).	Safeguard the independence and authority of the KPK to ensure the effective prevention, detection and investigation of corruption.
Accelerating the green transition	
Estimates suggest that the forest and peatland cover lost to burning rose during the pandemic.	Protect, rewet and restore peatlands and forests and increase the budget resources for environmental protection agencies.
Cost-reflective energy pricing is fundamental to reduce emissions.	Establish a carbon price on fossil fuels.
The share of renewables in the energy mix is still low.	Confirm plans to reform buy-in tariffs, to make cost recovery possible.
Jakarta and other metropolitan areas suffer from high pollution.	Accelerate investment in public transport and pursue inter-modal integration.
Expanding skills and well-being	
Early childhood education can reduce the impact of socio-economic backgrounds on education outcomes and encourage female labour participation. Enrolment is low, notably in rural areas.	Consider lowering the starting age of compulsory education.
Median wages are below minimum wages in a third of provinces, incentivising informality. Different minimum wage settings are not explained by different levels of development.	Review the level of statutory minimum wages in each province to better align them with local characteristics.
There is a large gender gap in employment. Female educational attainment is converging towards men's but remains below. There is evidence of gender discrimination in the labour market.	Promote female employment through public campaigns. Target more women in lifelong training programmes. Support the construction of more childcare facilities. Enforce laws promoting gender equality.
The share of youth not in education, employment or training is relatively high.	Pilot lower levels of employment protection and discounted minimum wages for youth in special economic zones. If successful, extend them.
The recently-introduced unemployment insurance scheme provides dismissed workers with a lump sum.	Expand the unemployment insurance scheme together with business associations and trade unions.
Computers are only available in 40% and 67% of primary and upper-secondary schools, respectively.	Invest more in information and communication technology infra-structure for pedagogical purposes in primary and secondary schools.

1 Key policy insights

Indonesia is confronting the most severe challenges since the 1997 crisis

The COVID-19 pandemic is hitting the Indonesian people and economy hard, with GDP falling and poverty rising. The pandemic-driven recession in 2020 was a brutal interruption to a long spell of sustained economic expansion that saw GDP per capita rise from 19% of the OECD average in 2001 to 29% in 2019 and Indonesia's contribution to ASEAN GDP grow from 27% to 35% (Figure 1.1). During the 2001-19 period, the compound annual growth rate of GDP was 5.1%, the third-highest in the G20, and growth volatility was the lowest.

Figure 1.1. The pandemic interrupted a long spell of sustained growth



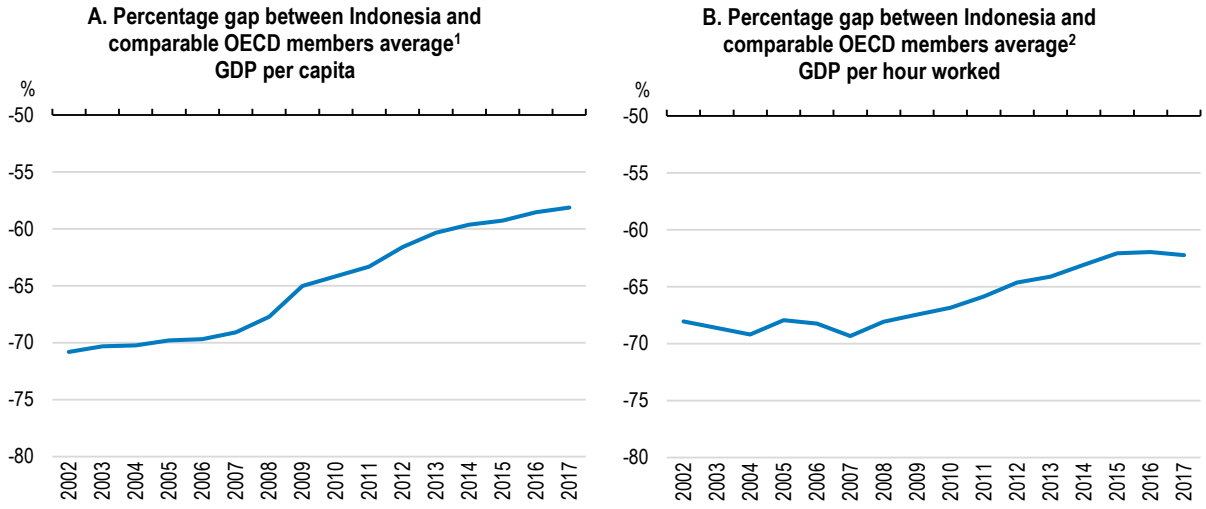
Note: Indonesia's GDP as a share of OECD and ASEAN GDP, computed at 2010 USD PPP. ASEAN GDP is the sum of Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.
Source: *OECD Economic Outlook*, No. 108 updated; World Bank, World Development Indicators.

StatLink https://stat.link/jbnd4i

The Indonesian economy has experienced considerable structural transformation over the period. Services have overtaken agriculture as the largest source of employment, the range of made-in-Indonesia products has become more sophisticated (in part also due to foreign direct investment), and the recent World Bank reclassification as an upper middle-income country testifies to Indonesia's rising global status. However, the pace of convergence in income per capita and productivity vis-à-vis the more comparable OECD countries has slowed in recent years (Figure 1.2), notably since the end of the commodities super-cycle in 2014. Moreover, low-value-added services and light manufacturing are still driving employment growth (Lewis, 2019a).

COVID-19 has triggered the first recession since the 13% contraction endured in 1998, with GDP shrinking by 2.1% in 2020, under the combined burden of the global recession and the domestic sanitary containment measures (Box 1.1).

Figure 1.2. Income and productivity convergence started decelerating around 2014



Note: 1. Panel A. OECD average refers to the population weighted average of 18 OECD member countries that have the lowest GDP per capita (in constant 2015 PPPs). 2. Panel B. OECD average refers to the population weighted average of 17 OECD member countries that have the lowest GDP per hour worked (in constant 2015 PPPs).
Source: OECD, National Accounts Database; APO Productivity database.

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Box 1.1. Indonesia's strategy to contain the spread of the COVID-19 virus

With its first case confirmed on 2 March, Indonesia was hit by COVID-19 relatively late, after Thailand, the Philippines, Singapore, Cambodia, Vietnam and Malaysia in Southeast Asia. By 9 April, infections had spread to all 34 provinces and the daily number of new cases hit a record high on 30 January 2021. Subject to the caveat that COVID-19 underreporting is non-trivial (LaporCovid-19, 2020), as of 8 March, 1 386 556 cases and 37 547 deaths had been confirmed. Indonesia has a high number of deaths among patients under surveillance and persons under observations. The substantial number of deaths among health workers due to COVID-19 calls into question the efficacy of protective measures. International comparisons, however, are difficult to make given differences in data collection.

The following elements have featured in the containment strategy:

- Foreign entry controls: A ban on the entry of travellers coming from Hubei province was imposed in early February 2020, later extended to all visitors from China. Starting on 8 March, travel restrictions were expanded to include selected localities in Korea, Italy and Iran, and eventually all foreign countries. Authorised persons arriving in Indonesia are potentially subject to a 14-day quarantine.
- Large-scale social restrictions (Pembatasan Sosial Berskala Besar, abbreviated as PSBB): These include: closing public places (such as schools, offices, religious and cultural buildings), restricting public transport, limiting internal travel, and outlawing the annual post-Ramadan Idul Fitri mudik (exodus). A partial lockdown was imposed in major cities in mid-April and lasted until early June.

- Post-PSBB transition: In Jakarta, the first phase, with opening of commerce and restaurants, began on 5 June. This “New Normal” (later re-named “adapting to new habits”) approach, based on wearing masks, respecting physical distancing, washing hands regularly, and avoiding touching eyes, nose and mouth, was originally supposed to end on 2 July. With limited progress in curbing infection spread, the transitory phase was prolonged and PSBBs were re-imposed in Jakarta in mid-September and extended until 22 November. New public activity restrictions (PPKM), were introduced in January 2021 in response to the emergence of a new COVID-19 variant. The new measures would only be implemented in regions that meet one of four criteria: a death rate that exceeds the national average, a recovery rate that is below 82%, active COVID-19 cases surpassing the 14% national average, and a hospital bed occupancy rate higher than 70%. Most of Java and Bali enforced PPKM between 11-25 January, although enforcement was lacklustre.
- Testing: Polymerase chain reaction (PCR) testing is free for patients with symptoms at a government hospital, and the government has announced the formation of a group tasked with setting the price outside hospitals. There are long waiting lists due to limited human resources and lack of PCR reagents, extraction kits, viral transport media and consumables. Narrow testing limits the ability to detect asymptomatic and mild cases. The number of tests performed per million population has been the lowest among G20 members. GeNose, a COVID-19 detection system using a breath sample method created by Gadjah Mada University, obtained the distribution permit from the Ministry of Health on 24 December 2020.
- Tracing: In March 2020, the Communications and Information Ministry launched PeduliLindungi, a mobile app to trace and track confirmed or suspected cases, but uptake has been modest. Economic concerns, low trust, and stigmatisation fears are major obstacles.
- Treating: Extra fiscal resources, including tax relief, have been allocated to procure medical equipment such as test kits and ventilators, incentivise medical workers and subsidise social security premia. Existing facilities have been adjusted in response to the pandemic. In Jakarta, 4 053 isolation beds and 528 intensive care unit (ICU) beds in 67 referral hospitals have been designated for COVID-19 patients and the largest makeshift hospital has been built, with capacity of up to 2 000 patients. The occupancy rate was 83% for ICU beds and 77% for isolation beds in mid-September. At the end of 2020, the Ministry of Health announced plans to increase treatment room capacity by 30% and add new referral hospitals totalling 7 901 new health workers and 740 new ICU beds.
- Vaccination: The government has adopted a roadmap, following the WHO and Indonesian Technical Advisory Group on Immunization (ITAGI) standards, which identifies medical workers, the police, the armed forces and public servants as priority groups. Indonesia is expected to benefit from the Asia Pacific Vaccine Access Facility (APVAX) of the Asian Development Bank that will provide support for procurement and transportation of vaccines, as well as investments in distribution systems, like cold-chain storage and processing facilities. Indonesia has secured more than 600 million doses, from several vaccine producers. On 11 January, the Food and Drug Monitoring Agency (BPOM) issued an emergency use authorisation for Sinovac Biotech's CoronaVac vaccine after interim results of its late-stage trials showed an efficacy rate of 65%. This made Indonesia the first country outside China to approve the vaccine. The efficacy rate is lower than the 91% and 78%, respectively, reported in Turkey and Brazil. The free vaccination programme aims at covering 181.5 million citizens (⅔ of the official population) to achieve herd immunity. Rollout began on 13 January 2021 when President Joko "Jokowi" Widodo received the first shot. By end-February, more than 1.5 million people had been vaccinated, with more than 900 000 people receiving their second jab. Also in late February, one of the world’s first private vaccination schemes was authorised, to allow companies to buy vaccines and inoculate

staff and their families for free at privately-run health centres with vaccines distributed by state-owned Bio Farma.

Source: OECD, UN-OCHA and WHO.

Indonesia has achieved a remarkable growth journey over the past two decades, but its structural frailties have been laid bare by the crisis: widespread informality, insufficient human capital, persisting inequalities, insufficient tax revenues, slow budget execution, cumbersome market regulations and opacity in the allocation of public monies. Against this background, the main messages of this *Survey* are:

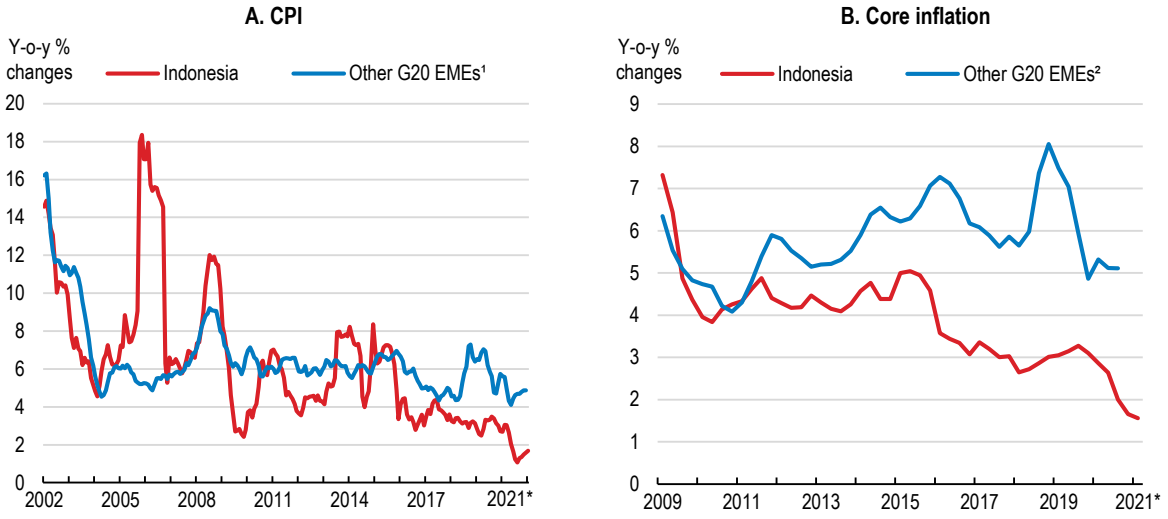
- The recovery from the 2020 recession will be gradual and subject to the evolution of the health situation. This will make it necessary to maintain government support to vulnerable households and businesses. The temporary suspension of the Constitutional limit on the fiscal deficit should be accompanied by structural reforms (such as the Omnibus Bills) that induce growth-enhancing investments. The inflation rate is low and monetary policy should remain accommodative, while the duration of the debt monetisation programme should be minimal and forward guidance provided.
- The demographic dividend that has assisted in the 2000s catch-up will soon dissipate, making it crucial to enhance human capital accumulation. Tackling pervasive informality and skills deficiencies should be a priority, through horizontal policies that simplify the business environment and sectoral policies that improve educational outcomes and the quality of vocational training. Additional efforts should be directed at promoting early childhood education, exploiting the learning opportunities of digitalisation and improving tertiary education.
- Exiting the recession, Indonesia faces the risk of experiencing a growth slowdown while still a middle-income country. State-Owned Enterprises (SOEs) play an important economic role and are meant to spearhead Indonesia's structural transformation from a low-wage to a knowledge-based economy, which is key to avoiding the middle-income trap. High standards of governance, integrity, transparency and responsible business conduct should therefore be adopted and respected. Competition should be promoted, including through regulatory simplification and regulatory certainty should be pursued to entice private and foreign investors. The fight against corruption requires the preservation of the independence of the anti-corruption commission (Komisi Pemberantasan Korupsi, KPK).

A deep contraction and a gradual recovery amid considerable uncertainty

The pandemic officially reached Indonesia on 2 March 2020, but the economic impact was felt earlier in the year, as commodity prices softened, international tourism slumped and financial markets gyrated. The introduction of containment measures brought activity to a near halt, with only one third of manufacturing firms operational in April, major investment projects suspended, household consumption in stand-by and the labour market hurting (see Chapter 2). The slow return to normalcy in the third quarter saw a timid rebound in industry and momentum built in the fourth, with the manufacturing Purchasing Managers Index recording in December the second-fastest rise in output in survey's history. Nonetheless, consumers remained very cautious and commercial activities modest. Mobility trends at transit stations proxy confidence levels: in late April 2020 they were 68% below baseline; by end-January 2021 they stood at -44% (Google LLC, 2021).

Against this backdrop, headline consumer price inflation has been exceptionally low, hitting 1.3% in August 2020 before rebounding to 1.6% in January 2021 (Figure 1.3, Panel A). The core measure of inflation, which excludes volatile foods and administered prices, has also declined over the past few years, falling well below 2%, to 1.6% in January. In both cases, the readings are lower than the average of the G20 emerging market economies.

Figure 1.3. Consumer price inflation is low



Note: 1. Other G20 Emerging Market Economies include Brazil, China, India, Mexico, Russia, South Africa and Turkey: data available up to December 2020. 2. Other G20 Emerging Market Economies include Brazil, Mexico, South Africa and Turkey: data available up to 2020 Q3. Data for Indonesia in both panels refer to January 2021.
Source: OECD Monthly Economic Indicators database.

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The recovery will be gradual (Table 1.1), with employment and income losses holding back consumption, uncertainty weighing on investment, and tourism depressed. The budget deficit more than doubled in 2020, and is expected to start falling in 2021. Bank Indonesia will maintain its accommodative stance, since inflation is under control. Forward guidance on normalisation as economic conditions improve would help. Resistance from public opinion may slow progress in social and regulatory reforms, underscoring the advantages of engaging the public at an early stage of the policy cycle. The socio-economic consequences of the recession will be dire, notably for lower middle-class groups. By end-2021 GDP is projected to be roughly 10% below its pre-crisis trend level.

Measures of financial market stress indicate a significant increase in March as panic spread through global financial markets, followed by rapid normalisation, which occurred as fast in Indonesia as in the rest of Asia and faster than in Latin America (Groen et al., 2020). However, various macroeconomic vulnerabilities have resurfaced in recent months, in particular the debt exposure of non-financial corporations (Figure 1.4). While general government gross debt, at 30% of 2019 GDP, is low relative to other emerging economies (IMF, 2020a), the share of foreign-currency-denominated debt means that when the rupiah weakens, financing costs rise. Other indicators are better oriented. The rupiah has remained stable against the US dollar in 2020 (-0.3%), but at year-end it had appreciated more than 18% with respect to the 23 March minima. Official reserve assets stood at USD 138 billion in January 2021 – slightly lower than the all-time high recorded in September, but still equivalent to 10 months of imports. The trade balance recorded a USD 2 billion surplus in 2020, reflecting compressed domestic demand and better terms of trade, while current account swung to a surplus of 0.4% of GDP in the third quarter, the widest since the first quarter of 2011. There are unexpected and/or uncontrollable events, however, which may worsen the economic outlook (Table 1.2).

Table 1.1. Macroeconomic indicators and projections

	2017 Current prices (IDR trillion)	2018	2019	2020	2021	2022
		Percentage changes, volume (2010 prices)				
Gross domestic product (GDP)	**13 589.8**	**5.2**	**5.0**	**- 2.1**	**4.9**	**5.4**
Private consumption	7 783.7	5.1	5.2	- 2.7	3.6	7.1
Government consumption	1 239.5	4.8	3.3	1.9	- 0.3	1.0
Gross fixed capital formation	4 370.6	6.7	4.5	- 4.9	2.0	6.0
Stockbuilding[1]	60.4	0.8	- 0.9	- 0.3	2.1	0.0
Total domestic demand	13 454.0	6.3	3.7	- 3.3	4.8	6.0
Exports of goods and services	2 742.1	6.5	- 0.9	- 7.7	2.0	3.9
Imports of goods and services	2 606.3	12.1	- 7.4	- 14.7	1.8	7.4
Net exports[1]	135.8	- 1.0	1.4	1.1	0.1	- 0.4
Other indicators (growth rates, unless specified)						
GDP deflator	_	3.8	1.6	- 0.5	2.0	3.0
Consumer price index	_	3.2	3.0	1.9	2.1	3.0
Current account balance (% of GDP)	_	- 3.0	- 2.7	- 0.4	0.9	0.3
General government financial balance (% of GDP)	_	- 1.6	- 2.2	- 6.5	- 5.7	- 4.1
Three-month money market rate, average	_	6.1	6.7	5.7	5.2	5.2
Ten-year government bond yield, average	_	7.4	7.5	7.0	6.3	6.3

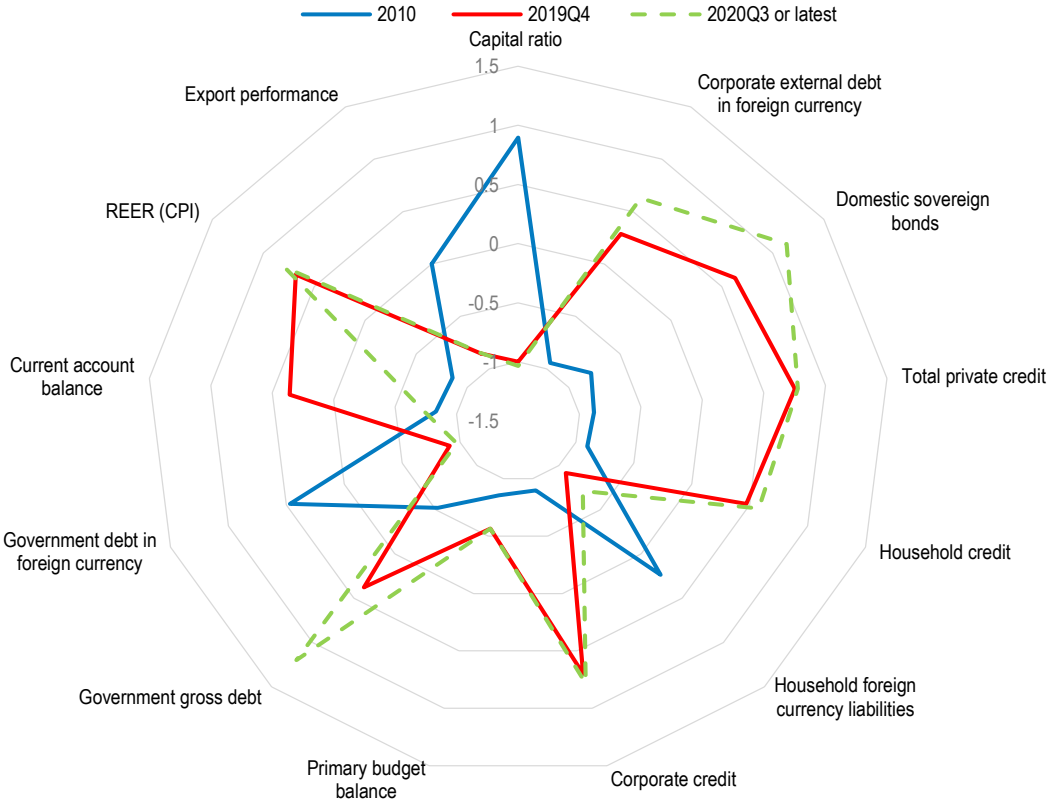
1. Contribution to changes in real GDP.
Source: OECD (2021), *OECD Economic Outlook*, No. 108 updated: Statistics and Projections (database).

Table 1.2. Events that could lead to major changes in the outlook

Shock	Possible impact
Further infectious disease outbreaks	Emerging market economies with a sizeable informal sector like Indonesia have found it difficult to cope with COVID-19 infections. A failure to curb the pandemic would put further strain on both vulnerable social groups and the health system, while a nationwide lockdown would further depress domestic demand and international tourism.
Heightened global trade and geopolitical tensions	Indonesia is integrated in Asia-Pacific supply chains through exports of raw materials and would be severely affected by a further and more pronounced slowdown in global trade. Geopolitical tensions would further exacerbate these difficulties.
International financial turmoil	Sudden capital outflows could lead to sharp currency depreciation and a tightening of monetary policy to contain inflation risks. Increases in financing costs could negatively impact consumer credit and business investment and complicate debt-servicing for firms and households. The Indonesian banking sector remains exposed to external shocks as shown in 2013 and 2018, when the price of bank shares plummeted due to a weakening currency.
Natural disasters	Indonesia is prone to natural disasters such as extreme weather, volcanic activity and earthquakes that can cause enormous economic, fiscal, ecological and humanitarian impacts. The same holds for man-made disasters, such as the 2015 forest fires.

Figure 1.4. A number of macroeconomic vulnerabilities have resurfaced

Index scale of -1 to 1 from lowest to greatest potential vulnerability, where 0 refers to long-term average



Note: Indicators are normalised to range between -1 and 1, where -1 to 0 represents deviations from long-term average resulting in less vulnerability, 0 refers to long-term average and 0 to 1 to deviations from long-term average resulting in more vulnerability. Long-term averages are calculated since 1995 or the latest year available. The indicators include: capital ratio (regulatory capital to risk-weighted assets) (inverted), debt to non-financial enterprises denominated in foreign currency (as a % of total debt), domestic rating bonds (% of total assets), total private credit (% of GDP), household credit (% of GDP), household foreign currency denominated liabilities (% of GDP), corporate credit (% of GDP), primary budget balance (% of GDP) (inverted), government gross debt (% of GDP), government debt denominated in foreign currency (% of gross government debt), current account balance (% of GDP) (inverted), real effective exchange rate (based on consumer prices), and export performance (exports of goods and services relative to export market for goods and services) (inverted).
Source: OECD calculations based on OECD Resilience database; OECD National Accounts database; Bank Indonesia; and CEIC.

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Macroeconomic policy action has been stepped up in the face of the pandemic

Faced with the economic shock imparted by the global pandemic and the sanitary measures taken to address it, the reaction of the central bank and the government has been swift and credible. In the process, authorities pushed out the boundaries of macroeconomic policymaking, using new monetary instruments and suspending some Constitutional fiscal rules on account of the exceptional circumstances. Looking further ahead, safeguarding fiscal sustainability will require enhancing the revenue base and adopting a medium-term consolidation framework, as well as promoting more efficient public spending.

Monetary and financial policy levers have been activated

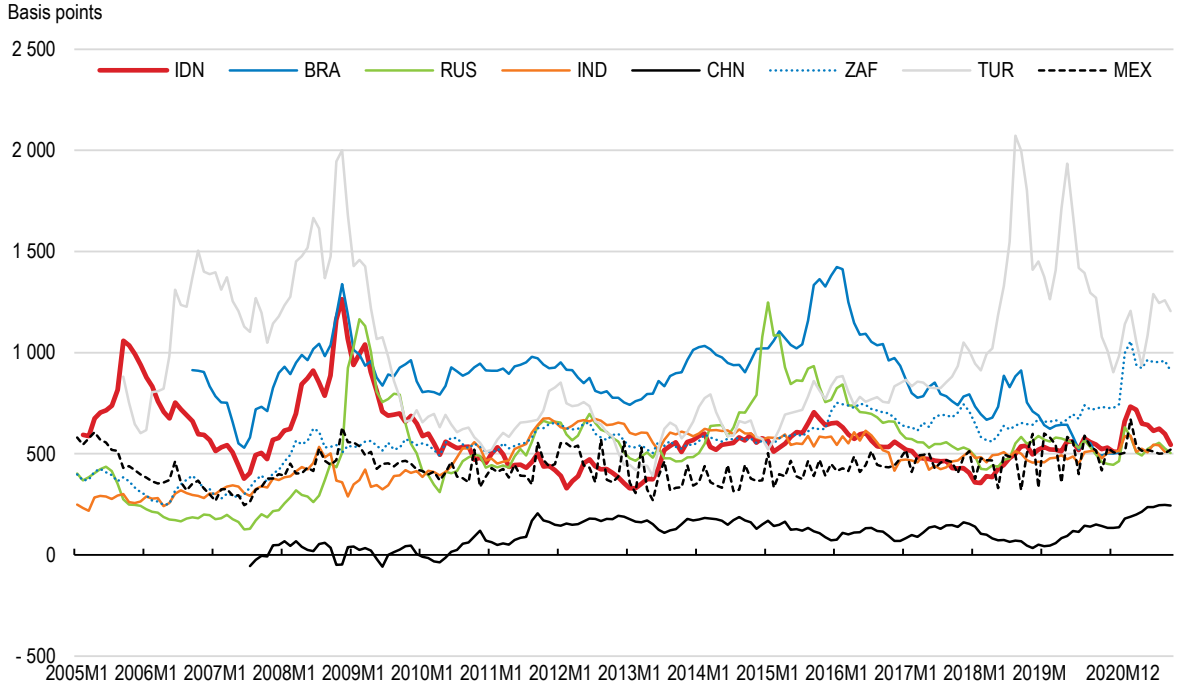
The goal of Bank Indonesia (BI), independent since 1999, is to achieve and maintain the stability of the rupiah. This, in turn, is defined as price stability and led in 2005 to the adoption of an inflation target, set for 2020 as 3% annual consumer price inflation, with a tolerance of ±1 percentage point (Perry and Solikin, 2019). BI started acting in response to the 2019 growth deceleration and then more massively to counter

the economic damage of COVID-19. BI cut the main interest rate (7-day reverse repo rate) in ten 25-basis-point steps, from 6% in June 2019 to a new record low of 3.50% in February 2021. In addition, it began quantitative easing in May 2019, providing banks and corporates a term-repo mechanism, and cut the minimum reserve requirements for both conventional and Sharia commercial banks. Liquidity is also regulated through changes in technical definitions, such as broadening the macroprudential intermediation ratio, which regulates banks' loan-to-deposit ratio. Another tool is the macroprudential liquidity buffer, which can be used as collateral for repo transactions with Bank Indonesia in the event that the bank requires additional liquidity. In addition, BI has maintained the supportive loan-to-value (LTV) regulation introduced in 2019 and eased LTV terms for environmental-friendly vehicles. Mandatory hedging requirements mitigate risks for corporations holding foreign debt. Lastly, OJK introduced credit restructuring measures to mitigate the impact of the pandemic on the banking industry, which it has extended until March 2022.

Indonesia also benefited from international cooperation at the height of the global financial turmoil in March-April 2020, signing or renewing bilateral currency swap arrangements with the People's Bank of China (CNY 200 billion, equivalent to USD 30 billion), the Bank of Japan (USD 22.8 billion), the Reserve Bank of Australia (USD 10 billion), the Monetary Authority of Singapore (USD 10 billion), and the Bank of Korea (KRW 10.7 trillion, equivalent to USD 8.2 billion). In addition, BI agreed on a repo-line with the US Federal Reserve (USD 60 billion), International borrowing costs remain high compared with other G20 emerging economies (Figure 1.5), but have receded since March and rating agencies have confirmed the country's lower-medium investment grade. In April, Indonesia placed a USD 4.3 billion 'pandemic bond' with a 50-year tranche, the longest-dated dollar debt ever issued by an Asian nation. By end-2020, Indonesia had raised up to USD 15.5 billion in the first round of funding for the Nusantara Investment Authority, its new sovereign wealth fund (Box 1.4), and was ready to launch a second round. Indonesia would seed the entity with up to USD 6 billion, while the US International Development Finance Corporation and the Japan Bank for International Cooperation would invest USD 2 billion and USD 4 billion, respectively.

Figure 1.5. The sovereign risk premium has decreased since March 2020 but remains high

Spread of 10-year government USD-denominated bond yields vis-à-vis the US Treasury instrument



Source: OECD Main Economic Indicators database.

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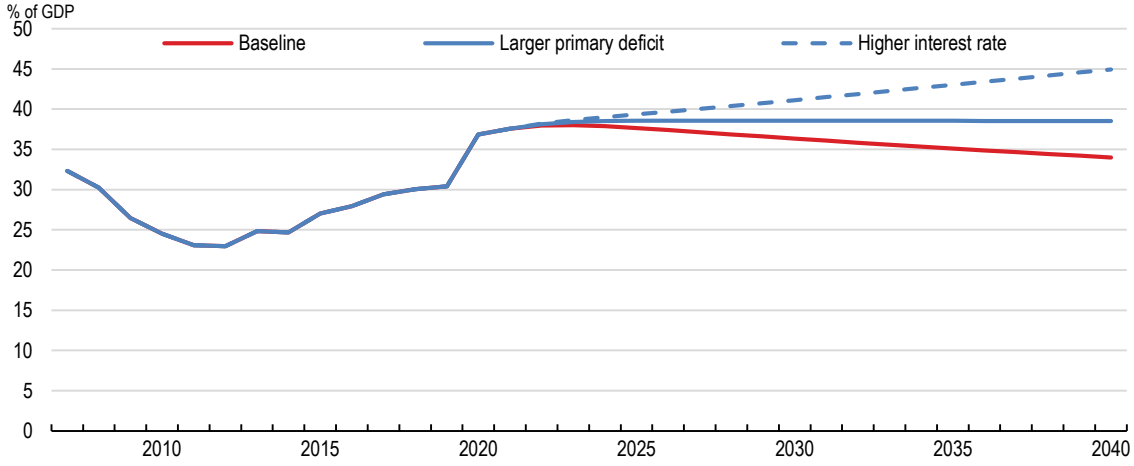
In the context of the National Economic Recovery programme (PEN), BI has been authorised to directly buy tradable government securities (SBN) at primary auctions, in addition to purchases on the secondary market. The central bank pledged to buy IDR 397.5 trillion in bonds at a coupon rate corresponding to its benchmark interest rate and then return the yield to the government in full on the day it is paid. Four principles guide BI's purchases of government bonds in the primary market: prioritising market mechanisms, buying tradable and marketable securities, taking into account measurable impacts on inflation, and intervening as a non-competitive bidder and "as a last resort". BI holdings of government bonds grew 150% between February and July 2020, its share of total outstanding SBN more than doubling from 4% to 9% and then declining. This action to monetise government debt is similar to actions taken by other independent central banks during the crisis. However, it could lead to higher inflation in the future and makes it crucial to preserve BI independence. Against this backdrop, a parliamentary proposal to allow cabinet members to vote at the Bank's monthly meetings to set interest rates and to set up a monetary policy council with government participation raised concerns. The proposal was eventually dropped from the list of 2021 priority legislation, but the experience of countries where central bank independence has been challenged, such as Argentina and Lebanon, shows the importance of managing communication on sensitive institutional issues.

The 2020-21 fiscal expansion pushes up the public debt ratio but, assuming the deficit reverts gradually to its pre-crisis levels by 2023, as mandated by the May 2020 law, the debt ratio would peak at 38% of GDP in 2023 (Figure 1.6). Thereafter, the public debt ratio would slowly return to the pre-crisis level, provided that the deficit remains under control and the interest rate is stable.

Figure 1.6. Debt will rise in the aftermath of COVID-19, but remain sustainable

General government debt



Note: In all scenarios, GDP growth and inflation are in line with OECD Economic Outlook projections to 2021. The baseline scenario assumes constant GDP growth of 5.1% and inflation (in the GDP deflator) of 3% from 2022. The primary budget deficit is 0.5% from 2022. The effective interest rate is converging to 6% from 2022. The "larger primary deficit" is an alternative scenario that assumes a primary deficit of 0.8% of GDP from 2022 onwards. In the "higher interest rate" scenario, the effective interest rate is assumed to rise by 150 basis points by 2023.
Source: *OECD Economic Outlook*, No. 108; IMF, *World Economic Outlook database*; and OECD calculations.

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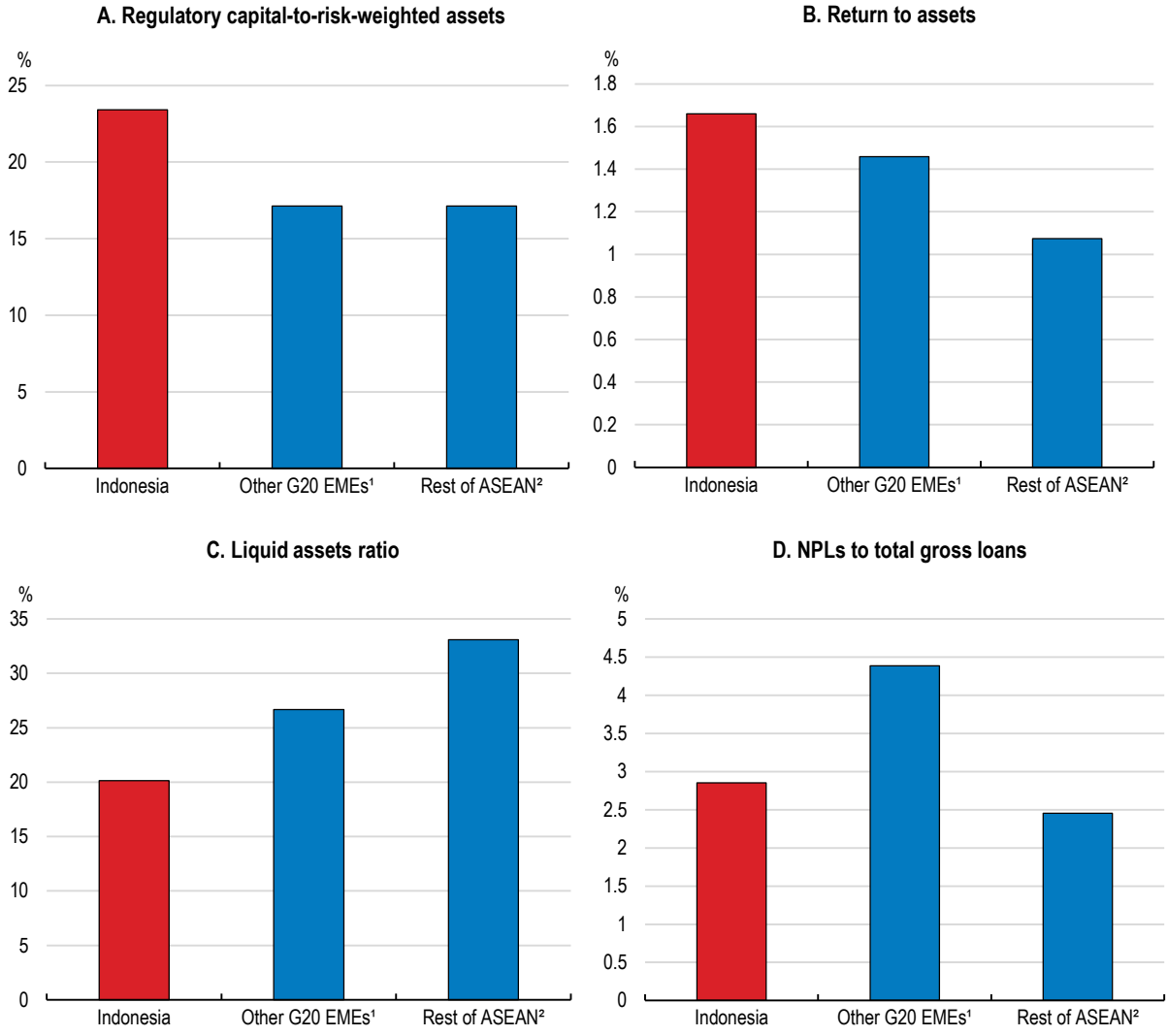
Banks' soundness indicators, such as capital adequacy, liquidity and profitability levels, have remained stable in the first half of 2020 (Figure 1.7). Another metric, the gross share of non-performing loans, inched up from 2.3% at 2018 to 3.2% in November 2020. Stress tests carried out by the Indonesia Deposit Insurance Corporation (LPS) in April 2020 produced reassuring results, despite a still-sizeable share of

foreign-denominated debt in portfolios (LPS, 2020). The authorities rightly encourage bank consolidation, notably by easing the "single-presence" policy, whereby a single investor cannot have a controlling interest in more than one bank, and enabling a larger bank to acquire a controlling interest in a smaller bank, with no obligation to buy out minority investors. In order to ensure financial system stability is maintained through both macro- and microprudential supervision, Bank Indonesia and OJK (the Financial Services Authority) have established the integrated banking supervision forum (now expanded to include LPS).

Figure 1.7. The financial sector is profitable and the authorities consider it well capitalised

2020-Q3 or latest



Note: 1. Values for other G20 EMEs refer simple average of Argentina, Brazil, China, India, Mexico, Russia, Saudi Arabia, South Africa and Turkey in all panels. 2. Values for rest of ASEAN refer to simple average of Brunei Darussalam, Cambodia, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam in all panels.
Source: IMF Financial Soundness Indicators.

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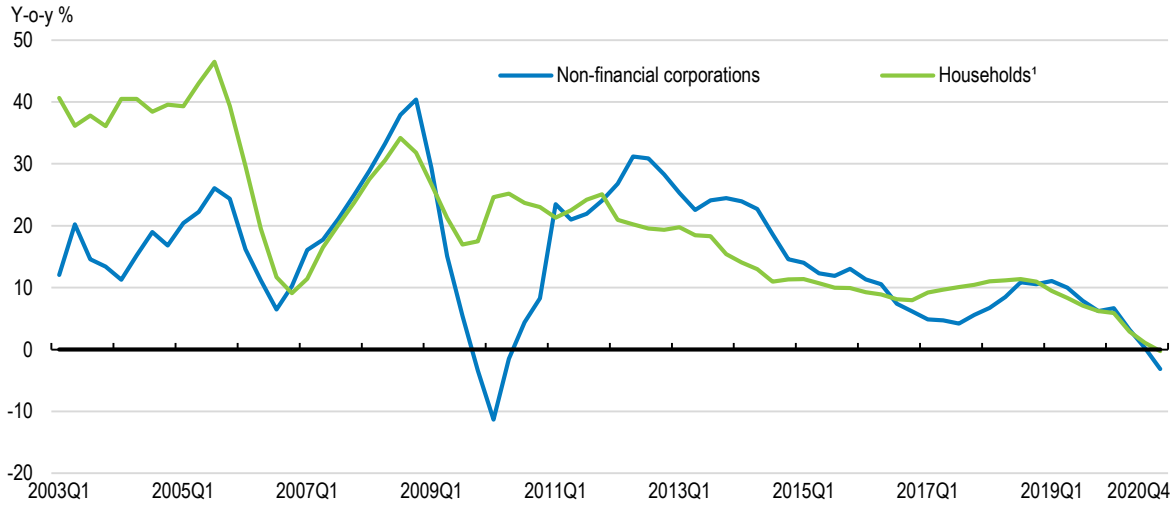
Despite looser monetary policy, bank credit expansion almost halved in 2019 (Figure 1.8), signalling a persistently suboptimal transmission from money market to bank interest rates (OECD, 2018). The COVID-19 recession is further slowing credit growth, as lenders increasingly worry about borrowers' risk profile

(Bank Indonesia, 2020a and 2020b). In the medium term, greater availability of consumer credit bureau information would facilitate the resumption of lending.

Figure 1.8. Credit growth to the real sector has weakened from very high levels



Note: 1. Household credit refers to consumption loans in the CEIC database.
Source: CEIC.

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Financial inclusion remains challenging. Comparable global data show that less than half of the adult population has a bank account, versus around 70% in Malaysia and Thailand (World Bank, 2018c), although a survey by the Indonesian National Council for Financial Inclusion suggests a dramatic increase from 35% in 2016 to 56% in 2018. Fintech offers the opportunity to reach customers via mobile phones – indeed, having a mobile money account is the single indicator where Indonesia leads the rest of the region, although penetration remains as low as 3.1%. A different model is *Laku Pandai* (or 'Smart Practice'), launched by OJK in 2015 to promote branchless banking throughout rural Indonesia. It relies on existing bank customers, offline retail merchants, or kiosks to offer basic financial products. By mid-2020, 31 banks and financial institutions were participating, the number of agents exceeded 1 million, and the number of accounts was more than 27 million. There have been some downsides to fintech development, as predatory online money lenders have emerged (ADB, 2020). Full realisation of the promises of technology for financial inclusion requires promoting financial literacy and protecting consumers (OECD, 2020g). In the most recent PISA assessment of financial literacy, Indonesia trails well behind other emerging economies (OECD, 2020h). The National Strategy for Economic and Financial Inclusion rests on three pillars: economic empowerment, finance access and literacy, and policy harmonisation. The Indian experience shows how the institutional and educational framework has been adapted in a similar context to make progress on this front (Box 1.2).

Box 1.2. Implementing effective financial literacy policies: the case of India

India has sought to improve financial sector soundness, making it more competitive and inclusive while supporting business investment. Non-banking financial companies (NBFCs) have played an increasing role while public banks' market share in total credit has declined by about 10 percentage points from 2012-18. NBFCs tend to serve borrowers often excluded from the formal banking sector in the form of

small personal loans or innovative financial services to small enterprises. They are also competing with banks in some areas, including financing infrastructure and housing projects.

Financial literacy is a significant challenge, as only 24% of the adult population is financially literate, the lowest incidence among major emerging economies. Inter-state disparities are also wide, with rates ranging between 36% in Kerala and 4% in Chhattisgarh. Under the aegis of the Prime Minister's People Money Scheme, launched in 2014, financial inclusion efforts involve incentivising and regulating financial services providers to sell financial services responsibly, reducing the number of scams and promoting financial literacy. In particular, members of self-help groups, who are mostly women, face a risk of over-borrowing and should first learn about budgeting and planning, as a way of focusing on the longer term and learning how to repay their loans.

The Reserve Bank of India (RBI) acknowledges the key role of financial education in supporting the demand side of its financial inclusion strategy and the need for effective implementation of financial education policies in the context of the changing socio-economic and technological landscape. The RBI started developing financial education material in the early 2010s and currently develops the content, translates it into local languages and trains the trainers on the basis of the OECD/INFE core competencies for adults.

Other government bodies are also contributing. The Securities and Exchange Board of India (SEBI) implements initiatives such mass media education on Ponzi schemes, and activities training for resource persons including retired teachers. Tailor-made financial literacy programmes for farmers have also been initiated. The Pension Fund Regulatory & Development Authority (PFRDA) and the Insurance Regulatory and Development Authority (IRDA) are also active, including a two-year IRDA pilot project in the state of Tripura to create awareness programmes. The involvement of IRDA and PFRDA is particularly important insofar as few people in India are aware of the need for risk protection and pensions are not a priority.

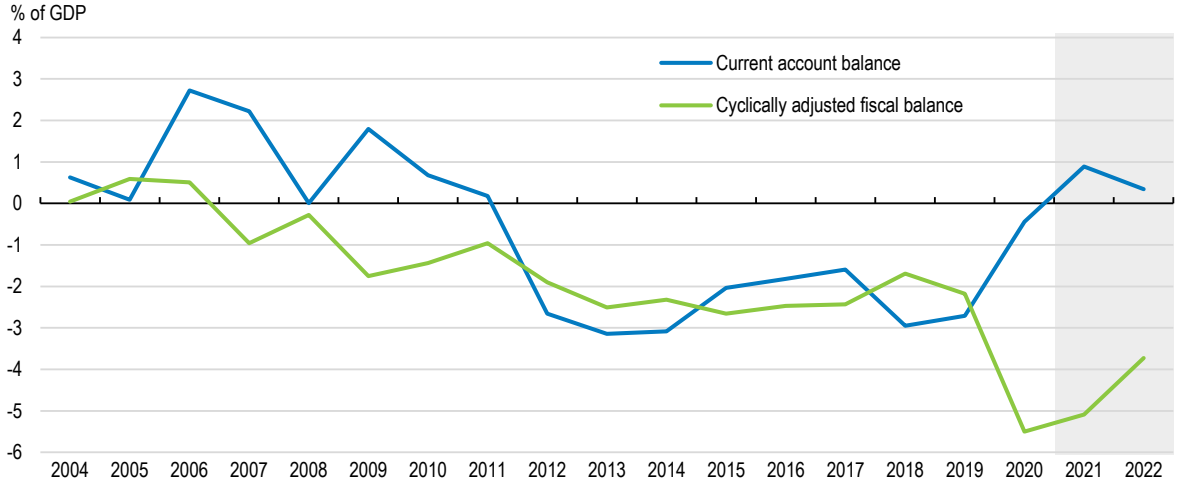
RBI, SEBI, IRDA and PFRDA have jointly set up the National Centre for Financial Education (NCFE) and work in close co-ordination, thus making it easier to identify and share best practices to deliver financial education in a cost-effective way. One is the benefit, in a complex country like India, of relying on regulated providers for implementation and of identifying key target groups, such as farmers, MSMEs, self-help groups (which are mainly composed of women), school children and the elderly. Digital channels are also proving crucial in teaching basic financial notions, creating materials in an icon-based way, which does not require high levels of literacy, and conducting awareness and education campaigns across the country.

Source: *Summary Record of the OECD-RBI High-level Global Symposium Implementing effective financial literacy policies in a changing financial landscape*, New Delhi, 8-9 November 2017; and OECD (2019d).

In the face of various risks, fiscal policy settings have long been prudent

Since 2002, fiscal policy has been run within the space of constitutionally-mandated caps on the deficit (3% of GDP) and public debt (60% of GDP). Fiscal policy loosened somewhat in the mid-to-late 2010s, but overall prudence has prevailed (Figure 1.9). Indonesia's credibility in international markets has improved, notwithstanding a persistent current account deficit funded mainly by debt, rather than more stable FDI.

Figure 1.9. Fiscal and current account deficits



Source: OECD Economic Outlook, No. 108 updated; IMF, World Economic Outlook database.

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The COVID-19 shock prompted fiscal intervention, with disbursements gathering momentum

The government has prioritised strengthening the health system, widening the social safety net and succouring business. Interventions have come in steps (Annex Table 1), notably Perppu (Government Regulation in Lieu of Law) 1/2020 (31 March), Law 2/2020 (16 May) and Perpres (Presidential Regulation) 72 (24 June), the first increasing the 2020 deficit to 5.1% of GDP and the third raising it further to 6.3%. Like many other governments, Indonesian authorities reckon that the virus will continue spreading until a vaccine is found and distributed or an effective treatment is developed.

The overall package – amounting to 4.3% of GDP, including quasi-fiscal measures – was relatively small compared to other G20 members (Table 1.3). Interventions to improve the health system focus on expanding testing, quarantine and treatment capacity and health protocols. Resources are directed at purchasing medicine, meeting equipment needs, and hiring additional doctors and paramedics. A second axis of emergency intervention is to support livelihoods, notably through additional resources for existing programmes (conditional cash transfer, basic food, social assistance), labour-intensive public works, wage subsidies for low-income workers, free loans for laid-off workers, and accelerated deployment of the pre-employment card. Struggling firms are helped through different instruments depending on size. Medium-, small- and micro-sized enterprises may benefit from interest subsidies and credit guarantees, as well as tax deferrals and reductions. Among the support interventions for larger firms, the most notable is the availability of fresh capital for SOEs.

Fiscal execution has initially lagged. There have been delays in aligning emergency resources with spending plans and administrative bottlenecks. To accelerate disbursement and execution, an ad hoc Policymaking Committee was set up in July. The President of Indonesia publicly and forcefully summoned Ministers to act and this resulted in tangible improvements. By January 2021, the disbursed share of PEN stimulus spending was 83% for the total allocated budget, with sectoral ratios ranging between 47% for business incentives and 100% for corporate financing. In the longer run, it is important to improve budget execution through meaningful structural interventions, such as, in particular, better data that minimises the risk of mis-targeting beneficiaries.

The 2021 budget deficit, following supplementary spending measures announced in January 2021, is expected to be 5.7% of GDP, based on government projections of GDP growth returning to its medium-term trajectory, the exchange rate strengthening and oil prices increasing. Spending is set to increase on infrastructure (by nearly 50% compared with 2020, to resume work on projects interrupted because of the coronavirus) and defence (16%, with additional procurement outlays intended to reinforce the manufacturing sector through offset agreements with vendors). After the exceptional efforts made in 2020, the allocation for health-care in the 2021 budget remains considerable, as extra resources are set aside to facilitate vaccine procurement and run the mass free vaccination campaign (see Box 1.1).

Table 1.3. Main economic stimulus measures in 2020

Area	Budget (IDR trillion)	Description
Healthcare	88	Prioritisation of procurement of medical equipment such as test kits and ventilators.
		Incentives for medical workers including doctors and nurses.
		Subsidy of Social Security Agency (BPJS Kesehatan) premium.
Social protection	204	Assistance to households in the Family Hope and Staple Food programmes.
		Doubling of the budget for the pre-employment card programme (from the initial IDR 10 trillion).
		Free electricity for 24 million customers using 450 KVa and 7 million customers using 900 KVa.
		Support for low-cost housing (IDR 1.5 trillion).
		Basic logistical support and basic needs (IDR 25 trillion).
Tax Incentives and Credit for Business	121	Income tax exemption for six months to workers in the manufacturing sector with incomes below IDR 200 million per year.
		Import tax payment deferral for six months (later extended to nine) in 19 manufacturing sectors.
		Acceleration of VAT refunds in 19 manufacturing sectors.
		Reduction of corporate income tax rate from 25% to 22%.
		Suspension of debt reimbursement for six months for micro businesses affected by COVID-19.
Stimulus for SMEs	123	Interest subsidies for microcredit (KUR), MSME financing, guarantees, and placement of funds in banks.
Stimulus for SOEs	54	Capital injections.
Support for Ministries & regional administration	106	Support for tourism sector, food security and fisheries, industrial estates, ICT development.

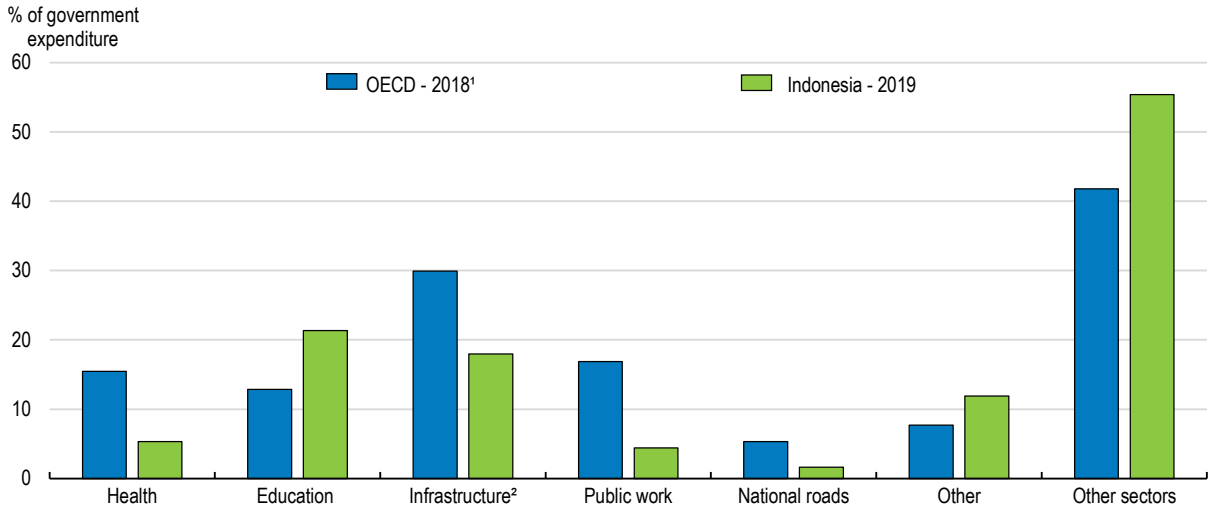
Source: Ministry of Finance.

The composition of public expenditures could be improved

General government expenditure as a share of GDP was the lowest among G20 countries in 2019. Based on budget commitments, the share of health and infrastructure therein is below the OECD average (Figure 1.10), while the opposite holds for education – though with caveats as to efficiency and equity (see below). The central government's leeway is limited by the obligation to allocate given shares of non-discretionary spending to education, health, and regional transfers, including the Village Fund and the Special Autonomy Funds for Aceh and Papua. While the priority sectors are justifiably selected for their multiplier effects, greater flexibility would allow fine-tuning of the budget and greater responsiveness to changing priorities.

Figure 1.10. Composition of budgeted public spending

Share of government expenditure



Note: 1. OECD average refers to simple average of 2018 or the most recent values of OECD countries. 2. Infrastructure in the OECD case includes economic affairs, general public services, housing and community amenities and transport.
The values per territorial category do not sum up to 100% as Public work, National roads and Other are components of Infrastructure.
Data for OECD countries refer to disbursed expenditures and follow COFOG standards, while for Indonesia data are from CEIC, refer to budgeted outlays, and have been re-classified by the OECD Secretariat.
Source: OECD Government Expenditure by Function (COFOG); and CEIC.

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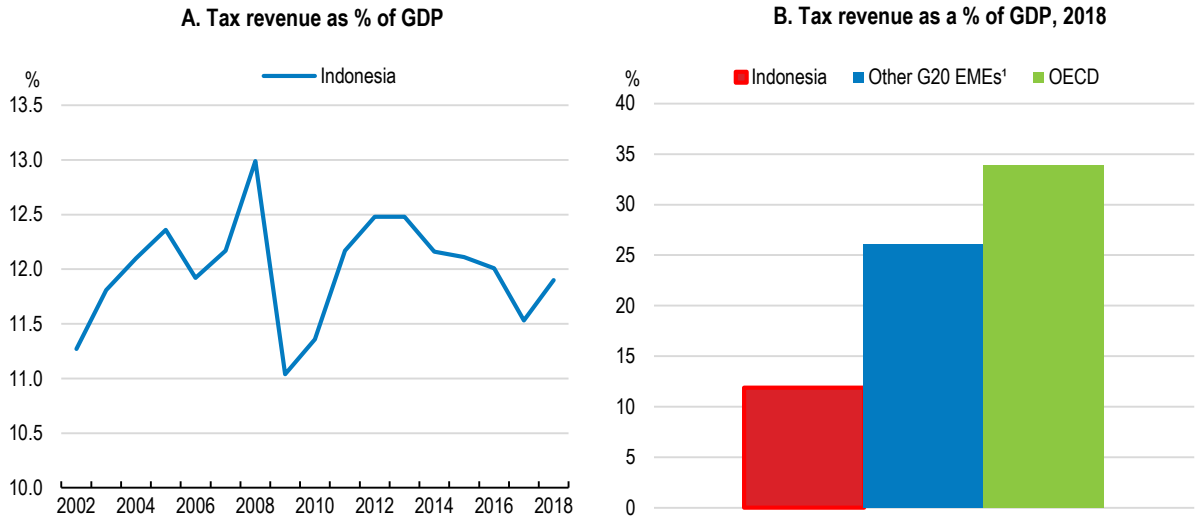
Ensuring high-quality public spending is a challenge due to several systemic constraints, including inconsistency between political directives, planning documents, and budget execution; poor data availability; weak intra-governmental organisational and information and communication technology synergies; and insufficient monitoring of outputs and outcomes. The Finance Ministry has improved the accuracy and flexibility of planning and budgeting and implemented performance-based budgeting on the basis of more comprehensive and informative documents. Looking ahead, it is crucial to reduce deviations between the Strategic Plan (*Renstra*) of the planning authority (Bappenas) and the line ministries' medium-term strategies, to improve data collection, harmonisation and standardisation, and to synchronise different financial application systems for spending units such as Bappenas' SAKTI and the Ministry of Finance's KRISNA.

A larger and more predictable revenue base is needed

Fiscal space, as well as the provision of public goods and redistribution, are limited by low tax revenues, due to low taxation levels and weak tax compliance (Figure 1.11), as documented in the 2018 *OECD Economic Survey* (OECD, 2018). Indonesia's tax-to-GDP ratio was 11.9% in 2018, far below the 34.3% OECD average (OECD, 2020a), and half as high as in G20 emerging economies. In 2018, taxes on businesses (corporate income, production, and trade) accounted for 66% of total revenue, more than twice as much as in the OECD (30%) (Figure 1.12). Property taxes contribute a meagre 2%, versus 6% OECD-wide. The government estimates that tax revenue fell 20% in 2020. Once the economy is out of recession, raising more revenue from recurrent taxes on immovable property would create relatively few distortions, address high levels of wealth inequality, and contribute to the budget of local governments (Lewis, 2019b). This requires speeding up land registration, which covers only 35% of the country, and completing it by 2025 (as per the government target). Other measures would include broadening the VAT base (by

removing exemptions and lowering the threshold for VAT registration) and increasing excise taxes (in particular on tobacco products and sugar-sweetened beverages) (*OECD Economic Survey of Indonesia*, 2018).

Figure 1.11. Tax revenue is low by OECD and G20 standards



Note: 1. Value for other G20 emerging market economies is computed as a simple average of Argentina, Brazil, Mexico, South Africa, and Turkey.
Source: OECD Global Revenue Statistics database.

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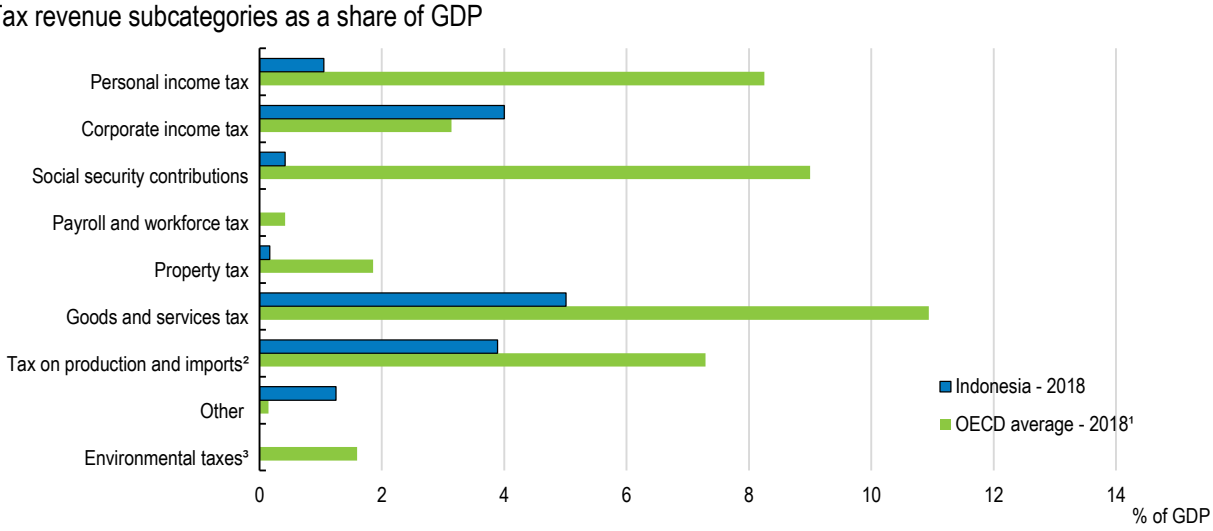
Figure 1.12. Composition of tax revenue



Note: 1. OECD average represents unweighted average of the OECD member countries that are available in the database. 2. Tax on production and imports represents a subcategory of Goods and services tax. 3. Environmental taxes cut across the classifications, and it shall not be considered as an exclusive, or belonging to any specific classification. https://www.oecd-ilibrary.org/taxation/revenue-statistics-2019_0bbc27da-en.
Source: OECD Tax Revenue Statistics, and OECD Green Growth Indicators.

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"Paying Taxes" is the World Bank's *Doing Business* sub-category where Indonesia has improved most between 2018 and 2019, gaining 31 positions in the global ranking (from 112th to 81st). The total yearly number of tax payments has decreased from 43 to 26 and it now takes 191 hours to complete the process, down from 208. Various actions have been taken since 2019 that match OECD recommendations (Table 1.4). An Omnibus Law – which amends the General Tax Provisions and Procedures Law, the Income Tax Law, the VAT Law, and the Regional Tax and Retribution Law – was presented in early 2020 and later integrated in the one on Job Creation. Various measures have been enacted : the cut in corporate income tax (CIT) rates, in particular, was passed as part of the PEN programme (Box 1.3). A 10% VAT is levied on digital or electronic purchases starting July 2020. The 2021 budget target is for total tax revenue to grow by 2.6%, but this amount would still be 7.7% lower than in 2019.

Box 1.3. Major tax reforms since 2019

Indirect taxes

- The range of services subject to 0% VAT has been expanded as of 1 April 2019.
- The excise tax on tobacco products was increased by an average of 23% in 2020 and 12.5% in 2021.
- The e-commerce purchase of foreign intangible goods and services is subject to a VAT rate of 10% as from 1 July 2020.
- A tax on plastic bags less than 75 microns thick was introduced in 2020 (IDR 30 000 per kg or IDR 200 per sheet).

Personal income taxes

- No significant changes have occurred since the enactment of the 2009 Income Tax Law other than the regular update on non-taxable income in 2012 and 2016 to accommodate inflation.

Corporate income taxes

- A flat CIT rate of 25% applied to net taxable income until fiscal year 2019. For fiscal years 2020 and 2021, the rate is set at 22%. From fiscal year 2022 onwards, the rate is set at 20%.
- From fiscal year 2020, newly-listed companies are entitled to a 3% rebate (previously 5%) off the standard CIT rate, provided they have a minimum floating of 40% of capital.

Source: OECD and PwC.

Tax efficiency in Indonesia is lower than in many G20 and ASEAN countries, due to low compliance, generous tax exemptions and widespread reduced rates. Relatively few individuals (around 7.6 million in 2019, up from 5.1 million in 2015) are subject to the personal income tax. VAT collection has declined as a share of tax revenue (from 36% in 1997 to 29% in 2018) due to exemptions and non-compliance. Improving tax collection is challenging given informality, as well as resource constraints of the Directorate General of Taxes (OECD, 2019b).

Reform options include reducing the scope of VAT exemptions, establishing a systematic approach in data collection and analysis to closely monitor taxpayer behaviour, and improving audit effectiveness by building trust between the tax authority and taxpayers (Iswahyudi, 2018). Of some success has been the experience with Medium Taxpayer Offices (MTOs), which in each region service large corporations (just 4% of corporate taxpayers), replacing a central Large Taxpayer Office in Jakarta. Assignment to an MTO more than doubled tax revenues, at a small cost (less than 1% of the increase in revenues) (Basri et al., 2019). In the case of import tax evasion, customs enforcement should be reinforced and penalties imposed also on consumers, so as to increase the risk of purchasing smuggled goods (Yubiwini and Patunru, 2018). Countries that have succeeded in enhancing trade tax collection have *inter alia* strengthened controls on

integrity, simplified customs procedures to increase effectiveness and reduce opportunities for rent-seeking, and promoted effective whistle-blower communication channels to enhance internal audits (OECD, 2017).

Table 1.4. Past recommendations related to raising revenue

Recommendations in previous *Surveys*	Action taken since the 2018 *Survey*
Tax administration and registration	
Increase investment in tax administration, particularly staff, electronic services and databases.	The Ministry of Finance (DG Taxes and DG Fiscal Balance) has signed a cooperation agreement with seven local governments in 2019 and 78 local governments in 2020 in order to optimize the collection of central and local taxes.
Establish standard procedures for public consultations on tax legislation before implementation.	The Indonesian Chamber of Commerce and Industry (Kadin) was involved in the process of preparation and public consultation of the Omnibus Bills, through a joint task force with central and regional governments, as well as academics.
Make greater use of information technology to strengthen monitoring and facilitate tax compliance. Increase use of risk-based assessment for conducting audits of all taxes.	The filing-and-paying process has been simplified through the adoption of the Online Single Submission (OSS) in 2019.
Continue to expand and improve tax expenditure estimates and publish them annually, as planned.	The 2019 Tax Expenditure Report (published in 2020) includes additional tax coverage, a new policy evaluation chapter, a chapter on incentives that are not included in the definition of tax expenditure, and improved technical calculations. The number of incentives/regulations whose cost is estimated is also higher than in the 2016-2017 Tax Expenditure Report.
Build tax capacity at sub-national government level through training and sharing of best practices.	Since 2018, DG Taxes has provided technical guidance on regional tax audits, collection of local taxes, and assessment of property tax (PBB-P2) to 2 113 local government officials.
Income taxes	
Freeze the basic tax allowance for individuals to broaden the tax base. Gradually lower thresholds for paying the top two rates of personal income tax.	The authorities consider the 2016 revision to the basic tax allowance (PTKP) appropriate under current conditions.
Include fringe benefits and employer allowances in taxable income. Reduce differences in the tax treatment of personal savings across sources.	Recent changes to the personal income tax base aim at catching income on a broader range of assets.
Shift from tax holidays towards cost-based tax incentives. Impose sunset clauses on all new tax incentives to ensure regular reviews.	To stimulate the development of large-scale infrastructure projects, the tax holiday and tax allowance incentives have been made more attractive for investors and easier to secure. A number of recent changes accelerate deductions or otherwise alleviate tax to incentivise investment.
Tighten eligibility for the turnover tax to very small firms and link registration to access to additional non-financial benefits.	Due to the pandemic, the decision of adjusting the threshold has been delayed and discussions continue with stakeholders.
Goods and services taxes	
Broaden the VAT base by removing most exemptions, especially for intermediate goods, replacing local sales tax with VAT, and lowering the threshold for compulsory registration. Compensate sub-national governments for lost sales tax revenue. Over the medium term, raise the VAT rate.	Indonesia has now moved to impose VAT on cross-border e-commerce purchase of taxable intangible goods and/or services.
Increase and harmonise tobacco excise across products	Cigarette excise taxes increased in 2020 by an average of 23%, while differences remain across products (10.9% for clove cigarettes, 13.5% for tobacco cigarettes and 7.3% for handmade cigarettes).
Link the level of motor vehicle taxes to their carbon emissions. Continue to phase out energy subsidies, then increase taxation of energy. Introduce a simple carbon tax at a low rate.	Since 2019, vehicle taxes are no longer based on engine capacity, but on fuel consumption and CO_2 emissions. Implementation will start in October 2021.
Non-tax revenues	
Finalise the One Map Initiative, and step up the fight against illegal resource extraction at all levels of government.	Completion of One Map was expected by December 2020.

Non-tax revenue includes royalties from the oil and gas sector (7.4% of 2018 revenue) (NRGI and PWYP, 2019). Indonesia has removed the USD 250 million upper limit on the value of signature bonuses when awarding a new production-sharing contract (PSC) and is now moving towards a gross split PSC model, whereby the government's share of production from a project derives from its gross revenue, rather than profits. This increases the importance of the disclosure and transparency commitments made by Indonesia as an EITI (Extractive Industry Transparency Initiative) implementing country.

The government has stepped up the fight against tax evasion and assets concealment. Indonesia has implemented the OECD's Common Reporting Standard for the automatic exchange of financial account information and now receives information on the foreign accounts held by its residents from more than 40 countries. Maximising the use of this information to enhance compliance, particularly in respect of high-net worth individuals, should be a priority. In 2017, Indonesia signed the Multilateral Instrument to implement certain tax treaty-related measures to help prevent Base Erosion and Profit Shifting (BEPS), which entered into force on 1 August 2020. Another important milestone has been the ratification in July 2020 of the Indonesia-Swiss Treaty on Mutual Legal Assistance in Criminal Matters. Further investment is required, for instance in specialised intelligence to cross-check information between the tax office and other national and foreign government agencies, to trace funds through complex financial systems, and to connect the assets discovered with the actual criminal activity. The "unexplained wealth order", which requires an individual or organisation to prove that the source of wealth is legitimate, could be introduced. Assistance from the UN/World Bank Stolen Asset Recovery Initiative would also help develop the legal framework and institutional expertise to recover assets stolen from the state.

Indonesia could gain more from globalisation

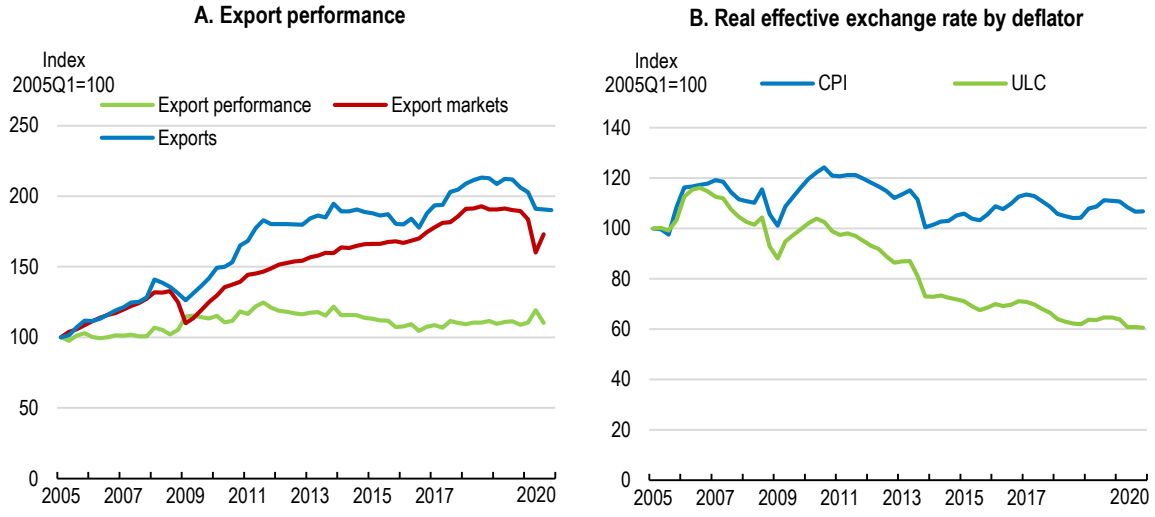
Emerging economies have by and large benefited from globalisation (Baldwin, 2016), but have not been exempted from the discussions about its limits. COVID-19 is now raising additional challenges. Commodity prices and trade volumes have fallen, while global trade and investment tensions remain high. The pandemic has highlighted the risk of single-sourcing critical components and goods, especially from China, and is leading multinationals to reassess the geography of their global production facilities (OECD, 2020e). More generally, as the resilience of value chains is tested, shortening the distance between suppliers and customers is becoming a significant competitiveness factor.

Exports are relatively low and concentrated in natural resources

Like some other large and rapidly growing emerging economies, Indonesia's trade openness (defined as the sum of exports and imports over GDP) has declined, from 59% of GDP in 2002 to 43% in 2018. Since 2005, Indonesia's export performance has mildly improved (Figure 1.13, Panel A) and its share of world merchandise exports has gone from 0.83% to 0.93% in 2018 (WTO, various years). Integration in global value chains is relatively weak and declining (ADB and IsDB, 2019), partly due to burdensome regulations, well-illustrated by the clothing industry: while competitors heavily rely on imported fabrics, raw material import restrictions apply in Indonesia.

In 2019, around 30% of Indonesia's exports and 41% of imports were with Northeast Asia (China, Japan, and Korea) (Figure 1.14, Panels A and B). China, in particular, has become the main trading partner of Indonesia and relations have been strengthening also in investment and finance. In terms of the export basket, Indonesia specialises in natural resources and labour-intensive, low-technology sectors (textile, footwear, tourism), with a slow upgrading toward medium-technology sectors (automotive, machinery, electronic equipment, information and communication services and high-end tourism) (Figure 1.14, Panels C and D). The only noticeable discontinuity between 2000 and 2016 is that coal and palm oil have replaced oil and gas as the top two export products (Breuer et al., 2018).

Figure 1.13. Export performance has been rather modest



Note: Panel A. Indicators of export performance are calculated by comparing the growth of a country's export volumes with that of its export market. This shows whether the country's exports grow faster or slower than its market, i.e. if over time it is experiencing market share gains or losses. Data for "Export performance" and "Export markets" are available until 2020 Q3.
Source: OECD National Accounts database; and OECD Monthly Economic Indicators database.

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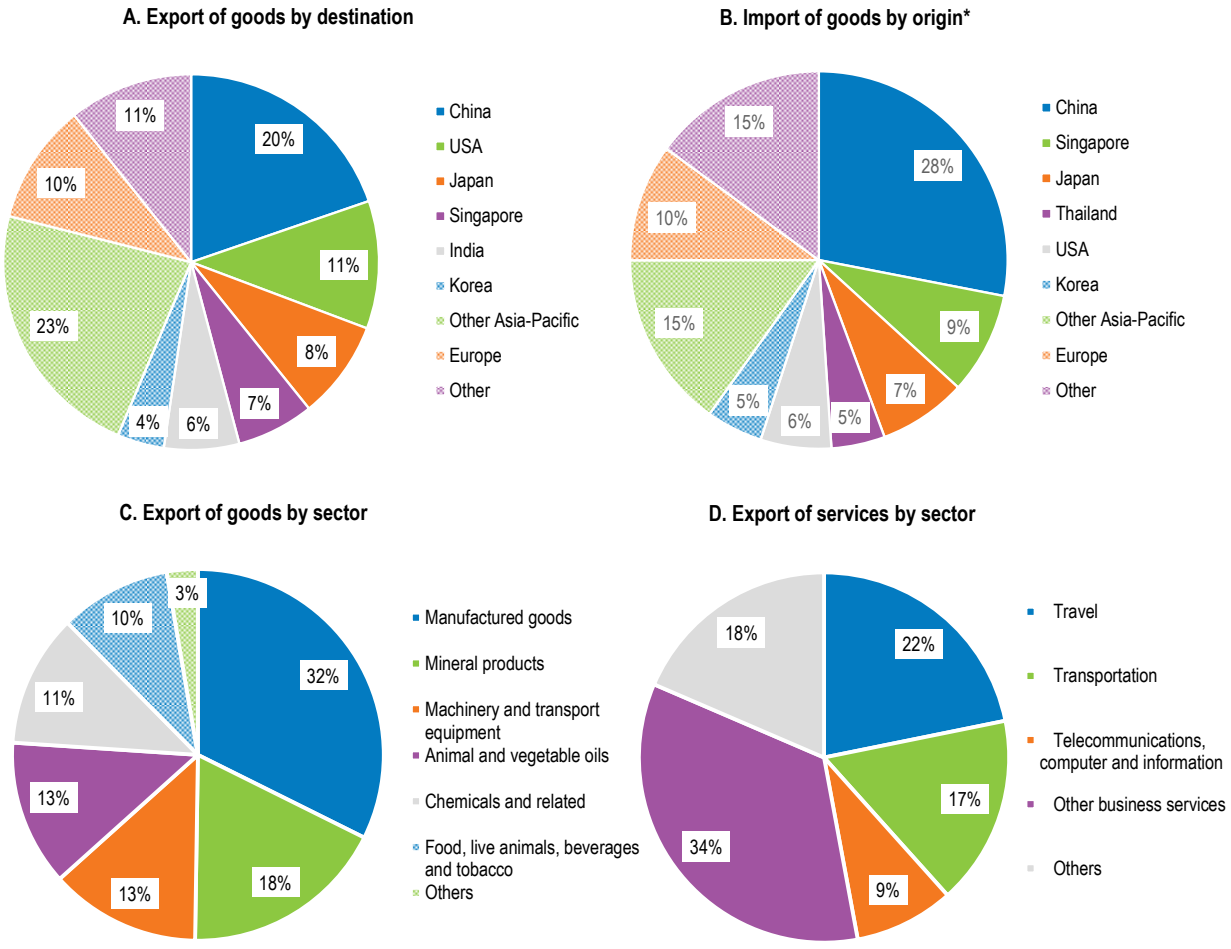
Figure 1.14. Northeast Asia is Indonesia's main trading partner

2019



Note: Panel B: Data do not include shipments to the Batam free trade area. Panel C: Other include Miscellaneous Manufactures Articles; Optical, Photographic, Musical Instruments; Works of Art, Antiques Special Provisions; Arms and Ammunition; Parts & Accessories. Panel D: Other business services include Government Goods & Services; Construction; Financial Services; Manufacturing; Maintenance & Repair; Personal, Cultural and Recreational Services; Intellectual Property; Insurance and Pension Services.
Source: CEIC; IMF Balance of Payments database.

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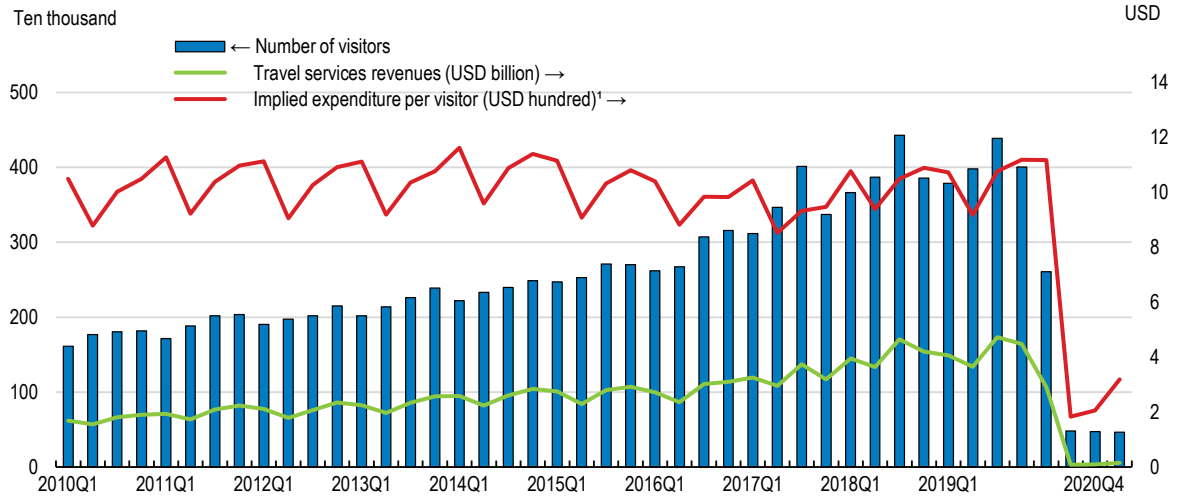
Tourism is deeply in crisis due to COVID-19

The pandemic was dramatic for the tourism industry, which in Indonesia contributes to around 4% to GDP. Tourist arrivals in January-October 2020 were 72% lower than during the same period a year earlier; with most international visitors coming from neighbouring countries (Timor Leste and Malaysia) on day trips and spending little in Indonesia, receipts were down 75% through September (UNWTO 2020). Travel corridor arrangements have been concluded with the United Arab Emirates, Korea, and Singapore. Domestic travel restrictions have been progressively eased since May, but those on international visitors have been extended (until February at the time of writing). Quarterly revenues, which in 2019 were on average around USD 4.2 billion, plunged to USD 88 million in the second quarter of 2020. Average spending per international visitor also nose-dived (Figure 1.15). The official target of increasing revenues from USD 16.9 billion in 2019 to USD 30 billion in 2024 was revised to around USD 22 billion. The sector

was among the first beneficiaries of aid, in the form of subsidies, tax cuts and accelerated cash-transfer and unemployment benefit programmes in major destinations. A second support package was announced in October. The first-order priority is to restore the international appeal of the country's traditional destinations, such as Bali and Lombok, even if this means slowing down the ambitious 10-New-Balis project. But even in this post-crisis context, past recommendations to upgrade the tourism offer and enhance the sector's development impact remain relevant (Table 1.5).

Figure 1.15. Mobility restrictions are hitting tourism hard



Note: 1. Implied expenditure per visitor is computed by dividing the travel services revenues on the number of visitors in the same time interval.
Source: Bank Indonesia; CEIC.

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Table 1.5. Past recommendations related to tourism

Recommendations in previous *Surveys*	Action taken since the 2018 *Survey*
Government planning	
Give more prominence to revenue-based targets for tourism in future plans.	Presidential Regulation No, 18/2020 on Medium-term National Development Planning 2020-24 shifts the focus of tourism development from mass to quality tourism and sets foreign exchange receipts as the main operational target for the next five years.
Better interconnect government plans across sectors, in particular ensuring coherence between tourism, transport and environment policy.	Bappenas and other ministries are preparing the Integrated Tourism Master Plan (ITMP) for six priority destinations (Lake Toba, Borobudur, Lombok, Labuan Bajo, Wakatobi, and Bromo-Tengger-Semeru). The Ministry of Tourism and the Creative Economy (MoTCE) is preparing the ITMP for Manado-Likupang, Bangka Belitung, Raja Ampat, and Morotai. Implementation will involve 17 line ministries/government agencies, SOEs, tourism authorities, local government, and the private sector. ITMPs include protocols on Environment and Social Management Framework and capacity-building activities for local government.
Incorporate expected tourism growth in all government planning, notably in the expansion of waste and water infrastructure and of broadband Internet.	Tourism nowadays is considered a priority sector for national development and all stakeholders are expected to contribute, including through implementation of the CHSE (cleanliness, health, safety, and environment) campaign.
Develop destination management plans, and establish destination management organisations in all strategic tourist areas. Adjust the size of destination areas covered by management plans to better balance management costs and local tourism linkages.	No action.
Local areas	
Incorporate needed infrastructure in forthcoming destination management plans to ensure sustainable development of tourism.	The Tourism Development Program is outlined in the Integrated Infrastructure Development for National Tourism Strategic Areas (Indonesia Tourism Development Project, ITDP). MoTCE collaborates with the World Bank to implements ITDPs in Toba Lake, Borobudur, and Lombok.
Create a small tourist tax on accommodation nights to fund local governments.	Law No. 28/2009 concerning Regional Taxes and Levies is under revision and taxes on housing rentals for tourists might be collected by local governments.
Build tourist service centres to promote local businesses, provide trusted information for tourists and offer specific services like free internet and ATMs.	MoTCE has DAK activities, including the development of a TIC (tourist information centre). The number of recipient regions has gone from 302 in 2018 to 331 in 2019.
Expand technical support to local governments on how to prepare tourism projects.	ITDP provides a framework for technical assistance.
Finalise the tourism satellite account update, and collect more detailed information at the regional level.	No action.
Labour and entrepreneurship	
Expand vocational and on-the-job training to build tourism-related skills in the workforce, especially in areas with skills shortages.	Presidential Regulation No, 18/2020 on Medium-term National Development Planning 2020-24 includes tourism among priority sectors for vocational education and training (TVET) development.
Increase interaction between high-level institutions and employers to better monitor missing skills and design appropriate curricula.	FKLPI (Forum Komunikasi Lembaga Pelatihan dan Industri) has been established to facilitate interactions between government, business and training institutions.
Further ease access to finance for female entrepreneurs.	No action.
Increase capacity building for firms by developing online applications and training, to facilitate start-ups and help them tap into foreign markets	No action.
Environment	
Increase the coverage of protected areas, and consider opening more for tourism use, but with visitor controls including regulations, and appropriate user and concession fees.	The Ministry of Environment and Forestry and other government bodies are working together to use protected areas as tourist destinations.
Take social and environmental impacts into account when selecting tourism-related infrastructure projects.	The Directorate of Nature, Culture and Man-Made Tourism refers to the MoTCE Regulation No. 14/2018 in its planning activities.

Improvements are needed to seize the opportunities of foreign investment and trade agreements

Indonesia has stepped up its economic diplomacy to gain favourable access into important markets. It is part of the Regional Comprehensive Economic Partnership (RCEP), combining ASEAN, Australia, China, Japan, Korea, and New Zealand – an area that represents 30% of the world's population and GDP and a quarter of trade flows. The RCEP, concluded in late 2019, was signed in November 2020. Moreover, the Indonesia-Australia Comprehensive Economic Partnership Agreement (CEPA) has been effective since 5 July 2020 and the CEPA with Korea was signed in December 2020, while negotiations are underway with the European Union and EFTA (European Free Trade Association). These are promising developments for Indonesian exporters and indeed for the whole economy (Petri and Plummer, 2020), but must be accompanied by public-private efforts to improve product quality, certification, branding, logistics, and the payment system, among other things.

Indonesia has made some progress with regard to the quality of infrastructure, as evidenced by the Global Competitiveness Report (WEF, various years), its ranking going from 102nd in 2007 to 70th in 2019. However, for logistics more generally Indonesia marginally slid from 43rd to 46th in the Logistics Performance Index (World Bank, various years), while road traffic casualties and sea transport incidents are the highest in Southeast Asia (WHO, 2018c; IMO, 2020). In 2014-19, the focus of public investment was on extending the road network and completing more than 50 irrigation reservoirs, mostly in peripheral regions. A massive USD 412 billion infrastructure programme is to be executed by 2024, with private investors expected to contribute for 35% of the sum through public-private partnerships (PPP). This goal requires making the PPP bidding process more transparent, enhancing the bankability of projects, setting tariffs at realistic levels that allow cost recovery, factoring in any possible contingent liabilities, and streamlining land acquisition procedures.

Opportunities and obstacles to investing and operating in Indonesia are analysed in greater depth in the recent OECD *Investment Policy Review of Indonesia* (OECD, 2020b). Restrictions on FDI remain among the highest in the G20 (Figure 1.16). Many of them could be removed without limiting policy space or jeopardising national security. The business environment is challenging and makes foreign investors cautious, depriving Indonesia of the many benefits of FDI, such as modern technologies and organisation practices, access to world markets, and better working and environment conditions. The Omnibus Bill on Job Creation, approved by Parliament in October (see Box 1.3), may improve the situation, in particular insofar as it provides for replacing the so-called negative investment list with a new and much shorter list of six sectors closed to foreign investors (controlled drugs, gambling, catching endangered fishes, harvesting of corals, manufacturing chemical weapons and industrial chemicals). The concrete realisation of this intent is conditional upon the enactment of implementation rules that fully respect the spirit of the Omnibus Law. Overlapping and complicated regulations affect export-oriented industrial parks and prolong dependence on government subsidies. The private sector should be allowed to promote and operate such parks, as their involvement produces better results than the current model of SOEs-led development. The *Investment Policy Review* also suggests to promote and enable responsible business conduct (RBC), notably in light of the heavy social impact COVID-19 has had on Indonesia's manufacturing sector. RBC standards, such as the OECD Guidelines on Multinational Enterprises, are becoming a norm in the global markets and can provide a useful framework to help stakeholders avoid making harmful unilateral decisions.

Box 1.4. The omnibus laws

In Indonesian legal parlance, omnibus laws designate laws that aim at reforming multiple laws and regulations in broad policy areas. The Omnibus Bill on Job Creation was passed by Parliament on 9 October 2020 and signed into law on 3 November.

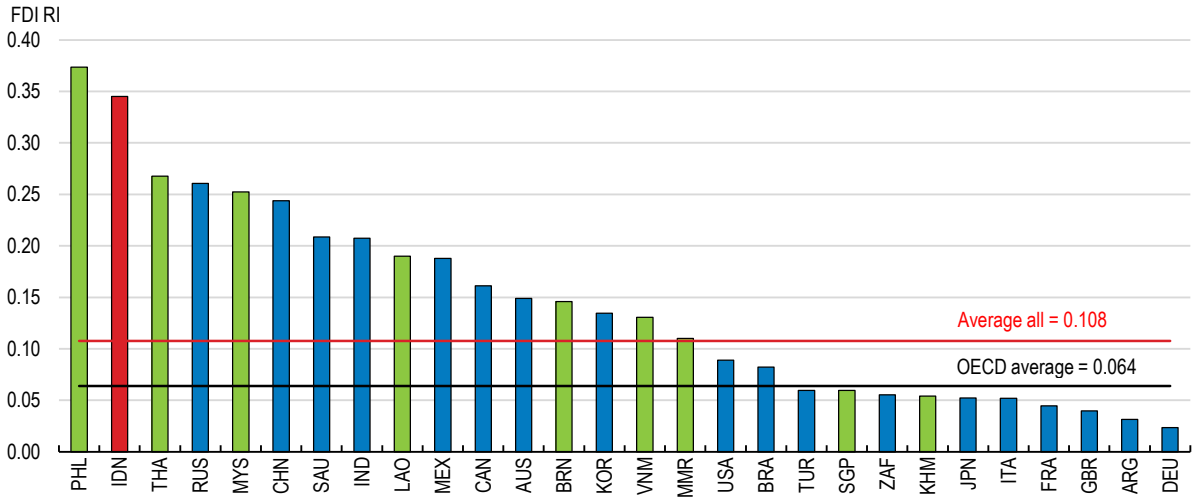
The Omnibus Bill on Job Creation, with 186 articles, amends 79 laws and eliminates thousands of regulations in ten main areas, including labour reform, ease of doing business, investment, tax, and land procurement. The main provisions include:

- Reduction of the severance payment liability to a maximum 19 months of salary (from 32);
- Addition of up to six months, covered by the government in the form of job loss insurance, that also includes access to training and job market/opportunities;
- Reformulation of the minimum wage to take into account variables such as GDP growth and/or inflation;
- Updated regulations on outsourcing and contract work;
- Establishment of a land bank that will ease management and redistribution land according to its rightful usage/owner;
- Simplification of business registration requirements to take into account the level of risk (in particular, only high-risk investments shall be subject to environmental impact studies);
- Clarification of the respective role of local (i.e. provinces and municipalities) and central governments in the processing of investment permits;
- Abolition of existing restrictions on foreign investment, except for a Negative List comprising six sectors (narcotics, gambling, chemical weapons, ozone-depleting substances, coral extraction and fishing activities for endangered species);
- Amendment of provisions of the Income Tax Law, the VAT Law and the Law on General Provisions and Guidelines on Tax.
- Creation of a sovereign wealth fund, with a view to draw in foreign entities as co-investors in infrastructure projects.

The implementing regulations are being drafted. In particular, Presidential Regulation No. 10/2021 stipulates the industries included in the priority investment list and the six prohibited sectors. Government Regulation No. 7/2021 obliges government and regional administrations to allocate 40% of their procurement budget for small businesses. Government Regulation No. 34/2021 provides easier terms regarding the employment of foreign workers.

Figure 1.16. Pervasive statutory restrictions discourage foreign direct investment

OECD FDI Regulatory Restrictiveness Index, 2019 (open = 0; closed = 1)



Note: The FDI Regulatory Restrictiveness Index (FDI Index) measures statutory restrictions on foreign direct investment in 22 economic sectors across 69 countries, including all OECD and G20 countries. Countries in blue are G20; countries in green are ASEAN.
Source: OECD the FDI Regulatory Restrictiveness Index https://www.oecd.org/investment/fdiindex.htm.

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The fruits of growth should be shared

The government is committed to reach the "No One Left Behind" goal (Box 1.5). The overall thrust of policy actions is solidly anchored in the pursuit of the Sustainable Development Goals (SDGs). Indeed, Indonesia is one of the few countries that presented twice its Voluntary National Review, a country-driven monitoring of the SDGs (Republic of Indonesia, 2019a). This inclusive policy approach has been confirmed in the COVID-19 context.

Box 1.5. Indonesia's government key goals and policy priorities

In his October 2019 inauguration speech for his second term, President Jokowi set out a number of objectives to be reached by 2045, when Indonesia will celebrate a century of independence. They include:

- Increase GDP to reach USD 7 trillion (in 2011 PPP).
- Become one of the world's five largest economies.
- Eradicate poverty.
- Escape the middle-income trap and become an advanced country.

The 2019-23 medium-term priorities include:

- Building a workforce that is hard-working, dynamic, skilled, with a mastery in science and technology.
- Continuing infrastructure construction.
- Simplifying, cutting down on and trimming all forms of obstructive regulation.
- Improving the bureaucracy and reducing drastically the number of bureaucracy echelons.

- Achieving economic transformation.

Two interrelated and interdependent development policy documents frame the process:

- The National Long-Term Development Plan 2005-25 spelling out the vision and mission for the country.
- The National Medium-Term Development Plan, with four five-year periods, starting with 2020-24 and issued through Perpres No. 18/2020.

Source: Bappenas and Sekretariat Kabinet Republik Indonesia.

Progress in poverty reduction is challenged by the recession

Different indicators show the progress made in reducing poverty. The share of the population living below the national poverty line declined from 13.3% in 2010 to 9.3% in September 2019 (Figure 1.17, Panel A). Based on the international poverty line, 5.7% of the population lived in extreme poverty (below USD 1.90 per day in 2011 PPP) in 2019 and 27.3% lived in moderate poverty (below USD 3.2) (World Bank, 2020a). Nonetheless, the pace of poverty reduction on the international metric in 2011-18 (0.3 percentage points per year) was half as high of what was achieved between 2003 and 2010 (0.6 p.p. per year). The Multi-Dimensional Poverty Index, which also takes into account non-monetary dimensions of poverty (Alkire et al., 2019), shows a quick decline in both the headcount (from more than 34 million people in 2015 to 21.5 million in 2018) and the share of the population (from 13.5% to 8.2%) in multidimensional poverty (Aidha et al., 2020). This positive result was mostly due to improvements in living standards, rather than income gains, although major gaps persist in indicators such as access to water and sanitation or reliance on cooking fuel.

The COVID-19 crisis is exposing the fragility of recent advances. A fifth of the population, their income marginally hovering above the national poverty line, is considered highly vulnerable to shocks. They mostly work in the informal sector (which accounts for three-quarters of total employment, see Chapter 2), have scant savings and assets to weather adverse economic circumstances, and are not always reached by existing social programmes. In the early phase of economic slowdown, around 1.6 million Indonesians fell into poverty in the six months to March 2020 and the poverty rate (on the domestic measure) rose to 9.8%, with the biggest increase in Java (BPS, 2000 and World Bank, 2020a). Social containment measures, the recession, labour shedding, and the freezing of most tourism activities is pushing 1 to 10 million people back into poverty in 2020 (Yusuf, 2020). Hunger and malnutrition, that were already hitting about 22 million people in 2018 (ADB and IFPRI, 2019), have further increased (World Bank, 2020b).

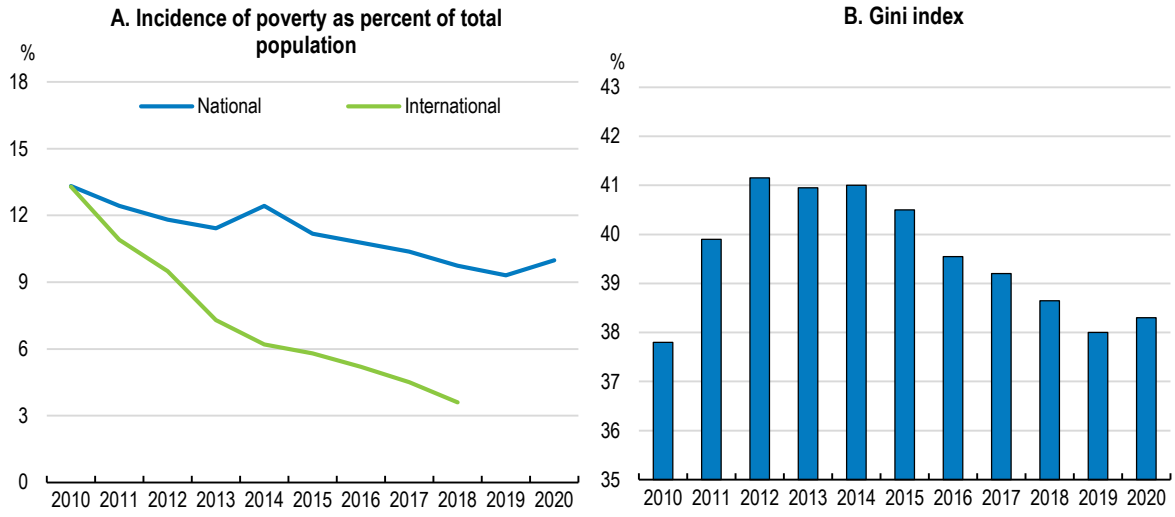
In response to the humanitarian crisis, Indonesia received official support from the Asian Development Bank (USD 2 billion) and the World Bank (USD 950 million for three projects, to some of which the Asian Infrastructure Investment Bank has been associated). Australia will provide an AUD 1.5 billion (USD 1.1 billion) loan, repayable over 15 years, to support the ADB-led COVID-19 Active Response and Expenditure Support Programme. Recognizing the crucial role that communities play in mitigating the socio-economic impacts of major shocks like the COVID-19 pandemic, the World Bank is implementing the Institutional Strengthening for Improved Village Service Delivery project, a community-driven development (CDD) operation that draws from a strong track record of moving funds quickly and flexibly in response to crises, such as the 2004 tsunami. Communities have indeed played an important role in organising the immediate response to the pandemic (Djalante et al., 2020), in some cases in parallel with group-based coping mechanisms such as the revival of seaweed farming in seaside destinations that saw tourists disappear (Al-Jaazira, 2020).

Income inequality declined since 2013 (Figure 1.17, Panel B), although it remains above the levels prevailing before the global financial crisis (World Bank, 2020a) and may well have increased again during the COVID-19 recession. While large-scale calamities historically cause labour shortages, which have a

"levelling effect" on income distribution (Scheidel, 2019), COVID-19 is likely to aggravate inequality. The pandemic has affected workers in the informal sector, increased unemployment, and depressed workers' remunerations (see Chapter 2). The crisis is also widening inequalities in access to education and health services, in particular in maternal and child health centres (*Pusyandu*).

The authorities have reacted to the social crisis, earmarking 29% of PEN resources to interventions such as basic food support, conditional cash transfers and the Village Fund. The coverage of the flagship Family Hope Programme (PKH, see OECD, 2019c) is being expanded from 6 million to 10 million families. It will be necessary to improve the programme's delivery systems and coordination with other initiatives such as the new Social Entrepreneurship programme that builds the business skills of former PHK beneficiaries.

Figure 1.17. Poverty and income inequality remain high



Note: Panel A. The national poverty line corresponds to the amount of money required to obtain 2 100 calories per day, along with a small amount for other basic non-food items. The international poverty lines is set at USD 1.90 in 2011 PPP on the basis of the poverty lines of the 15 poorest countries in 2005. Panel B. Inequality as measured by the Gini coefficient of the distribution of household consumption.
Source: BPS; World Bank, World Development Indicators.

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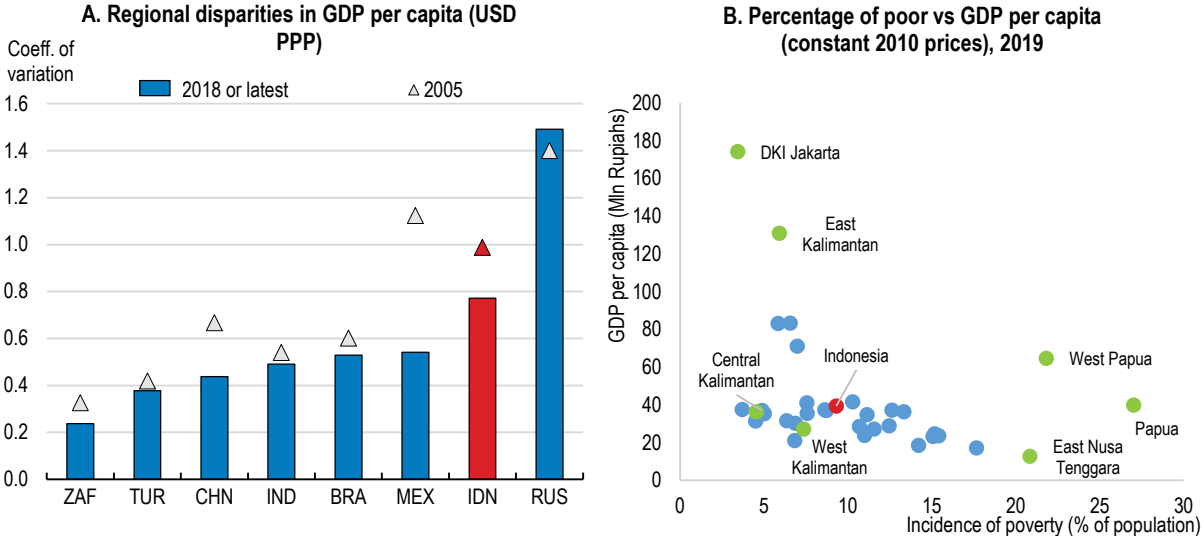
Regional disparities are considerable

Regional income disparities are higher than in most other G20 emerging market economies (Figure 1.18). The benefits of growth mostly accrue to urban areas, notably Jakarta, where GDP per capita is four times as high and the incidence of poverty five times as low as in the poorest province (East Nusa Tenggara). Inequality within locations has also increased, largely driven by disparities in human capital, insufficient housing and lack of spatial integration.

Figure 1.18. Regional disparities are high with pockets of deep poverty in the poorest provinces



Source: OECD Regional Economy database; and Statistics Indonesia.

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While metropolitan areas around the world have seen the fastest growth in the share of the middle class, in Indonesia urbanisation, compared to peer countries, has generated fewer benefits (Roberts et al., 2019). All urban areas in East Asia face heavy congestion costs, but in Indonesia the potential benefits of agglomeration in terms of productivity are not fully achieved due to low levels of infrastructure, competencies and skills.

Economic decentralisation is therefore an important policy goal, as indicated by the 26 August 2019 announcement by President Jokowi to build a new capital in Kalimantan "for the sake of realising an equitable and just economy". The move is meant to address the problems building up in Jakarta over the years: declining air quality, sinking seawalls, polluted groundwater, and heavy congestion. The Government estimated the move to cost USD 34 billion, of which 55% provided by SOEs, and to occur in 2024. Pre-COVID, this timetable seemed optimistic in view of the global experience with transferring capital cities: in Korea, for instance, the new administrative capital, Sejong, was founded in 2007, five years after the proposal was first made, and the first ministries relocated there only in 2012. In any event, the Indonesian project has been put on hold as a consequence of the pandemic.

Selected well-being indicators point to tenuous improvements that will dissipate during the recession

Over the past two decades, well-being has improved on the whole with respect to health, housing and gender balance. However, major challenges remain and the pandemic recession is adding further pressure, notably on the poor and other groups.

Life expectancy at birth increased by more than five years and a half between 2000 and 2018, to 71.3 years; according to the WHO Global Burden of Disease project, years of healthy life lost due to communicable, maternal, neonatal, and nutritional causes decreased by 58.6% (Mboi et al., 2018). On the other hand, those lost from non-communicable diseases (like ischaemic heart disease, cerebrovascular disease and diabetes) rose. Nearly 70% of adult men smoke, one of the highest rates in the world, and tobacco is held responsible for one out of seven deaths (WHO, 2018b). Dietary risks are also rising: obesity grew at the fastest rate in Asia in 2000-16, from 2.6% to 6.9% of the population (FAO, UNICEF, WFP and WHO, 2019).

The COVID-19 emergency cannot hide the prevalence of other diseases such as tuberculosis (around 1 million cases per year), HIV/AIDS (transmission rate is at an all-time high), malaria (223 468 cases in 2018), and dengue (the incidence rate has increased almost every year since the first case was detected in 1968) (Harapan et al., 2019). It is important to maintain efforts to curb these diseases, which are disproportionally affecting the poor. The most effective way to fight the pandemic without sacrificing hard-won progress in other areas is to provide differentiated, patient-centred care. Access to healthcare should be made more responsive and efficient by telemedicine, drug delivery services, and remote drug dispensing systems as well as more investment in education and prevention.

More than 30% of urban Indonesians live in precarious housing conditions (World Development Indicators). Out of approximately 64 million housing units in Indonesia, around 20% are in poor condition (World Bank, 2017). In addition to the need of renovating low-quality housing, up to 1 million new units are needed each year to respond to pressure from population growth, new household formation and internal migration.

The 2011 housing law requires at least 20% of newly-built apartments to be affordable, whereas the *Satu Juta Rumah* (One Million Homes) programme was launched in 2015 to build 1 million houses per year. Unfortunately, vacancy rates are high, since subsidised housing is disproportionally found in rural areas, far from employment opportunities, and is of poor quality (van Doorn et al., 2020). Since August 2019, financial institutions can offer mortgages to first-time buyers without taking a down-payment. BI also eased the rule that forbade banks from lending to build houses for which construction had already begun. A combination of regulatory requirements and incentives could be used to promote the construction of higher-density, resource-efficient houses.

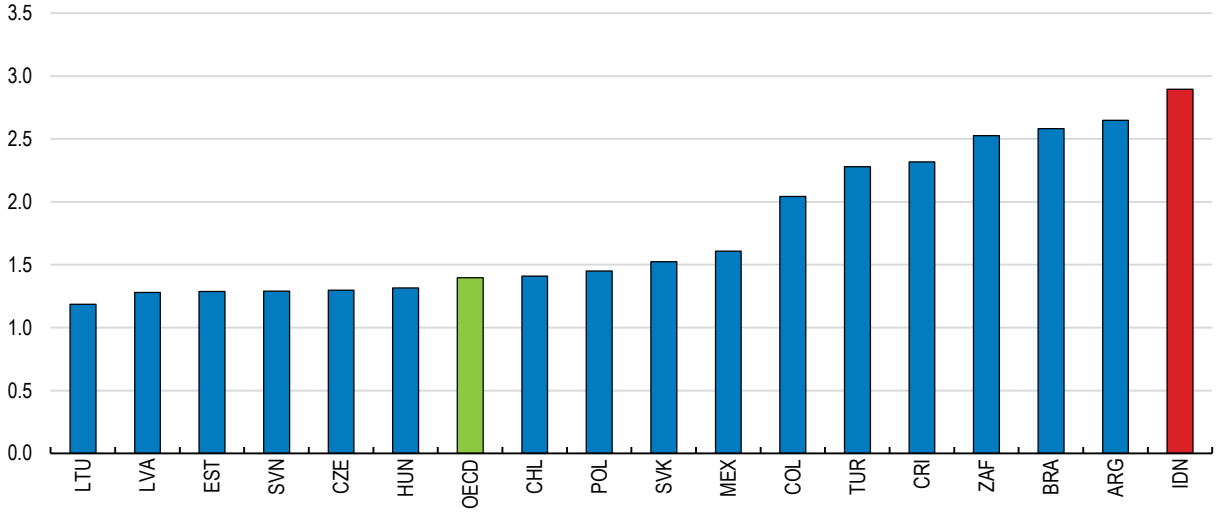
Indicators of gender balance point to strident gaps in opportunities and outcomes – Indonesia ranks 85th out of 153 countries in the *Global Gender Gap Report* (WEF, 2019). Women are disproportionally affected by the current crisis, with extra burden of unpaid work (including care-giving), massive layoffs in female-dominated service sectors, such as retail and tourism, and light manufacturing, such as clothing. When restrictions ease, female commuters are also more exposed to the risk of infection because they are more frequent users of public transports than men; in addition, poor women have less access to hospitals and are more likely to visit community health centres (Setyonaluri and Samudra, 2020). Better employment and career progression opportunities for women should be promoted, especially through actions that generate benefits that are not necessarily gender-specific such as enhancing childcare quality, supporting better work-life balance, and facilitating return to work after career breaks. During the COVID-19 confinement and the recession, an increase in reports of domestic violence has been recorded (Komnas Perempuan, 2020). Developing a culture of gender equality is important to fight abuse and efforts to move forward with the bill on sexual violence that has been in the making since 2015 should be stepped up.

Regulatory barriers are high and State-owned enterprises ought to lead by example

The 2018 OECD Product Market Regulation (PMR) indicators show that Indonesia maintains very high barriers to firm entry and competition (Figure 1.19). For most dimensions of state involvement and business operations, Indonesia is either the least competition-friendly country or close to it (Figure 1.20). In particular, retail price controls and command and control regulation (i.e. coercive rather than incentive-based regulation or reliance on markets) in both network and service sectors are used more extensively, while the public procurement framework is less competition-friendly. The exception is the administrative burden on start-ups – which is light and has supported the emergence of a vibrant business scene (World Bank and IFC, 2019), notably in ride-hailing. With no significant risk to consumers, it would be possible to shift the burden of proof from the regulated to the regulator – as in Korea, where around 2 000 regulations were found to be unnecessary (OECD, 2020d).

Figure 1.19. Indonesia has very strict regulations on product markets

Product Market Regulation indicator for OECD and selected G20 emerging market economies, 2018



Note: OECD average refers to the simple average of 37 OECD member countries.
Source: OECD Product Market Regulation database.

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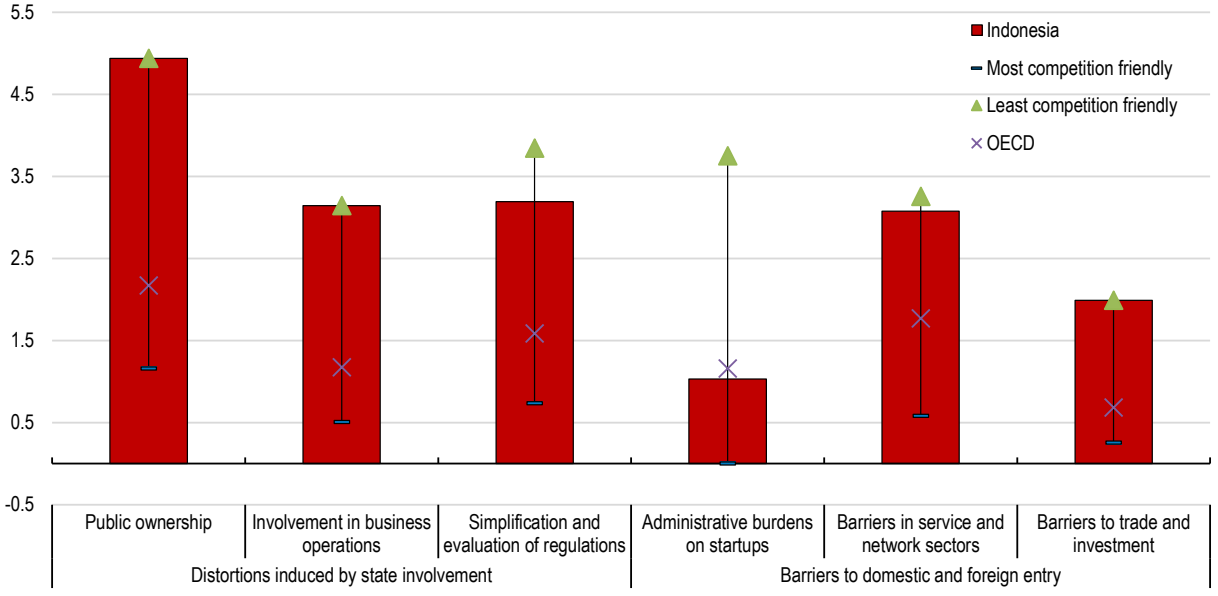
Figure 1.20. Indonesia's regulatory barriers to competition are very high

Index scale 0 to 6 from most to least competition-friendly regulation, 2018



Note: OECD average refers to the simple average of 36 OECD member countries, excluding USA; most and least competition-friendly among all countries for which data are available.
Source: OECD Product Market Regulation database.

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State-owned enterprises are omnipresent and powerful

The vast scope of activities performed by SOEs and the market power they exercise are captured in the PMR public ownership sub-index, which is almost twice as high as the OECD average. It reflects the wide presence of SOEs across the economy, the existence of special voting rights by the government in privately owned firms, the tight constraints on the sale of government stakes in publicly-controlled firms, and a comparatively high level of government involvement in network sectors through its control of incumbent firms.

In general, SOEs dominate the industry in which they operate, and it is not unusual for the main challengers to also be SOEs. For example, in the special fuel retail sector, Pertamina's market share was 96% in 2016 (Kim, 2018), while State-owned banks account for 40% of banking assets (IMF, 2020). In infrastructure like water, toll roads, ports and airports, SOE domination is absolute. Bio Farma is the only vaccine and serum manufacturer in Indonesia. SOEs are generally exempted from antitrust policies when their market power is connected to the pursuit of national development objectives (Siswanto and Janpieter Hutajulu, 2019). This exception weakens the principle of competitive neutrality under which private businesses manage to compete with SOEs, in particular in new markets such as logistics (OECD, 2020i). Moreover, tier I SOEs (i.e. directly controlled by the government) own a vast array of direct and indirect subsidiaries – 49 in the case of Telkom, while Pertamina has subsidiaries in air transport, property development and health care. It is in the public interest to subject SOEs to standard competition law and to require SOEs to justify the business logic of unrelated diversification.

Over the past two decades, SOE rationalisation has become an important policy objective, although progress has been limited by the provisions in the 1945 Constitution (art. 33) regarding government control. After the global financial crisis, the authorities announced the intention of “rightsizing” SOEs from 139 to 25. Yet, there were 114 central government SOEs at end-2019 (although the tally is higher, at 142 plus 782 provincial SOEs, according to World Bank and IFC, 2019). Most sell-offs in the 2000s were partial, leaving the state in control of companies that account for a quarter of stock market capitalisation and creating a lingering tension between the government’s emphasis on using SOEs to promote non-market, socio-economic objectives (and resorting to subsidies and soft loans to that effect) and private investors’ focus on financial metrics.

In general, SOEs have managed to pursue their plans despite minority shareholder dissatisfaction with the shift in corporate goals towards non-financial objectives (Kim, 2019). SOEs have been assigned a prominent role in infrastructure investment and are highly leveraged (ADB, 2018). The ensuing fiscal risks are not confined to government-guaranteed loans, but include the potential need for capital injections. Minority shareholders (often foreign institutional investors) can improve financial and accounting standards and governance practices, for example in demanding transparent criteria for recruiting top managers and board members. Still, the government has sometimes delayed compensating SOEs for performing public-service obligations (Fitch Ratings, 2020) and political interferences in corporate appointments remain (Apriliyanti et al., 2020). While some progress has been achieved in the past few years, in particular with respect to managerial appointments, stricter application of global standards such as the *OECD Guidelines on Corporate Governance of SOEs* would guarantee that public resources are always and solely used in the pursuit of public goals. Banking supervisors should be particularly vigilant regarding credit quality of new loans from public banks to SOEs.

Reform is all the more necessary because the financial and operational performance of SOEs has experienced a trend deterioration in recent years (Khatri and Ikhsan, 2020), which the current crisis is further aggravating. The gross combined debt of SOEs increased to 7.3% of GDP in March 2020 from 4.7% two years earlier (Fitch Ratings, 2020). In addition, several SOEs are operating with high debt-to-equity ratios, creating contingent fiscal risks that are not adequately covered. In the PEN programme, the government has allocated IDR 318 trillion (USD 21 billion) to public enterprises through capital injections, state guarantees and other support. An additional IDR 37.38 trillion (USD 2.5 billion) in capital injections

for SOEs has been budgeted for 2021, some of which will be used to resolve the investment mismanagement scandal involving state insurer PT Asuransi Jiwasraya. These intervention follows Krakatau Steel's debt restructuring in January 2020 and the default of Perumnas, a developer of affordable housing.

The SOE Ministry intends to continue consolidating SOEs and their odd 800 subsidiaries. Following the establishment of PTPN as the holding company of 14 national plantation firms, in mid-2020 consolidation in the pharmaceutical and insurance sectors reduced the number of SOEs to 107. Going forward, the government expects to group Pertamina's subsidiaries into specialised sub-holdings and list two of them (for upstream and marketing) by 2022. Plans have also been announced to rationalise SOEs in micro-lending and sharia banking and to list Telkom's tower subsidiary. Given the potential gains from consolidation – such as reinforcing and bringing together competencies on key matters, such as financial reporting or board nomination, or avoiding extreme competition among SOEs that operate under a soft budget constrain – the strategy could be extended to other sectors. But for such efficiency gains to materialise, it is indispensable that the financial situation of individual SOEs is presented in full transparency (OECD, 2018a). Progress on the recommendations made in previous *Surveys* has been uneven (Table 1.6).

Table 1.6. Past recommendations regarding SOEs

Recommendations	Actions taken
Develop an ownership policy to guide the process of listing more SOEs.	No action.
Give clear mandates to boards, with sufficient independence to achieve them, and appoint board members in transparent nomination processes with limited political interference.	The SOEs Ministry has reinforced application of Regulation No. PER-03/MBU/02/2015 that spells out qualification requirements and dismissal procedures for SOEs' directors.
Strengthen supervision by line ministries.	No action.
Pay greater attention given to the implicit risks stemming from SOE losses and rising debt.	The SOEs Ministry has encouraged asset securitization, debt reprofiling, and stronger risk management and governance practises.

Public procurement practices can be improved

Public procurement represents a third of the budget and is essential to kick-start the recovery, provided certain conditions apply regarding transparent contracting for goods and services, as well as licensing and budget allocations. In fact, full disclosure remains somewhat elusive (OGP, 2019) and cases under this rubric dominate investigations handled by the Corruption Eradication Commission (Komisi Pemberantasan Korupsi, KPK). The costs are huge, in terms of prices paid, delivery times and project quality. Moral hazard and adverse selection are additional concerns: in a corrupt public procurement system, good companies are discouraged from bidding.

The National Public Procurement Agency (LKPP) was established in 2008 and operates under Bappenas. Despite limited resources (OECD, 2016), its record in making tender and bidding processes more transparent is largely positive. The launch of an electronic procurement system in 2009 has lowered the risk of fraud and corruption by limiting one-to-one interactions between buyers and sellers (ADB, 2016). Nonetheless, procurement remains highly vulnerable to bribe solicitation, conflicts of interest, cronyism, trading in influence and insider information, and bid-rigging. Benefits would accrue from the introduction of a number of well-tested procedures, such as the opportunity to comment on procurement-related regulations and proposed tenders, notification to losing bidders and a description of why they lost, and an independent review mechanism (Transparency International-USA and Center for International Private Enterprise, 2011).

These issues acquire renewed relevance in the context of the PEN programme. Particular caution is needed in interpreting Article 27 of Perppu 1/2020, which stipulates that any emergency expenditures be considered "economic costs to save the economy from crisis" instead of state losses (which under the Anti-

Corruption Law is one of the key elements for an action to be deemed a corruption offence). The article also grants immunity to government officials as long as they act in "good faith and according to the law". This legal concept is also used in other jurisdictions and it is generally agreed that it should be clearly and unambiguously defined.

Subsequent alleged cases of corruption by public officials responsible for COVID-19 emergency procurement have exacerbated these concerns. Procurement regulation provides for streamlined procedures, such as direct contracting and force account work, in emergency situations, which LKPP further elaborated during COVID-19 to emphasise the need for expediting urgent requests. While direct awards seem an efficient solution for procuring specific goods, services, and works, public procurement entities should take extra care: limit direct awards only to current, urgent and unforeseeable needs, ensure that there really is only one qualified supplier, and phase out emergency procedures and contracts as needs become foreseeable (OECD, 2020c).

The fight against corruption requires an independent KPK

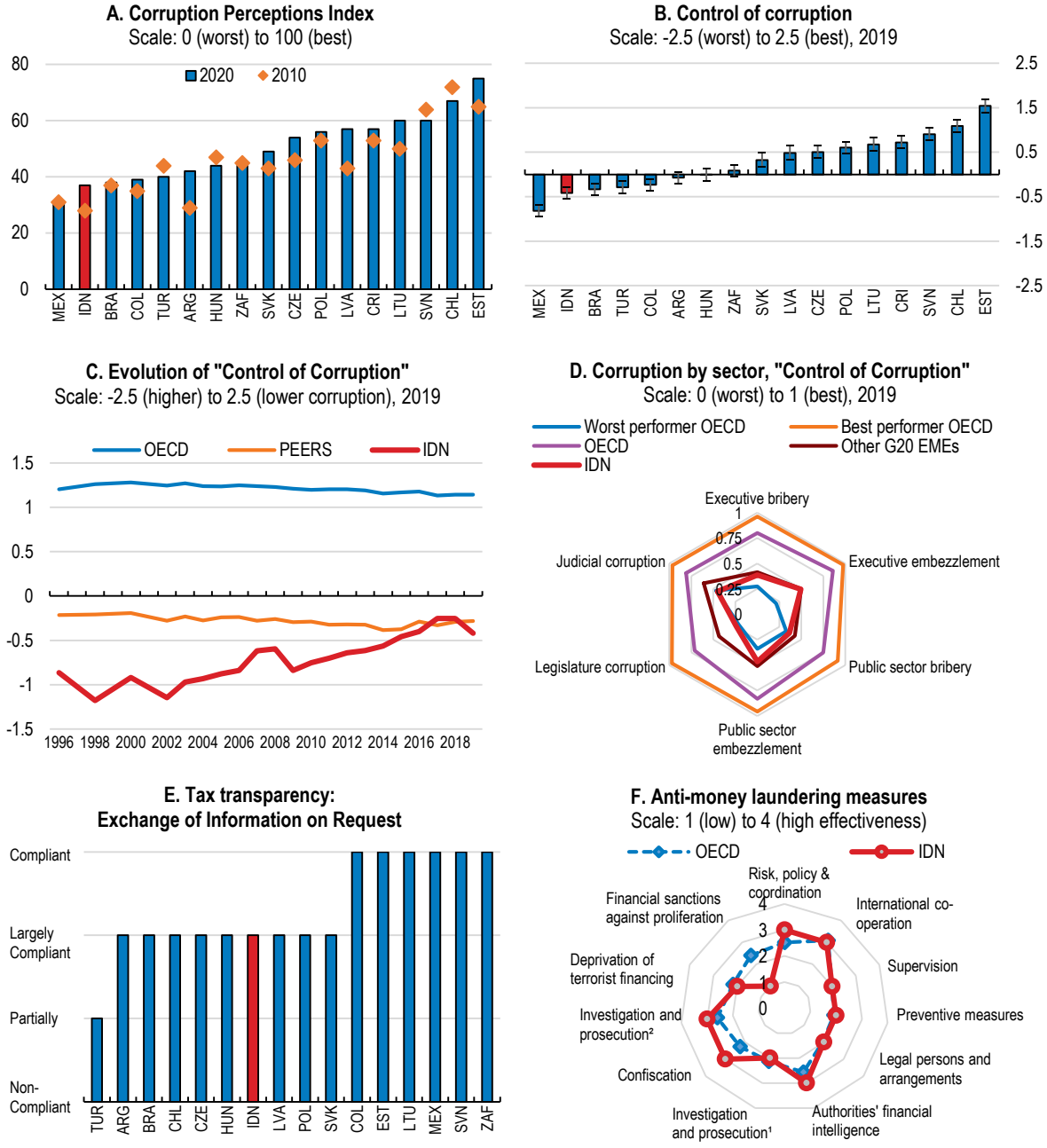
Corruption in the public sector is perceived to remain a major hurdle to development (Figure 1.21), it deters foreign investment and the COVID-19 emergency raises new challenges related to transparency and integrity (KPK, 2020). Recent governments have put great emphasis on fighting corruption and significant progress has indeed been made (Panel C). Recently, Presidential Decree No. 54/2018 outlines a national strategy to prevent corruption and some monetary incentives to report wrong-doing have been put in place by the Ministry of Law and Human Rights (Government regulation on public participation in the prevention and suppression of corruption, No. 43/2018).

The KPK was established in 2002 and has built a solid reputation after achieving an almost 100% conviction rate in its first 13 years of existence (Centre for Public Impact, 2016), before registering the first acquittal in July 2019. The entity reckons to have avoided IDR 63.8 trillion (USD 4.52 billion) in potential losses in 2016-19. At mid-2020, 274 national and regional parliamentarians, 28 Ministers, 21 Governors, and hundreds of high-ranking civil servants and managers had been successfully prosecuted. The KPK and the Anti-Corruption Court (ACC), established in 2003, have fought attempts to discredit and hobble them (Butt, 2011; OECD, 2016). A recurrent argument is that all state agencies need oversight, checks, and balances and that the KPK should be no exception.

In 2019, Parliament unanimously approved Law No. 19/2019 that transforms the KPK into an executive agency, rather than an independent authority, and places the Commission under the oversight of a supervisory board, which will authorise its most crucial activities, such as wire-tapping, searches and seizures. Subjecting the KPK to executive oversight and depriving it of law enforcement tools and prosecutorial power, as well as recruitment independence, has been criticised as a move to weaken its ability to investigate and prosecute graft. Furthermore, the establishment of 33 new ACCs, one in each provincial capital, has the potential to undermine their future efficacy (Butt, 2019). The new legislation appears to deviate from international standards (Buehler, 2019; Schütte, 2019; OECD, 2020j) and extreme care is needed to avoid making the Commission more vulnerable to pressure.

Indonesia, which ratified the UN Convention against Corruption (UNCAC) in 2006, should criminalise the bribery of foreign public officials and enact corporate liability for corruption offences as a Party to UNCAC and a G20 member. These legislative changes would address key criteria for accession to the OECD Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions (the Anti-Bribery Convention). Policies and actions to raise awareness in SOEs on business ethics, conflicts of interest, bribery and lobbying should be extended to the private sector, in particular among SMEs.

Figure 1.21. Corruption is still perceived as high



Note: Panel B shows the point estimate and the margin of error. Panel D shows sector-based subcomponents of the "Control of Corruption" indicator. Panel E summarises the overall assessment on the exchange of information in practice from peer reviews by the Global Forum on Transparency and Exchange of Information for Tax Purposes. Peer reviews assess member jurisdictions' ability to ensure the transparency of their legal entities and arrangements and to co-operate with other tax administrations in accordance with the internationally agreed standard. The figure shows the results from the second round of peer reviews. Panel F shows ratings from the FATF peer reviews of each member to assess levels of implementation of the FATF Recommendations. The ratings reflect the extent to which a country's measures are effective against 11 immediate outcomes. "Investigation and prosecution¹" refers to money laundering. "Investigation and prosecution²" refers to terrorist financing. In panels C and D, other G20 EMEs include Argentina, Brazil, China, India, Mexico, Russia, Saudi Arabia, South Africa, and Turkey.
Source: Panel A: Transparency International; Panels B & C: World Bank, Worldwide Governance Indicators; Panel D: Varieties of Democracy Institute; University of Gothenburg and University of Notre Dame; Panels E and F: OECD Secretariat's own calculation based on the materials from the Global Forum on Transparency and Exchange of Information for Tax Purposes; and OECD, Financial Action Task Force (FATF).

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The KPK and the Elections Supervisory Agency have warned about policy capture risks, as many candidates depend on private donations, and potential vote buying in regional elections, as voters suffer from financial hardship (Bawaslu and KPK, 2020). A comprehensive framework for managing conflict of interest and preventing undue influence through lobbying should set clear definitions for "lobbyists" and "lobbying" and regulate private donations to candidates, as well as the engagement of elected officials with lobbyists and other third parties who seek to influence the legislative process. It remains crucial to protect the policymaking cycle from undue influence and capture by implementing standards for integrity in lobbying and managing conflict of interest situations (OECD, 2015).

A greener post-COVID-19 Indonesia?

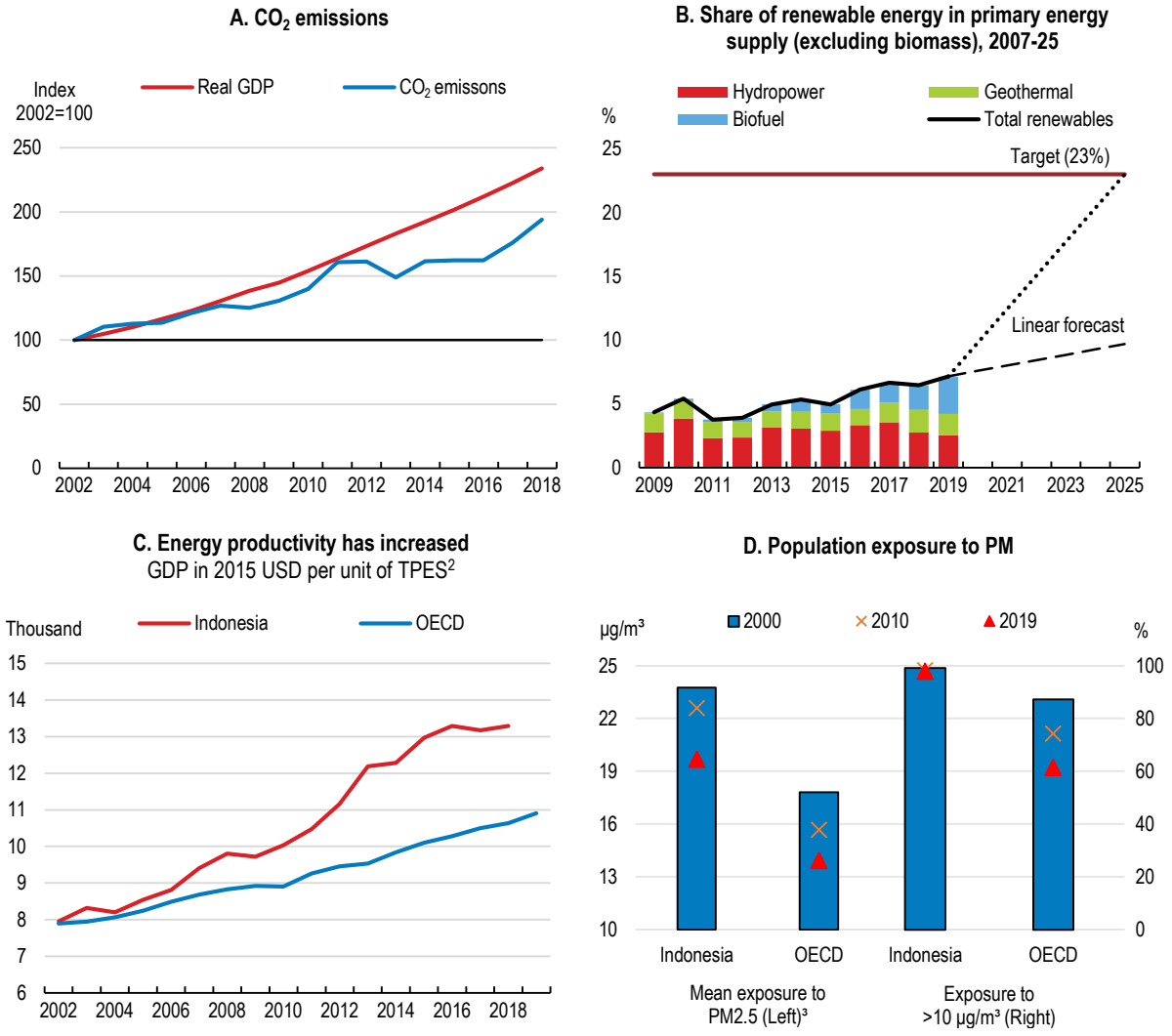
Indonesia's recent economic development, population growth and rising living standards have combined to increase demand for land, energy, water, and other natural resources, as well as to put pressure on the environment. As one of the world's largest greenhouse gas emitters, Indonesia also plays an important role in addressing climate change. While it is far too early to draw firm conclusions, available data suggest a deterioration of the environment during COVID-19. Independent estimates based on Landsat satellite imagery suggest that the forest surface lost to burning rose dramatically as budget reallocations and travel restrictions hit the agencies in charge of fire prevention and impoverished farmers and return migrants turned to illegal activities, including gold mining and logging (Margono et al., 2014 and WWF Deutschland, 2020). The pandemic has produced a surge in pollution from disposable products, which coincided with a reduction in the number of formal workers and informal waste pickers in the plastics recycling chain. On the other hand, as long as mobility restrictions were in place, greenhouse gas (GHG) emissions dropped and air quality in cities improved, although the impact was only temporary (Rossita, 2020). Indonesia is the second largest plastic polluter after China and in mid-2020 the government announced its intention to cut plastic waste by 70% by 2025, and cut it entirely by 2040 – the most ambitious national plan to tackle plastic pollution anywhere. The ban on single-use plastics was introduced in mid-2020 in Jakarta and it is too early to assess its impact.

Climate change mitigation

Progress in decoupling GHGs emissions from economic growth has been substantial (Figure 1.22, Panel A), driven by the decline of energy-intensive industries, the switch to services, and higher penetration of cleaner forms of energy sources, although it recently slowed down. Low-carbon action was streamlined in the National Medium-term Development Planning 2020-24 (OECD, 2019b). The Nationally Determined Contribution target to reduce GHG emission levels from business-as-usual by 29% by 2030 (or even 41% with international support) is ambitious (Bappenas, 2019). As in any other major economy, including ones that are much richer than Indonesia, decarbonisation is a tough challenge. Although energy productivity has increased, Indonesia remains very carbon-intensive due to high reliance on fossil fuels across all sectors and recent addition of coal-fired capacity. Despite the 2015 reform, in 2019 fossil fuel subsidies equalled 1.7% of GDP, the second-highest incidence in the G20 (IEA, 2020). In the wake of the COVID-19 crisis, low oil prices may generate further headwinds to the energy transition. Authorities should double down on efforts to move away from fuel subsidies and, considering the close link between the carbon content of fuels and the associated CO_2 emissions, increase the carbon price.

Policy coherence, government coordination and capacity building are needed to plan and implement the energy transition and gradually decarbonise the energy system – tough challenges for any country. The Asia-Pacific experience highlights the importance of strengthening coordination among ministries and establishing a stable and consistent enabling environment for the private sector (UN, 2019). Financial innovation can also make an important contribution (Box 1.6).

Figure 1.22. The transition to a greener economy could be quicker



Note: 1. Data refer to production based CO_2 emissions; 2. TPES stands for total primary energy supply; 3. Exposure to PM2.5 refers to mean population exposure to fine particulate matter that is calculated as the mean annual outdoor PM2.5 concentration weighted by population living in the area. It is the concentration level, expressed in micrograms per cubic meter (µg/m³), to which a typical resident is exposed throughout a year.

Source: OECD, Green Growth Indicators; OECD, Environmental risks and health; World Bank, World Development Indicators; IEA (2018), IEA World Energy Statistics (database); MoEMR (2020), 2019 Handbook of Energy & Economic Statistics of Indonesia.

StatLink https://stat.link/3870dk

Box 1.6. Financing Indonesia's clean energy transition

Realising Indonesia's clean energy potential will require an unprecedented scale-up in investment (estimated at USD 10-15 billion annually for renewables, see IRENA 2017) and the development of bankable pipelines of clean energy projects. Notwithstanding numerous opportunities, there are significant barriers, including lack of grid access, an unattractive tariff structure in certain areas,

concerns around the electricity system impacts of variable renewables, insufficient financial capacity among smaller project developers, and lack of access to land.

Low energy and electricity prices make the business case for investing in energy efficiency less compelling. Consumers do not have the right incentives to change behaviour, as prices do not reflect the full costs of energy. Financial innovation, such as aggregation models, is needed to overcome the small-scale challenge and high transition costs related to financing and developing energy efficiency projects.

In the financial sector, innovative financing instruments and mechanisms will also be needed to increase access to affordable capital for clean energy projects. Such efforts will need to focus on reducing transaction costs particularly for small projects. Blended finance instruments, for example, could help mobilise commercial finance in Indonesia. A de-risking instrument or guarantee could blend public funds from international financial institutions and philanthropy to leverage private capital with a potential multiplier effect of up to 10 to 20 times in some cases and help create early markets for clean energy. This would also provide the financial sector with experience and help build capacity to better appraise clean energy projects that are still perceived to be high-risk even though such technologies already are becoming the norm in other parts of the world.

In 2019, the OECD launched a multi-year engagement with the Government of Indonesia to help support the country's efforts to accelerate the development and scale-up of investments in clean energy. The OECD Clean Energy Finance and Investment Mobilisation Programme supports Indonesia to strengthen and align policy frameworks; build robust pipelines of bankable projects; and mobilise institutional investors for clean energy and sustainable infrastructure projects.

Meeting the Nationally Determined Contribution targets (and eventually adopting the zero-net emissions target in the country's Long-Term Strategy for Low-Carbon Climate Resilience) will require higher energy efficiency and development of renewable energy sources. The geography of Indonesia should facilitate the development of renewables, but their share remains modest (Figure 1.22, Panel B). The electricity buy-in tariff is the major stumbling block in attracting investors, since the regulation uses average historical accounting cost as the benchmark for determining the price at which electricity from renewables can be sold to the grid (ADB, 2020b). However, Regulation No. 4/2020 issued during the pandemic abolishes the Build-Own-Operate-Transfer scheme which obliged independent power producers (IPPs) to transfer all assets to PLN (the state-owned electricity company) at the end of the project. The possibility for IPPs to own renewable energy facilities will help to alleviate the bankability concern surrounding most such projects. Foreign equity restrictions in renewables should also be removed.

The stimulus packages designed to address the short-and medium-term socio-economic impacts of the pandemic offer an opportunity to rebuild the Indonesian economy and enhance resilience against future shocks. There is a high employment generated per dollar invested in efficiency and in general, the job creation intensity in emerging economies is higher than that of developed economies. Stimulus can be used to subsidise installations such as energy efficient lighting, cooling and motor systems and help manage project risks associated with new technologies or new business models. So far, few of the announced measures integrate environmental sustainability (OECD, 2020f). Better coordination among ministries and other government institutions would help identify priority measures that can be supported by green stimulus programmes, as well as commitments from development partners under the SDG One Fund and the BPLDH (the environment fund). In addition, it would be desirable to better align financial support to businesses with energy efficiency improvements and renewable energy installations.

Deforestation and air pollution are major environmental challenges

Deforestation (largely due to "slash and burn" clearing to cultivate palm) and the resulting peatland megafires, combined with the burning of fossil fuels for energy generation, as well as transportation and

residential buildings, make Indonesia one of the world's largest GHG emitters, the fourth in 2019 (BP, 2020). Per capita emissions exceed the world average, as well as those of China and the European Union, although they are 55% lower than in the United States (Carbon Brief, 2019). In addition, palm oil plantations have broader environmental impacts, such as destruction of endangered animal habitats, biodiversity loss, and the relocation of indigenous communities.

Indonesia contains 10% of the world's tropical rainforests and 36% of tropical peatlands. A nationwide moratorium on peatlands draining was announced in 2015 and the Peatlands Restoration Agency (BRG) was established with the goal of restoring 2.7 million hectares of tropical peatlands by 2020. Results have been encouraging (primary forest loss has decreased for three years in a row since 2017) and a three-year moratorium on new permits for palm plantations was introduced in September 2018 (OECD, 2019b). International cooperation has been important, in particular with Norway under the Reducing Emissions from Deforestation and Forest Degradation (REDD+) scheme that resulted in a USD 56 million grant to Indonesia. However, more than a quarter of the peatlands put under protection by the BRG had already been auctioned off and the government is compensating the companies concerned with a "land swap" scheme, offering access to unprotected land (Carbon Brief, 2019). The BRG mandate should be renewed beyond 2020.

Under the Omnibus Bill on Job Creation, the authority on spatial planning and management is set to move from local administrations to the central government (PWYP Indonesia, 2020). The envisaged centralisation of the issuance of the Environmental Impact Assessment document ought not weaken the evaluation of authorisation requirements, nor drop strict corporate liability for environmental damages. More generally, the natural resources sector suffers from corruption, as documented since 2009 by the KPK National Movement to Save Natural Resources. The secrecy surrounding commodity trading also makes it difficult to identify corruption risks (EITI, 2018). More transparency should be pursued with respect to both contracts and trading. Indonesia also has the sixth-highest number of "threatened" species in the list of the International Union for Conservation of Nature, and the largest number of mammals: illegal trade remains a problem and the 1990 law on natural resources conservation could be revised to introduce heavier sanctions on hunters and traders.

Air pollution

Although the right to clean air is enshrined in the 1945 Constitution (Article 28 H1), Indonesians face major environmental and health hazards caused by air pollution. Despite a slight improvement since 2000 (Panel D), the great majority of the population is exposed to fine particles above 10 micrograms per cubic metre levels, the maximum threshold recommended by the World Health Organisation (WHO, 2018a). According to the US Embassy's air monitoring stations, air quality in Jakarta was "unhealthy" or worse on 226 working days in 2019, and good on just 15 days. According to the TomTom Traffic Index 2019, Jakarta is the 10th most congested city in the world, an improvement in the ranking that is mostly due to longer commuting and traffic-related exposures in other mega-cities in the Global South. Bappenas has estimated that traffic congestion in Greater Jakarta costs around IDR 65 trillion (USD 4.6 billion) each year.

The average Indonesian can expect to lose 1.2 years of life expectancy because air quality fails to meet the WHO guideline for concentrations of fine particulate matter (PM2.5) (Greenstone and Fan, 2019). The health effects are much larger in Jakarta, where residents can expect to lose 2.3 years of life expectancy if 2016 pollution levels are sustained over their lifetime. At least 7 390 Jakartans die early every year due to high levels of PM2.5 (Koplitz et al., 2017). The yearly welfare costs of premature deaths associated with ambient particulate matter pollution amount to 3.5% of GDP (Roy and Braathen, 2017).

There has been significant progress in public transportation. The first corridor of the TransJakarta busway, now the backbone of the capital's transportation service along with the rail-based commuter line service, was opened in 2004, the first such system in Southeast Asia. City-owned PT TransJakarta operated 3 865 buses in 2018, compared with fewer than 500 in 2005, while users report a level of satisfaction in line with

international standards (Nurlukman et al., 2020). Nonetheless, public transportation only accounted for 32% of all movements in 2019, as against the Jakarta transportation masterplan target of 60% by 2029. The authorities should encourage the creation of a single clearing house to coordinate the public fare and payment systems and facilitate private investment in transit-oriented urban development. Electric vehicles, including scooters, can also contribute to improving air quality. A Presidential Regulation (No. 55/2020) was published, as recommended by the *Green Growth Policy Review* (OECD, 2019b), with modest 2025 targets (in particular, 2.1 million electric motorcycles, whereas there are already more than 18 million traditional units in Jakarta alone). Technical regulations have also been recently published, but need to be backed by fiscal incentives.

Considerable risks arise from the burning of solid fuels for cooking and heating within houses. Roughly 40% of households cook with firewood and are exposed to higher levels of indoor pollutants than households that cook with cleaner fuels (Silwal and McKay, 2015). A lot of the biomass is burned in traditional old stoves with incomplete combustion, which are energy-inefficient and emit polluting fine particles. Between 2007 and 2012, the Kerosene-to-LPG Conversion Programme proved very successful in increasing the number of liquid petroleum gas (LPG) users in urban areas (World Bank, 2013). Interim results from the Indonesia Clean Stove Initiative to universalise clean cooking solutions by 2030 highlight the benefits of integrating culturally-rooted social practices in designing and executing development projects (Durix et al., 2018), a finding that should have broader applications.

Sustainable buildings

The building sector is a big energy consumer and policies aimed at improving the energy efficiency of buildings can bring significant benefits. Most of the expected growth of energy consumption in the residential sector is in space cooling, as only 10% of households currently have access to air conditioning (IEA, 2019). Specific regulations have been enacted to optimise the environmental design and construction of buildings and Green Building Council Indonesia (GBCI) has introduced a voluntary green ratings tool. According to an IFC survey, in June 2018 there were 339 buildings covering 21 million sqm in Jakarta that complied with the GBCI code, and over 3 000 buildings covering 880 000 sqm in Bandung. Faster transition towards sustainable buildings requires tax and technical incentives, stronger administrative capacity, and greater involvement of homeowners. Non-compliance with standards (or labelling regulations) should also be subject to penalties (OECD, 2019b).

Ambitious reforms are needed to sustain improvements in living standards

Reforms can deliver strong gains in productivity and living standards, without necessarily involving high upfront fiscal outlays. For example, making one year of early childhood education compulsory is estimated to add 0.4 percentage points per year to GDP growth in the long run (Table 1.7) at a relatively small cost (Table 1.8). More broadly, investing to improve Indonesia's PISA scores – for instance by equipping schools with more computers – would also enhance skills, productivity and GDP per capita. There are also ways to boost adult education and training to accelerate skills acquisition in the population. Boosting human capital has a tremendous potential to develop Indonesia's economy including through higher rate of formality (see also Chapter 2).

Overly stringent product market regulation hampers the functioning of the economy and the allocation of resources. Lowering barriers to trade and investment to the average OECD level would add 1.3 percentage points to Indonesia's GDP growth in the long run (Table 1.7). Reducing the reach of state controls would have an even larger estimated impact on GDP growth (1.5 percentage points). Even though these numbers are simply illustrative, they highlight the huge potential gains from liberalising policy settings and bringing them closer to those in OECD countries. Last but not least, reducing corruption – which largely overlaps with the abovementioned liberalisation measures – would boost growth by as much as 1.9 percentage points over the long term.

Table 1.7. Structural reforms to close gaps can yield large long-term gains

Average additional annual GDP growth over 2020-2060 relative to baseline

Reform	Detail	%
Make compulsory one year of early childhood education	Equivalent to increasing average PISA score by 25 points	0.4[1]
Lower barriers to trade and investment	The respective sub-index of the OECD Product Market Regulation indicator declines to the OECD average	1.3[2]
Diminish state control	The respective sub-index of the OECD Product Market Regulation indicator declines to the OECD average	1.5[2]
Reduce corruption	Improvement in control of corruption index to the OECD median country, equivalent to an increase of 1.6 point in the index	1.9[2]

1. Estimates are based on OECD (2017) and OECD, Hanushek and Woessman (2015), and corresponds to the long-run growth increase.
2. Estimates are based on Égert and Gal (2016) and Égert (2017).

Note: Outcomes should not be cumulated across reforms as they sometimes cover similar benefits.

Source: OECD (2017), *Starting Strong 2017*, OECD Publishing, Paris; OECD, E. Hanushek and L. Woessmann (2015), *Universal Basic Skills*, OECD Publishing, Paris; B. Égert and P. Gal (2016), "The Quantification of Structural reforms in OECD countries: A new framework", OECD Economics Department Working Papers, No. 1354; B. Égert (2017), "The quantification of structural reforms: Extending the framework to emerging market economies", OECD Economics Department Working Papers, No. 1442.

Table 1.8. The fiscal cost of reforms is modest

Additional annual cost as a share of GDP

Reform	Detail	%
Mandatory schooling starts at age five	Based on 2013-14 estimate of cost per student, multiplied by number of five-year old children, and divided by two to take into account the average enrolment rate.	0.03
ICT equipment in all schools	Install one computer per class	<0.01

Source: OECD calculations.

Key policy insights recommendations

FINDINGS	RECOMMENDATIONS (Key ones in bold)
Policies to mitigate the impact of COVID-19 pandemic	
A broad range of temporary measures has been adopted to succour vulnerable households and businesses.	**Prolong measures directed at providing financial support to households and businesses to protect livelihoods and employment.**
The central bank has lowered the policy rate in steps during the crisis and inflation has drifted down to below target.	**The monetary stance should remain accommodative as long as inflation is within target, with forward guidance on normalisation as conditions improve.**
In the current highly volatile financial environment, emerging economies are subject to sudden changes in investor sentiment.	Keep using macro-prudential tools to preserve financial stability.
Disbursements in the context of the emergency fiscal package have been slow, but have accelerated in the latter part of 2020.	**Improve inter-ministerial policy coordination and between government levels and ensure consistency between government accounting systems.**
Past fiscal prudence has made room for fiscal expansion in the face of exceptional circumstances.	**Authorities should plan for fiscal consolidation over the medium run but avoid a premature and abrupt removal of stimulus.**
The economic crisis and the tax policy actions to mitigate its impact have further reduced tax revenue from already low levels.	**Efforts to raise tax revenue should be stepped up, notably by:** • **improving compliance;** • **broadening the base;** • **increasing selected tax rates (e.g. on tobacco);** • **enhancing international cooperation; and** • **closing loopholes.**
Blanket support measures to businesses carry the risk of artificially guaranteeing the survival of low-productivity firms and stifling business dynamism, especially in view of very stringent product market regulations, as measured by OECD indicators.	Monitor the implementation of the Omnibus Bills in order to improve resource allocation.
The "burden sharing" scheme is part of the unconventional apparatus, unlikely to generate inflationary pressures as long as demand stays compressed, and intended as temporary.	**Phase out "burden sharing" agreement, as envisaged.**
Central bank independence is key for the credibility of macroeconomic policy, especially in difficult times.	**Bank Indonesia's independence should continue to be fostered.**
Extra healthcare resources are being primarily channelled to COVID-19.	Maintain preparation to fight against still-widespread diseases like TBC, HIV, and dengue.
State-owned enterprises and other forms of government intervention	
SOEs' financial and operational performance has deteriorated during the crisis and some needed capital injections or restructuring.	**Improve SOEs' corporate governance to align it with global best practices.**
The government is rationalising the SOE universe through the creation of holding companies that control operating companies in different sectors.	Reinforce financial reporting of operating companies before establishing sectoral holding companies.
A number of SOEs enjoy various competitive advantages and the lack of a level playing field may hamper private sector growth.	**SOEs should always be subject to competition law and be held responsible for abusing their dominant market position.**
Restrictions on FDI are amongst the highest in the G20.	**Review existing restrictions, eliminate those that generate costs without producing benefits, and monitor the remaining ones.**
Public procurement	
Procurement, despite improvements, remains highly vulnerable to bribe solicitation, conflicts of interest, cronyism, and bid-rigging.	Adopt global public procurement standards (with respect to the quality of bidding documents, the possibility to comment on procurement-related regulations and the establishment an independent review mechanism).
Streamlined procedures and direct awards may be an efficient, but only temporary, solution for procuring specific goods, services and works in emergency situations like COVID-19.	**Limit direct awards only to current, urgent and unforeseeable needs, when there really is only one qualified supplier, and terminate them as soon as possible.**
Corruption	
The recent requirements to seek prior approval by the supervisory board before launching investigations and to turn investigators into civil servants weaken the independence of the Corruption Eradication Commission (KPK).	**Safeguard the independence and authority of the KPK to ensure the effective prevention, detection and investigation of corruption.**
Indonesia has ratified the UN Convention against Corruption in 2006 and participates in OECD and G20 anti-bribery activities.	Strengthen implementation of the UN Convention against Corruption and align more closely with the OECD Anti-Bribery Convention.
There are no clear rules on how members of Parliament engage with lobbyists.	Introduce a clear definition of lobbyists and lobbying activities and a code of conduct for the engagement of members of Parliament with lobbyists.

Environmental policies	
Estimates suggest that the forest and peatland cover lost to burning rose during the pandemic.	**Protect, rewet and restore peatlands and forests and increase the budget resources for environmental protection agencies.**
Cost-reflective energy pricing is fundamental to reduce emissions.	**Establish a carbon price on fossil fuels.**
Jakarta and other metropolitan areas suffer from high pollution.	**Accelerate investment in public transport and pursue inter-modal integration.**
The share of renewables in the energy mix is still low.	**Confirm plans to reform buy-in tariffs, to make cost recovery possible.**

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Annex 1.A. Evolution of budgetary allocations since 2019

Annex Table 1. Budget comparison, 2019-2021 (IDR trillions)

	2021 Budget	2020 Budget			2019 Budget (audited)
		Second revision	First revision	Original	
REVENUE					
Total revenue	1 743.6	1 699.9	1 760.9	2 233.2	1 960.6
Domestic revenue	*1 742.7*	*1 698.6*	*1 760.4*	*2 232.7*	*1 955.1*
Tax revenue	1 444.5	1 404.5	1 462.6	1 865.7	1 546.1
Income tax	683.8	670.4	703.3	929.9	772.3
Value added tax	518.5	507.5	529.7	685.9	531.6
Excise	180.0	172.2	172.9	180.5	172.4
Non-taxation revenue	298.2	294.1	297.8	366.9	409.0
Oil and gas revenue	75.0	53.3	53.3	127.3	121.1
Grants	*0.9*	*1.3*	*0.5*	*0.5*	*5.5*
EXPENDITURE					
Total expenditure	2 750.0	2 739.2	2 613.8	2 540.4	2 309.3
Central government expenditure	*1 954.5*	*1 975.2*	*1 851.1*	*1 683.5*	*1 496.3*
Interest payments	373.3	338.8	335.2	295.2	275.5
Subsidies	175.4	192.0	157.3	187.6	201.8
Energy subsidies	110.5	95.6	97.4	125.3	136.9
Funds for regional autonomy	*795.5*	*763.9*	*762.7*	*856.9*	*813.0*
BUDGET FINANCING					
Budget balance	-1 006.4	-1 039.2	-852.9	-307.2	-348.7
Budget balance as % of GDP	-5.7	-6.3	-5.1	-1.8	-2.2
Total financing	1 006.4	1 220.5	852.9	307.2	402.1
Net bond issuance	1 207.3	1 173.7	549.6	389.3	446.3

Source: Reuters.

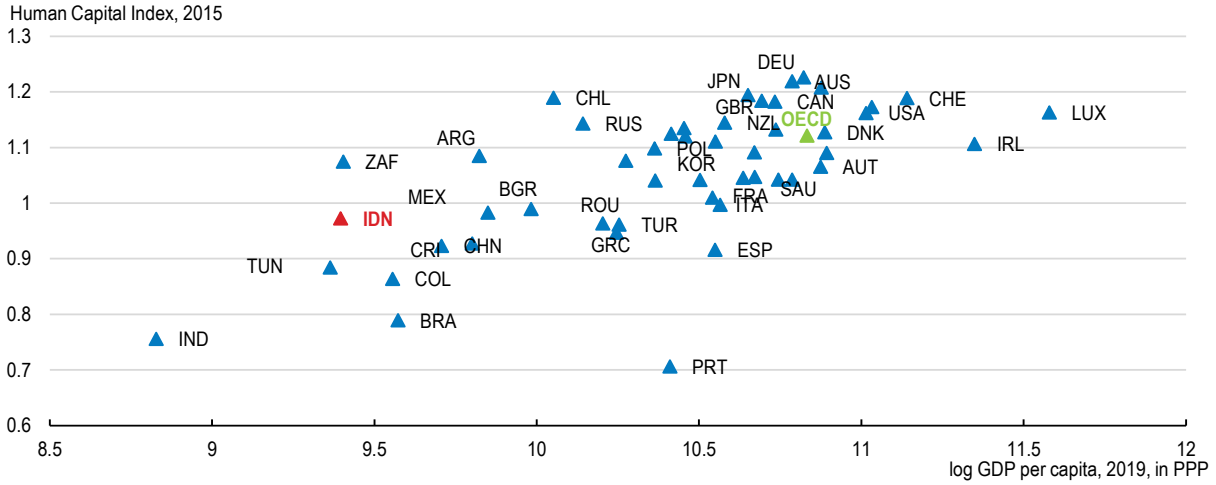
2 Investing in competences and skills and reforming the labour market to create better jobs

Favourable demographics has boosted Indonesia's economic growth in recent decades, but its contribution will wane over time. Skills and competences will therefore become increasingly important to raise living standards. Educational attainment has improved considerably, but the quality of education remains disappointing. At the same time, technological changes, new organisational business models and evolving worker preferences make upskilling and reskilling increasingly important. This warrants continuous investment in improving education and lifelong training, regarding both quality and quantity, with an enhanced role for social partners. Tackling existing and rising skill shortages requires more participation from women, older adults, internal migrants, disadvantaged groups, and foreign workers. Expanding access to early childhood education would provide all children with better opportunities and bring significant benefits. Reducing informality is key to encouraging investment in skills. The COVID-19 crisis has highlighted workers' insufficient protection against shocks, underlining the need for unemployment insurance. It is also an opportunity to boost digitalisation and innovate with smart practices. School closures are already penalising learning outcomes and will reduce future earnings.

Indonesia is struggling to recover from the COVID-19 pandemic and its high human cost, especially for disadvantaged groups. Unemployment and poverty are set to increase dramatically, putting at risk two decades of improvements. The ongoing recession limits government and household resources for investment in human capital. For Indonesia to prosper over the longer run, it is key to uphold funding for education and life-long learning, so that skills match the future needs of the economy and society at large. Indeed, human capital, defined as capabilities developed through formal and informal education and through training, experience, and mobility in the labour market (Mincer, 1981) is key for productivity, GDP growth, well-being and inclusiveness. This is a longstanding top policy priority.

Indonesia's human capital compares favourably with other emerging market economies (Figure 2.1) but needs to improve further to avoid the middle-income trap and prepare for the future. The index summarises the performance in terms of years of schooling and returns to education, the latter being U-shaped and varying across time and countries. The OECD estimates show substantially higher average returns to education in large emerging market economies than in OECD countries, with a generalised increase over time (Botev et al., 2019). On this metric, Indonesia has recorded impressive and continuous progress since 1950 but slower improvements in recent years.

Figure 2.1. The OECD measure of human capital puts Indonesia in the middle of peer countries



Source: OECD Spider database; OECD Economic Outlook 108 database.

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This chapter analyses a range of areas influencing human capital formation in Indonesia. The first section discusses demographic transitions and skills. The second section reviews the education system including recent trends in expenditures, coverage, attainment and performance, as well as the importance of early-childhood and tertiary education, and digitalisation. The last section turns to the labour market, focusing on the need to foster formalisation and training and continuous learning, exploit untapped sources of skills, and promote higher-quality jobs.

The main messages of the chapter are:

- Improving human capital is key to accelerating the recovery as the contribution from demographics is waning.
- Education attainment has improved remarkably in past decades, partly due to the high share of public expenditures devoted to the sector. Nonetheless, education quality is insufficient, making it necessary to raise efficiency through better monitoring of public spending and appropriate use of incentives.

- The negative impact of COVID-19 will be felt in both the short and the long term. Rising unemployment will damage skills and alter career paths. Similarly, prolonged school closures could have a substantial impact on students' future performance.
- Tight employment legislations have produced a dual labour market where most workers enjoy weak protection and are offered few opportunities. The recently-passed Omnibus Law on Job Creation is a step in the right direction, which may boost employment in the formal sector and productivity growth, subject to adequate implementation.

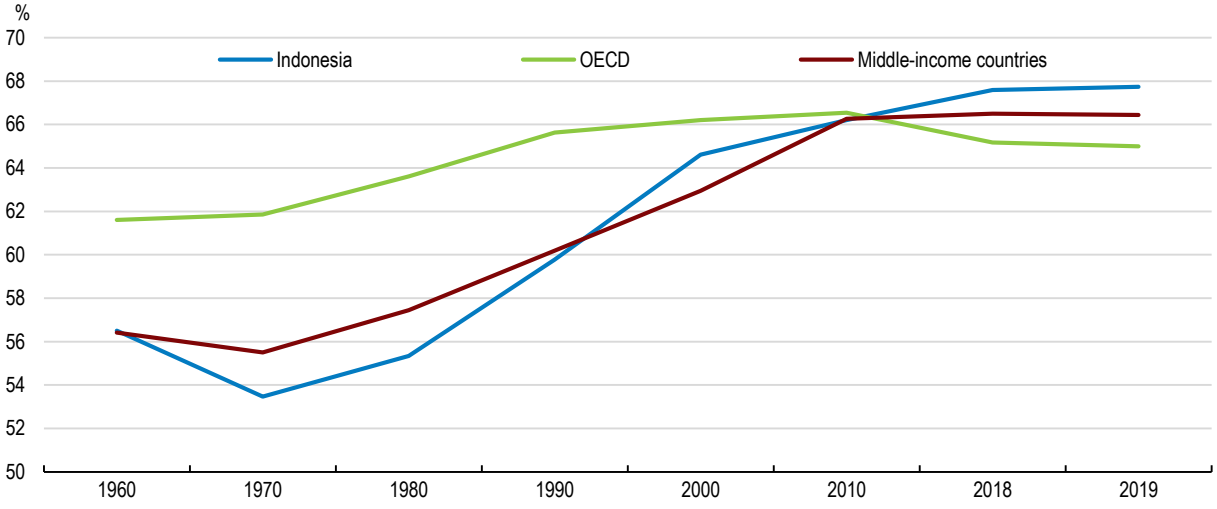
Demographic transitions and skills

For several decades, Indonesia has been enjoying a "demographic dividend", as the age structure of the population changes due to the transition from high to low fertility and mortality rates. The share of the working-age population is still increasing, contrary to many countries (Figure 2.2), supporting the growth of GDP per capita. The share is expected to peak in 2021 at 68%, to remain broadly stable for a decade, and then to gradually decline to 66% in 2040 and 64.5% in 2050 (UN, 2019). In order to increase productivity, income, employment and well-being, gains from demography should be accompanied by reforms that boost skills and competences. A smooth school-to-work transition and the knowledge and skills that students bring to the workplace are key drivers of future economic performance.

Indonesia's birth rate has gradually declined since the 1970s, from more than 5.5 births per woman, until it reached a plateau in the mid-1990s slightly below 2.5. Concomitantly, the death rate fell from around 19 per 1000 people in 1960 to about six nowadays. Going forward, the population aged 15 to 64 is projected to increase by around 1.7 million annually over the next decade. However, the dependency ratio – defined as the ratio of the over 65 over the working-age population – is inching up and will rise fast in the future, notably from 2030 (Figure 2.3). COVID-19 may also have implications for fertility rates.

Figure 2.2. Indonesia is enjoying a demographic dividend

Share of the population aged between 15 and 65 over total population



Source: World Bank, *World Development Indicators*.

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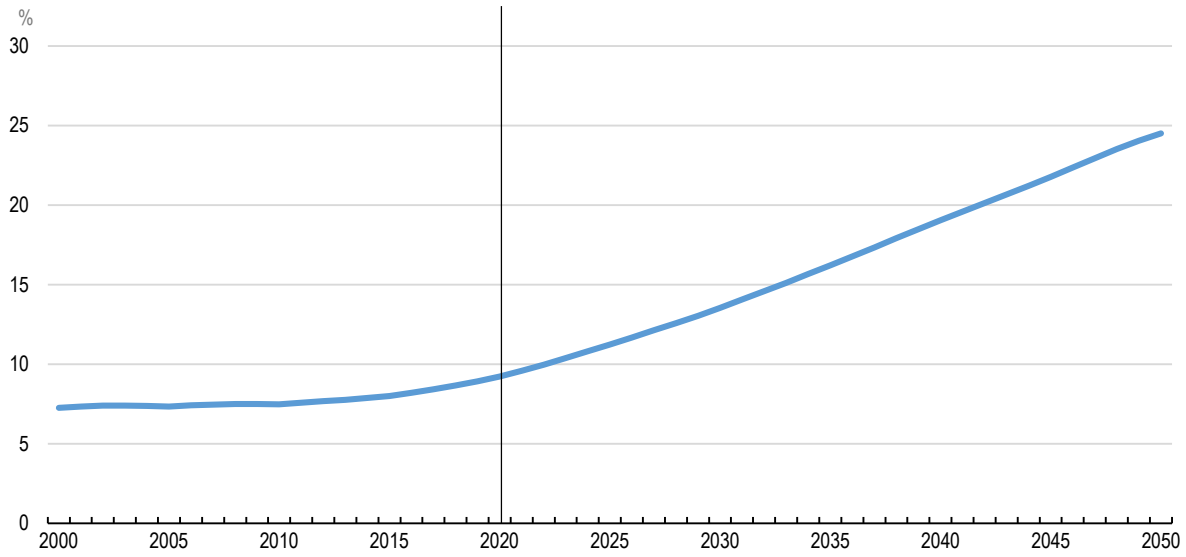
Figure 2.3. The dependency ratio is currently low but set to increase significantly

Share of the population aged above 65 years to the population aged between 15 and 65 years



Source: United Nations (2019), *World Population Prospects: The 2019 Revision*, Online Edition.

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Favourable demographics generate economic growth only if skills supply (i.e. the bulge in working age population) matches demand in the labour market. Foreign firms in Indonesia complain about the quality of employees, even though it is not the main obstacle they face, compared to other countries in the region (JETRO, 2020; World Bank *Enterprise Surveys*). There is an excess of unskilled workers and a shortage of skilled ones, with the mismatch affecting up to around 25% of the labour force and expected to endure (OECD, 2019a). Shortages are particularly acute for engineers (Petriella, 2017) and in the ICT sector (World Bank, 2018a). Before COVID-19, the lack of qualified staff was also penalising tourism (OECD, 2018a). This may happen again in the medium term and hinder the strategy to reposition Indonesia as a high-end tourism destination. More broadly, there could be a deficit of 1.3 million high-skilled workers in 2020, increasing to 3.8 million in 2030 (representing about a third of the highly-skilled labour force by then) (Korn Ferry, 2018). In addition to shortages, there is occupational mismatch: Allen (2016) estimates that 51.5% and 8.5% of workers are underqualified and overqualified, respectively.

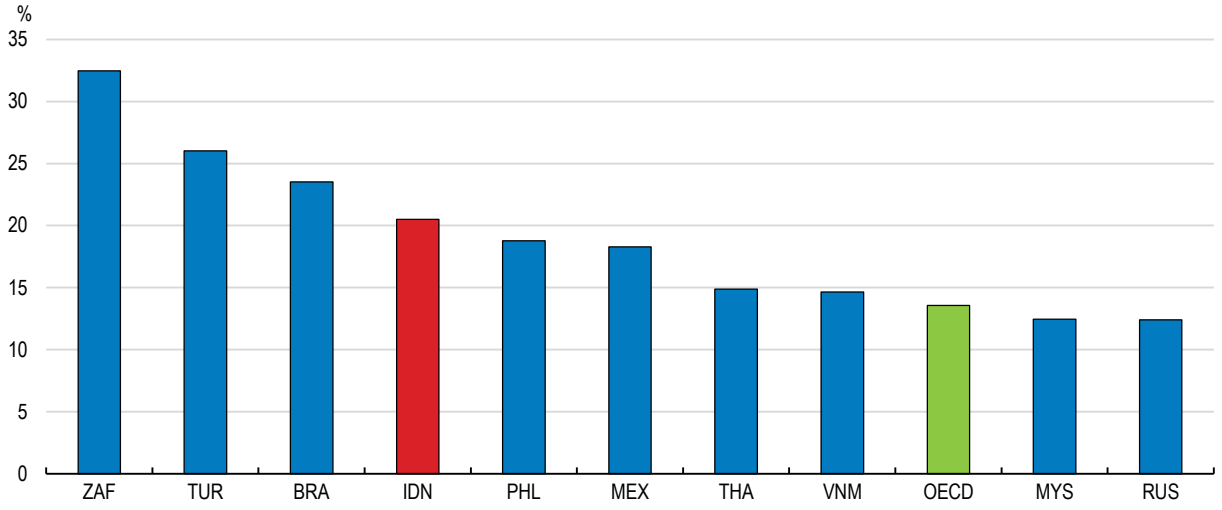
School enrolment in primary education has been close to 100% since 1980, boosting the literacy rate to 96% by 2018 (from 81% in 1990). However, Indonesia has also a relatively high share of youth that is not in education, employment or training (Figure 2.4). While the youth unemployment rate declined from 26% in 2005 to 17% in 2019, it remained above the 12% OECD average and above ASEAN peers such as the Philippines (6%) and Viet Nam (7%). The skills portfolio of the young population (15-24 years-old) is especially important insofar as it determines their entry job and therefore their work life. Indeed, it can be difficult to reduce a skills gap later. Interruption of education and inactivity during the early 20s can have long-lasting negative effects.

Improving education quality is crucial to boosting human capital

The learning process at school provides basic knowledge and is a fundamental stage in skills development for future adult life. In that context, both the number of years in school and the quality of learning matter. An average Indonesian six-years old child can expect to attend school for 12.3 years, which, adjusted for quality, amounts to 7.9 years (Figure 2.5). On the adjusted measure, Indonesia outperforms India and South Africa, but fails to match regional peers such as Malaysia or Viet Nam. In order to avoid wasting resources, Indonesia should ensure more people receive more education but also improve quality and ensure relevance for a changing labour market (OECD/ADB, 2015).

Figure 2.4. More than 20% of Indonesian youth are inactive

Share of the 15-to-24-years-old population not in education, employment or training, 2019



Source: World Bank, *World Development Indicators.*

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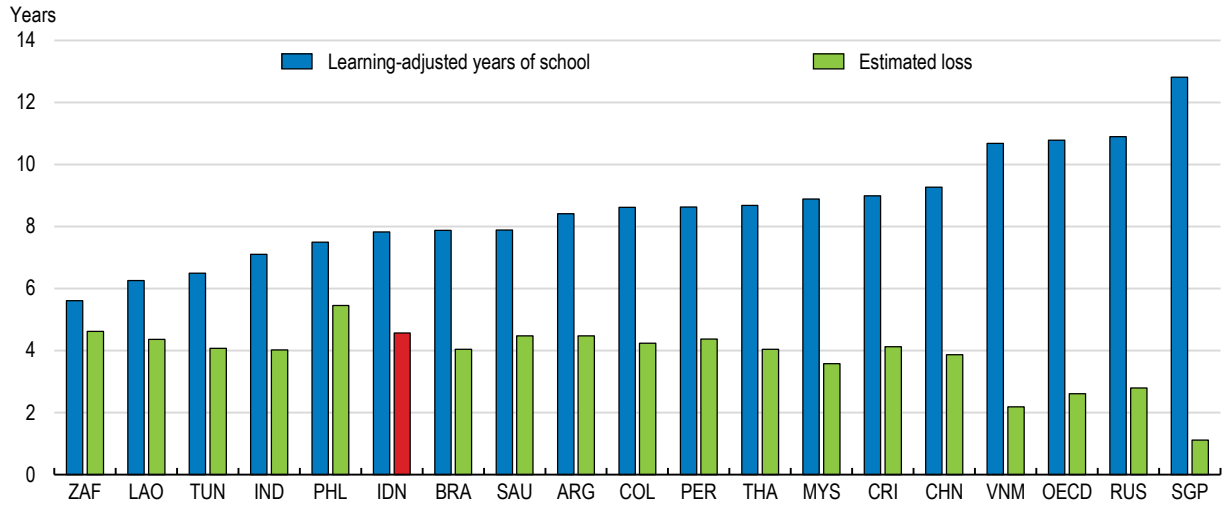
Figure 2.5. There is ample room to improve the quality of schooling



Note: The estimated loss is the difference between the expected number of years of school (given enrolment ratio at successive ages) and the learning-adjusted years of school (incorporating test scores). OECD represents the simple average across 38 OECD countries.
Source: World Bank, *Human Capital Index 2020 database*.

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More efficient and higher public spending would improve education quality

Government resources are limited

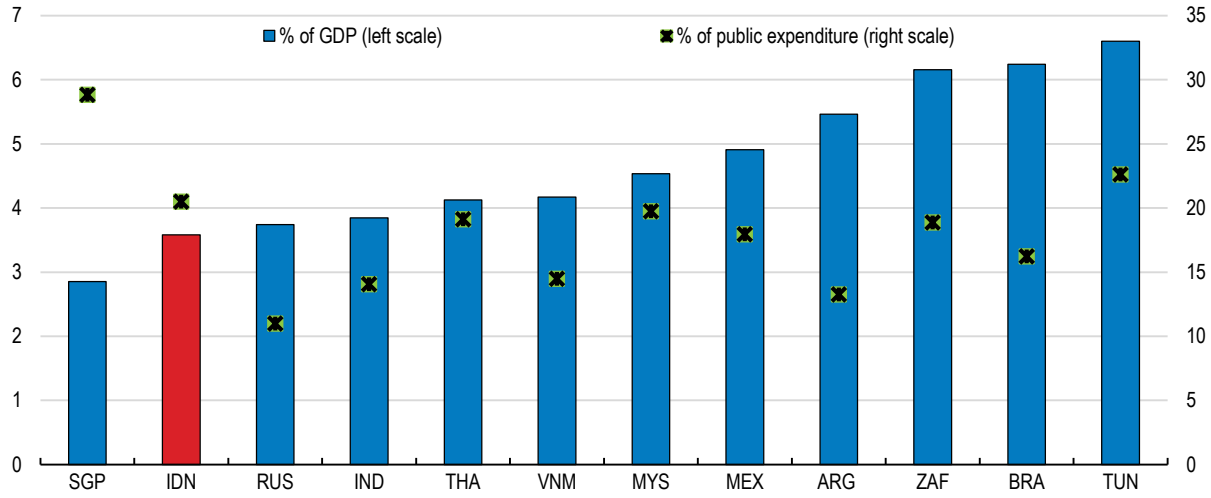
The share of total government expenditures devoted to education has gradually increased from about 15% in the early 2000s to 20% in recent years, in line with the 2002 amendment to the Constitution that posits that at all government levels are to spend 20% of the budget on education. This exceeds the share of many middle-income countries (Figure 2.6) and it likely contributed to boosting innovation in education, with indicators exceeding the OECD average, notably regarding the spread of practices to foster students' higher-order skills (Vincent-Lancrin et al., 2019).

However, because the government raises little revenue (OECD, 2018a), education spending as a share of GDP is comparatively modest. In Southeast Asia, despite a similar share in government expenditures, Malaysia's spending on education is 1% of GDP higher, and Thailand's 0.5% of GDP higher. One consequence is that educational inputs in Indonesia, such as the quality of buildings, air-conditioning or lighting, fall short (the fourth-worst score across 68 countries), to the detriment of student performance (OECD, 2016a).

Primary education in Indonesia receives relatively more funds than in peer countries (Figure 2.7). To some extent, this reflects past efforts to have universal primary education. Spending per student compared with most peer countries is lower at all levels of education, but less so for primary education (Figure 2.8). With enrolment in primary education very close to 100%, and in the context of continuing efforts to raise more revenues, the authorities should increase outlays in pre-primary and secondary education (see *infra*).

Figure 2.6. Indicators of government spending on education

2018 or latest data



Note: 2015 data for Indonesia.
Source: UNESCO Institute for Statistics, Education database.

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Households bear nearly half of total education expenditures, while the share is about 14% for high-income countries, and significantly lower in countries such as Mexico and Turkey (UNESCO, 2018). The share has increased fast in the past decade, from a third in 2009, even though government spending also increased. This underlines the need for the government to raise more revenues to reduce the share paid by households. The increasing burden on households means that progress in enrolment rates (see below) came at a cost for them.

The relatively high share of household expenditures works against inclusiveness and the equality of opportunities. Completion rates at upper secondary level for the poorest children are over 50 percentage points below those of the richest. This difference stems from two factors. A standard income effect helps explain higher completion rates among students from high-income households. In addition, better institutions with higher completion rates charge higher fees that exclude children from low-income households. Funding to institutions should follow better-designed performance measures that control for socio-economic factors. This could help improve spending quality and efficiency, but also equity (Marmolejo, 2016).

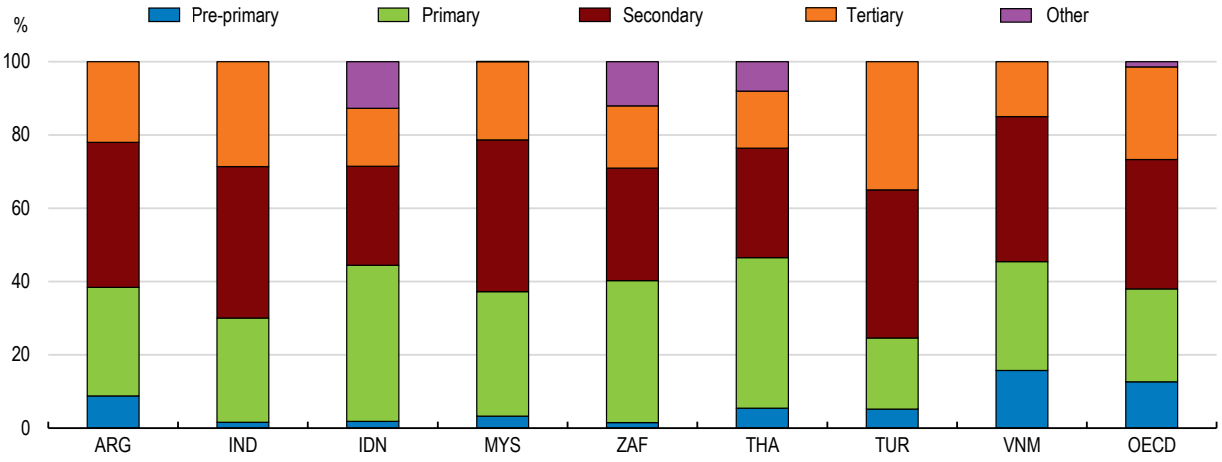
The growing burden on household budgets is a source of increasing inequalities. There are two main programmes to support education outcomes for the poorest. Programme Indonesia Pintar (PIP, Assistance for Poor Students) has expanded to cover about 20 million beneficiaries by 2018, but suffers from leakages to the non-poor (OECD, 2019b). Programme Keluarga Harapan (PKH − conditional cash transfers) is the most effective tool to reduce poverty thanks to its long-term impacts on human capital development (*ibid.*). It has also expanded, reaching 10 million households. A database is used to manage PKH recipients, among which there are 23 million children. The government is also accelerating digitalisation of social assistance to improve targeting, swiftness and transparency of distribution, notably through electronic cards. Integrating PIP with PKH to expand social assistance coverage would reduce administrative costs and leakages.

It is also important to improve co-operation with all stakeholders, including subnational governments. One example in this area is Thailand's Equitable Education Fund, launched in 2018, which supports youth at

all education levels and underpins a comprehensive strategy to meet provincial education and employment needs (OECD, 2020a). The Fund develops flexible learning strategies and provides conditional cash transfers, collaborating with the provinces, to reach out-of-school children.

Figure 2.7. Public funds are tilted towards primary education

Share of total expenditures by level of education, 2018 or latest



Note: Post-secondary non-tertiary education is included in tertiary. OECD represents the simple average of available OECD countries. Other refers to spending not associated with an education level. 2015 data for Indonesia.
Source: OECD, *Education at a Glance* database; UNESCO Institute for Statistics, Education database.

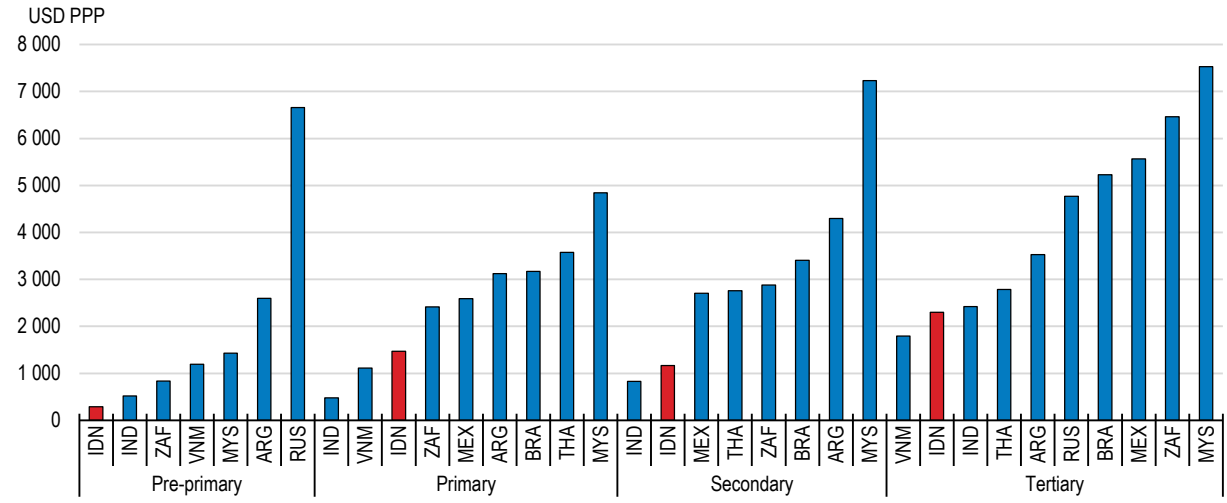
StatLink https://stat.link/s9tic4

Low spending leads to poor outcomes

While only a tiny minority of the population never attended school, the population share with at least a secondary education is lower than in most peer countries (Figure 2.9). There has been progress, as the share of the population with upper secondary education rose from 19.5% in 2006 to 24.6% in 2018, but it has been slow. Now that Indonesia has reached upper middle-income level status according to the World Bank, it is important to continue improving education attainment to remain in this income group. While the net enrolment ratio in primary schools is about 95%, enrolment in lower and upper secondary education lags behind at about 84% and 77%, respectively. Overall, participation in secondary education is slightly below the upper middle-income country average (Figure 2.10). The government is promoting upper secondary education, notably through the implementation of the *Kartu Indonesia Pintar* College Programme, which targets the distribution of 1.1 million scholarships in 2021 to well-performing students.

Figure 2.8. Spending per student is lower than in peer countries

Public spending on education per student by education level, in USD PPP, 2018 or latest



Note: Initial government funding (excludes transfers received from foreign donors).
Source: UNESCO Institute for Statistics, Education database.

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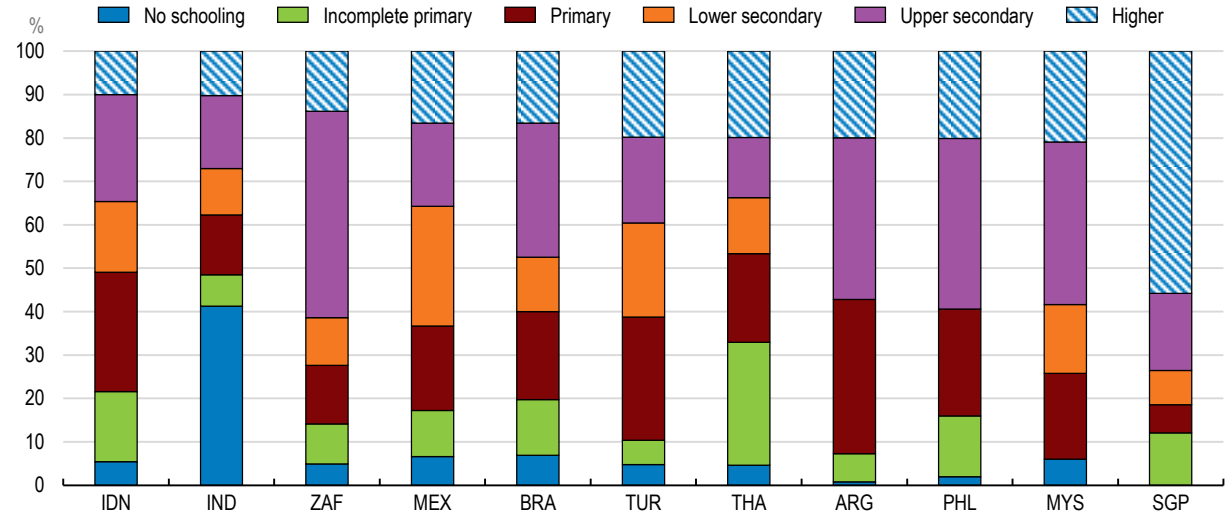
Figure 2.9. Only half of the population has completed secondary education

Share of population by educational attainment, population 25 years old and more, 2018



Source: UNESCO Institute for Statistics, Education database.

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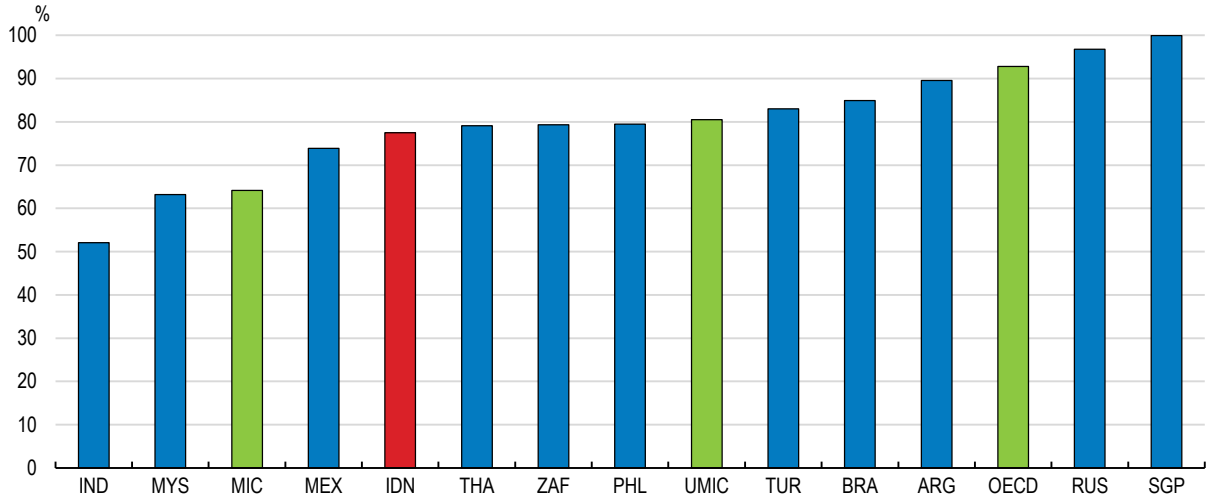
Spending on primary education over many years succeeded in lifting literacy rates to universal levels, even though disparities across provinces remain a concern. The youth literacy rate (population aged 15-24) has approached 100% since the 1990s; for those aged 65 and more, the rate increased from 53% in 2004 to nearly 75% today. Building on this achievement, the government needs to focus on secondary education. As the Indonesian economy becomes more sophisticated, the importance of secondary education in

providing workers with the necessary skills increases. However, spending more years at school is not enough to generate higher skills, as shown by the sizeable gap between the official curriculum and student ability (Beatty et al., 2018).

Figure 2.10. Indonesia is close to the average of peer countries in participation in upper secondary education

Total net enrolment rate, upper secondary education, 2018 or latest



Note: MIC refers to middle-income countries and UMIC refers to upper middle-income countries according to World Bank Income Groups classification.
Source: UNESCO Institute for Statistics, Education database.

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The National Exam (Ujian Nasional, commonly abbreviated as UNAS or UN) is a standard evaluation performed at the end of primary, and lower and upper secondary schools. UNAS scores are low overall (World Bank, 2020a). In international comparison, the scores for 15-year-old Indonesian students in the OECD Programme for International Student Assessment (PISA) tests trail well behind their peers in other emerging-market economies, such as Brazil, Malaysia, Mexico, Thailand, or Turkey (Figure 2.11). A further cause for concern is the stability of the PISA score since the early 2000s and their recent decrease. A likely explanation for this relatively poor performance over time is the broadening of the population sampled by PISA from 46% of the 15-year-olds in 2001 to 85% in 2018, which has resulted in the inclusion of low-achieving students (OECD, 2019c). In 2020, the government abolished the National Exam and replaced it with the National Assessment (starting from September 2021), which focuses on minimum competencies acquisition instead of subject mastery.

Teachers lack adequate preparation

The education outcome gap vis-à-vis best international performers is notably due to weak teacher competencies and pedagogical skills (Rosser, 2018). One essential lever to raise learning outcomes is to strengthen the quality of teachers (OECD, 2019d). That requires making the profession more attractive, reviewing teacher selection, promoting professional learning, and rewarding performance. Qualified teachers account for 90% and 96% of the staff in primary and secondary education, respectively, as compared with 100% in Thailand and the Philippines (according to UNESCO). A useful step would be to reduce the number of honorary teachers and increase tenured positions (Huang, 2019) – honorary teachers have temporary contracts and receive no salary, but honoraria which are usually below minimum wages, often forcing them to have another job. The share of non-permanent teachers (about 42% in

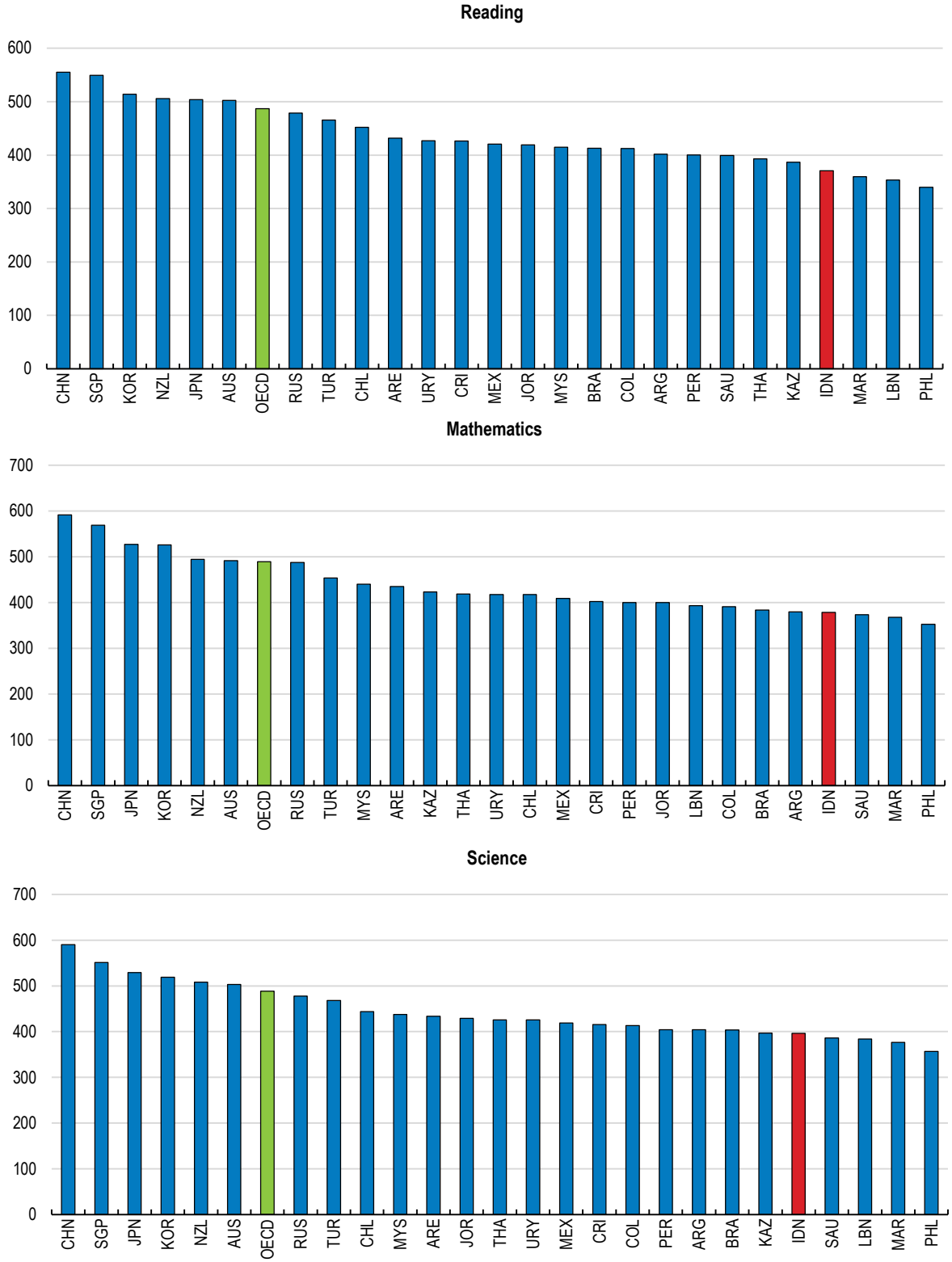
secondary) is much higher than in India, Lao PDR and Malaysia, for example (UNESCO, 2018). Permanent contracts should become the norm and local governments – responsible for contract teachers' recruitment – should make greater efforts to ensure that teachers without permanent contracts have the necessary qualifications and competencies. The government's project to convert the status of one million honorary teachers in 2021 by making their contracts permanent is welcome.

Teacher professional development can fill possible gaps at recruitment. However, in Indonesia, teachers' continuous training has suffered from lack of incentives, poor adaptation to teachers' experience and absence of follow-up (Revina et al., 2020). Therefore, training does not improve teaching quality and the latest government's initiative (*Pengembangan Keprofesian Berkelanjutan*) has failed to produce significant advances (*ibid.*). The situation is unlikely to change until the education system rewards highly-skilled teachers and investment is stepped up in training low-skilled teachers who do not meet minimum standards.

An earlier reform, the teacher certification programme, aimed at raising teacher competence (OECD, 2016b; World Bank, 2018b). It raised the share of certified teachers and their pay. Unfortunately, despite important fiscal outlays, it failed to significantly lift student achievements (de Ree et al., 2018). The programme was meant to provide financial incentives to teachers seeking quality certification. It ended up rewarding teachers' degrees or seniority instead of demonstrated competences and a large share of teachers became certified (World Bank, 2016). Renewed efforts to improve the pool of teachers are called for via more rigorous entry standards to the profession, enhanced supervision, more relevant pre-service teacher education and enhanced teacher professional development (OECD, 2019d). One recent example along these lines is Malaysia's plan to improve teachers' situation through raising entry requirements, enhancing working conditions, emphasising continuous professional development and revamping career progression (OECD, 2019e). In Indonesia, one step in this direction is the new teacher certification scheme (*Pendidikan Profesi Guru*), introduced in 2020 to improve the linkages between teacher allowance and student results. It requires one year of training (six months) for new (current) teachers. As with the previous system, it is important to evaluate and adapt the model to make sure the best-performing teachers are duly rewarded (rather than almost all teachers).

Figure 2.11. Indonesians' performance in reading, mathematics and science is lagging

PISA mean scores for pupils aged 15, 2018



Source: OECD, PISA 2018 database.

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Allocation and efficiency of spending should improve

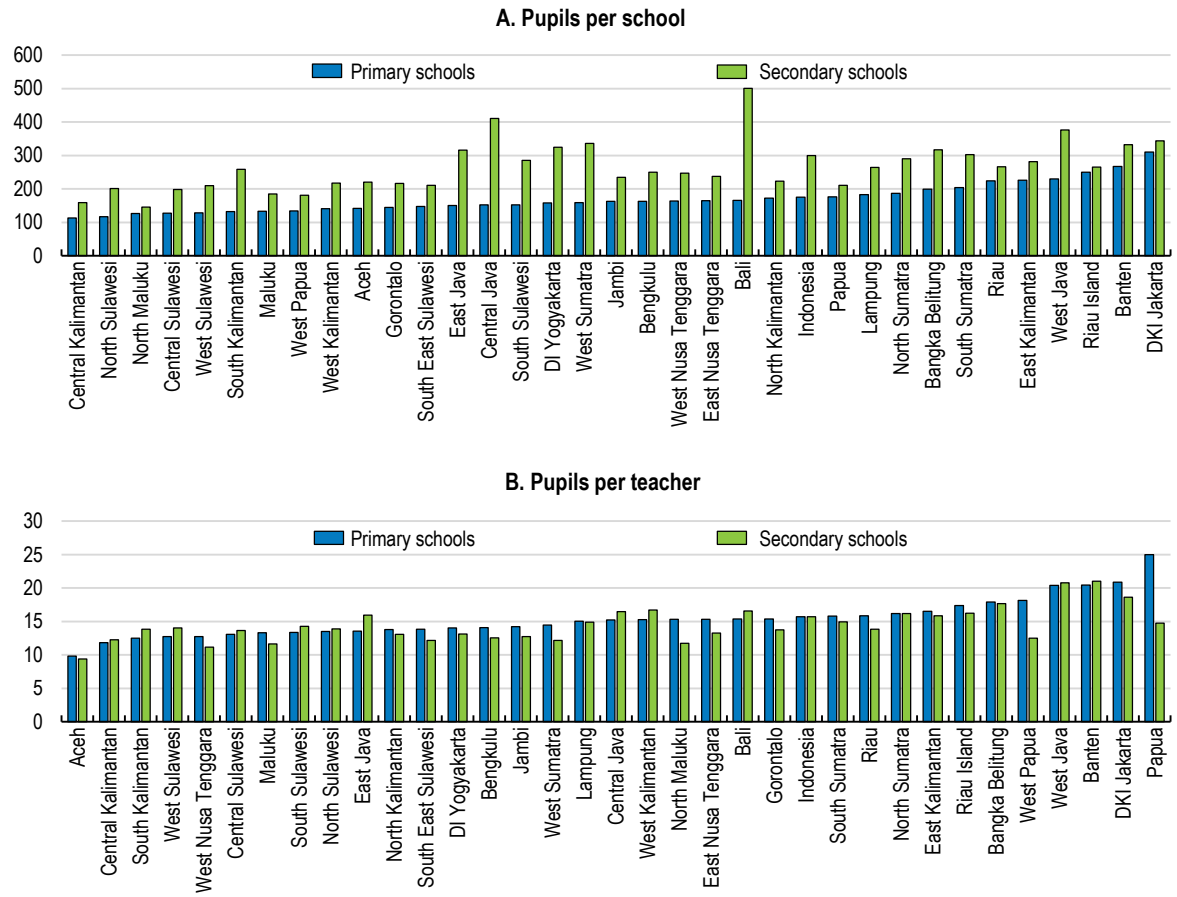
More efficient and effective spending would mitigate the difficulty to raise more revenues (OECD, 2016b). There seems to be a gap between the current level of spending and outcomes (Kurniawati et al., 2018). Therefore spending better is important and will help Indonesia achieve its development goals (World Bank, 2020a). Conditioning expenditures to learning outcomes would encourage efficiency. As mentioned in previous *Surveys*, intergovernmental transfers also tend to incentivise personnel spending (including teachers) and therefore reduce capacity to invest in other areas (OECD, 2016b). Improving the quality of learning is now one of the main focus areas of the government, including through a projected redesign of intergovernmental transfers.

One Indonesian idiosyncrasy is the large number of schools and teachers. Schools are relatively small and the ratio of pupils per teacher is comparatively low. The national average ratio is below Thailand's and Viet Nam's, both having better learning outcomes (OECD, 2016b). To some extent, this is related to poor transport infrastructure. In addition, many schools lack basic infrastructure: only 93% of primary schools have access to electricity, 72% to basic handwashing facilities and 84% to drinking water (according to the Ministry of Education). As a term of comparison, nation-wide access to drinking water was 89% in 2019. More broadly, only 25% and 40% of primary and upper secondary schools, respectively, are in good condition (World Bank, 2020a). To reduce staff and infrastructure costs per school and better focus spending, previous OECD *Economic Surveys* recommended closing selected small schools, developing multi-grade teaching and using massive open online courses, such as The Ministry of Education's *Rumah Belajar*, when appropriate. When closing schools is not possible, improving existing infrastructure is crucial.

Efficiency objectives should go hand in hand with quality and equity goals. In particular, there is room to allocate resources more fairly across provinces (OECD, 2016b). Regional differences are substantial, with a ratio of 1 to 3 for the number of pupils per school (Figure 2.12, Panel A). There is also a wide range regarding the number of pupils per teacher (Panel B), from less than 10 in Aceh to about 20 in Banten, West Java and DKI Jakarta. The intra-provincial dispersion of resource allocation is also significant, reflecting geographical and social differences that justify more spending in certain areas. However, not all dispersion is explained by characteristics such as remoteness, poorer school results or the need to boost attendance since 13% of provinces fail to fulfil the requirement to spend 20% of the budget on education (World Bank, 2020a). Low spending comes mostly from weak co-ordination with districts, poor subnational government capacity, and insufficient monitoring and incentives. A comprehensive review seems necessary to identify and share best practices across districts and improve accountability of spending decisions at each level of government (OECD, 2017a). This requires a clear division of responsibilities (see Box 2.1 for a description) and adequate financial capacity, as well as control structures. Rewarding good performance would also strengthen efficiency.

Figure 2.12. Indicators of spending per pupil vary substantially across provinces

2016



Note: Secondary schools include lower and upper secondary schools as well as vocational high schools.
Source: Statistics Indonesia.

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Enrolment varies considerably across provinces, notably for lower secondary education (Figure 2.13). There is a difference of almost 30 percentage points between the best (Bali) and worst performer (Papua). In six of the 34 provinces, the enrolment rate is at least nine percentage points below the national average. To improve national performance and make schooling more inclusive, enrolment rates in lagging regions need to rise. In addition, only 67% of districts fulfil minimum standards – for basic learning resources such as stationary and textbooks, and for the number and competencies of teachers – for curriculum implementation (World Bank, 2020a). In the context of decentralisation (OECD, 2016b), benchmarking and spreading best practices across districts and provinces would help underperformers improve. More co-operation would create synergies, reduce inefficiencies and further clarify roles. Central government monitoring is weak (World Bank, 2020a) and needs to be reinforced with a more comprehensive framework and better ICT tools.

Box 2.1. Distribution of responsibilities in education

District/municipal governments (more than 500) are the frontline public actor for education as they directly manage schools and teachers at primary and lower secondary levels. There are school committees – comprising parents, community leaders, education professionals, private sector representatives, teachers, NGOs and village officials – to take decisions at the school level. Provinces are responsible for upper and vocational secondary education. The central government is responsible for regulations and guidelines at the national level. In particular, the Ministry of Education and Culture (MoEC) sets standards for the curriculum, processes, graduate competencies, education staff, facilities and infrastructure, management, financing and educational assessment. The Ministry of Religious Affairs supervises and finances Islamic schools, which are about 16% of primary and secondary schools in Indonesia.

There are co-ordination needs across levels of governments, notably regarding teachers. For example, even though districts recruit them, the hiring process and pay rates of civil servants depend on national ministries (Ministry of Finance, Ministry of Administrative and Bureaucratic Reform) and the National Civil Service Board (BKN). Responsibilities for contract and honorary teachers are fully in the hands of provincial governments and individual schools, respectively. The Teacher Certification programme led by MoEC is also carried out in co-ordination with districts.

MoEC manages tertiary education (including for accreditation, salaries and recruitment) even though some institutions have a degree of autonomy.

Subnational governments account for nearly two-thirds of total education spending. Most of their resources come from five types of inter-governmental transfers of which some are earmarked and some depend on equalisation formulas.

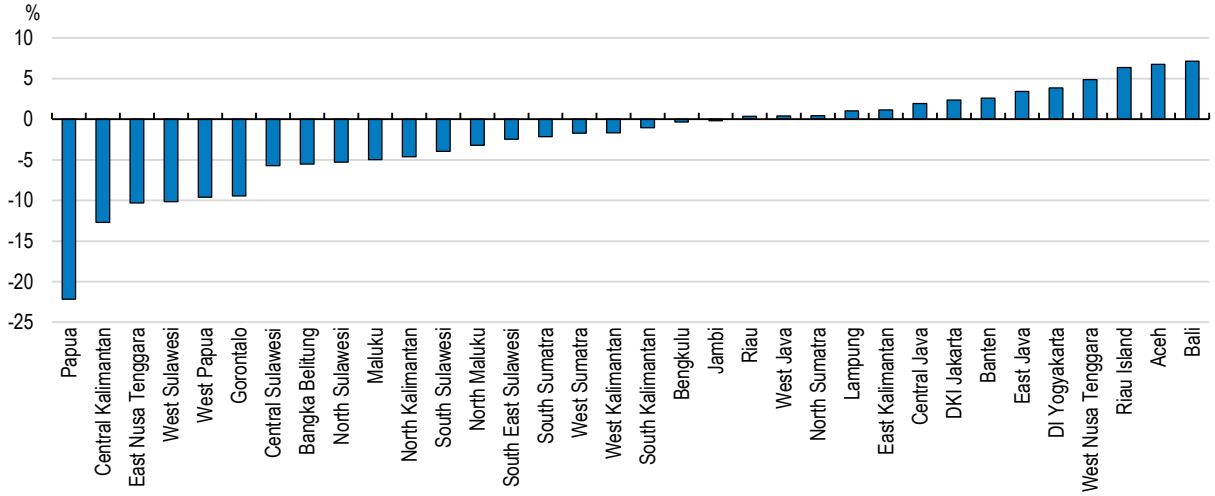
Source: OECD (2016), *OECD Economic Survey: Indonesia 2016*, OECD Publishing; World Bank (2020), *Indonesia Public Expenditure Review: Spending for Better Results*, World Bank, Washington, DC.

Intergovernmental transfers contribute to inequality as they partly come as fixed block grants per district (World Bank, 2020a). This restrains the capacity of subnational governments to manage education spending. Transfer through the general allocation fund (about a third of subnational government receipts) is equivalent to IDR 5 million per student or below in three provinces (West Java, Banten, and Riau) and above IDR 15 million in three provinces (North Maluku, Papua, and West Papua) (*ibid.*); differences are even bigger across districts. In addition, there is a weak correlation of the amount of transfers with infrastructure needs and with poverty rates (*ibid.*). This would call for a review of the equalisation funds' formula (OECD, 2016b). District needs, notably regarding the number and characteristics of students, should have more weight in determining intergovernmental transfers for education.

The education system and its actors are resistant to change. In particular, implementation challenges weaken reform potential (World Bank, 2018b). A first element is the implication of multiple public actors, including the Ministry of Education and Culture, the Ministry of Religious Affairs (managing religious schools), the Coordinating Ministry for Human Development and Culture, and the different levels of subnational governments (provinces, districts, and municipalities). Competing priorities add to the complexity of educational processes, the diversity of contexts and cultures and the nature of institutional arrangements (OECD, 2017a). Co-ordination is often a problem (OECD, 2016b). Private actors, who in most cases have refrained from getting involved in policymaking, have often preferred to lobby to derail reforms, as in the case of the implementation of the teacher certification programme (Rosser, 2018). The OECD has developed a framework to address such implementation issues and collaborated successfully with some governments (Box 2.2).

Figure 2.13. Lower secondary education enrolment varies considerably across provinces

Gross enrolment ratio in lower secondary education: difference with the national average, in percentage points, 2020



Source: Statistics Indonesia.

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Early childhood education should be promoted

Experiences across the world show the importance of early childhood education for future education outcomes. On average across OECD countries, a 15-year-old student with no pre-primary education is around twice as likely to suffer from a low performance in mathematics than a student with at least one year of pre-primary education, after controlling for student characteristics (OECD, 2016c). In emerging market economies, the size of the effect depends notably on the quality of programmes (Engle et al., 2011). Early childhood education may also be the most effective way to reduce the strong role of family background and the intergenerational persistence of educational inequality (Smidova, 2019). Pre-primary education is particularly effective for the most vulnerable children, and therefore particularly important to reduce inequality of opportunities. Expanding early childhood education could then contribute to reducing inequalities and break the link between being poor as a child and earning little as an adult (Rizky et al., 2019).

Early childhood education enrolment in Indonesia has increased from about 3.2 million to slightly over 8 million pupils between 2013 and 2018. However, it remains rather low compared to other G20 emerging-market economies (Figure 2.14). For children aged between three and six, the average attendance rate was 41.2% in 2019-20 (MoEC, 2020). Across provinces, the three lowest rates are for Papua (16.5%), West Kalimantan (22.7%) and Riau Islands (26.1%) while the three highest are for DI Yogyakarta (68.6%), East Java (67.9%) and Gorontalo (58.6%). Within provinces, inter-district differences are even larger: in Papua, for example, out of 29 districts, the enrolment rate is below 5% in seven and exceeds the national average in four. Efforts to increase participation in early childhood education should continue, especially for pupils with a poor socio-economic family background and in remote areas.

Box 2.2. The importance of education policy implementation

Education policy reforms may sometimes fail to produce visible results in schools. The possible reasons are manifold: weak design, stakeholder resistance, lack of implementation capacity and/or resources. Such a gap between promises and results can then create reform fatigue, weaken trust in government, and waste political and financial resources. In addition, failure may have dire long-term consequences.

Successful implementation requires first of all to acknowledge that this phase of the policy cycle is as important as the policy elaboration, and then to engage with key stakeholders, and be ready to adapt the strategy throughout the process. The OECD developed a framework to analyse education policy implementation and help enhance processes. It proposes to weave together policy design, stakeholder engagement and contextual elements into a coherent implementation strategy.

The OECD Implementing Education Policies project aims to promote education reforms, offering peer-learning opportunities and tailored support. The project has for instance supported the implementation of Norway's new competence development model for schools and Wales' large-scale improvement reform.

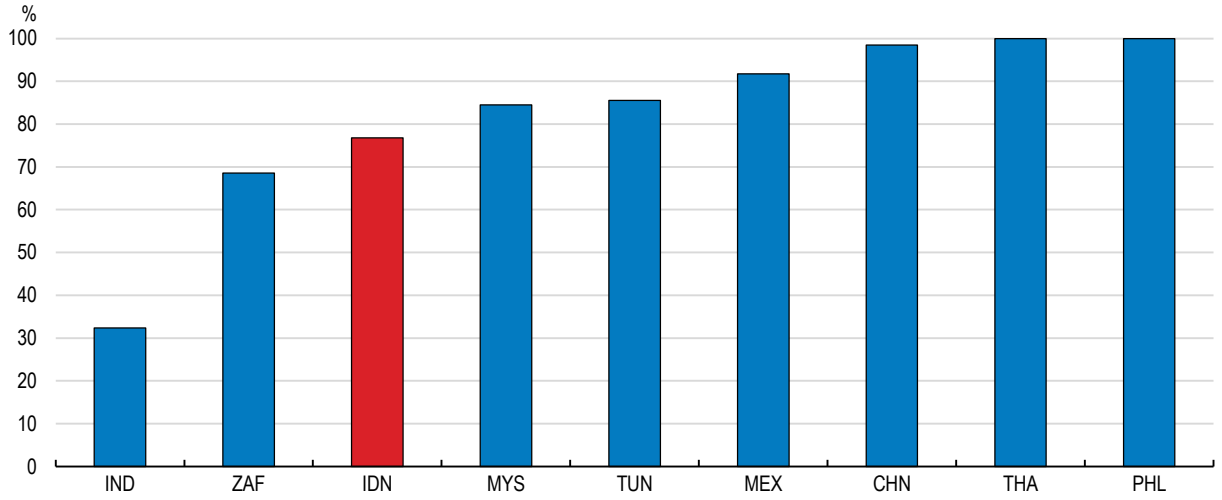
Source: OECD (2019),*Improving School Quality in Norway: The New Competence Development Model*, Implementing Education Policies, OECD Publishing, Paris; OECD (2018), *Developing Schools as Learning Organisations in Wales*, Implementing Education Policies, OECD Publishing, Paris.

Earlier entry in the education system improves performance during primary school, notably in rural Indonesia (Hasan et al., 2019). As primary education is now universal, it is time to develop early childhood education and make parents aware of its importance. A first step could be to make one-year pre-primary education compulsory, notably to attract pupils from poorer families. This is the case in Brazil since 2009. It requires a transition to ensure the right teachers are available. Introducing some degree of conditionality, such as the risk of losing welfare benefits in case of non-attendance, could contribute to increase enrolment.

Health is crucial for young children to build their future. In particular, stunting has a sizeable negative impact on physical and mental development and is correlated with poor education performance in some areas. The stunting prevalence in children under five years decreased from 37.2% in 2013 to 27.7% in 2019 but remains elevated compared to the global average (21.3% according to World Bank Development Indicators). The government ambitiously targets a reduction of stunting prevalence to 14% by mid-2020s and 18 public institutions devoted IDR 30 trillion (about USD 2 billion) in 2019 to fight child stunting. As mentioned in the previous *Survey,* improving targeting of support, promoting breastfeeding and informing about the dangers of child malnutrition are crucial. Early childhood education could play a substantial role by providing food and nutrients to children and improving detection and prevention.

Figure 2.14. A quarter of Indonesian primary school pupils have had no early childhood education

Percentage of new entrants to grade 1 of primary education with early childhood education experience, 2018 or latest



Source: UNESCO Institute for Statistics, Education database.

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Technical and vocational education and training need to be enhanced

In international comparisons, Indonesia stands out for the very high proportion of students in technical and vocational education and training (TVET) (OECD, 2018a). In 2011, the Ministry of Education's masterplan (MP3EI) envisaged to reach a secondary gross enrolment rate of 97% by 2020, of which 60% in vocational schools. The share of upper-secondary students in the vocational stream did increase from 33% in 2007 to nearly 44% in 2018, and there were nearly 40% more classrooms and 70% more teachers (including headmasters) in vocational schools in 2019-20 than in 2012-13. Nonetheless, academic education remains the first choice – 87% of students consider that society values vocational education less than academic education (Das et al., 2018). In addition, the rapid expansion of vocational education entails risks for the quality of education, with the recruitment of many unqualified teachers in poorly-supervised schools (which are mostly private). Indonesia could follow the example of the Philippines, which in 2017 launched the National TVET Trainers Academy to oversee trainers' development. Indonesia could also improve data collection, monitoring and evaluation of TVET programmes (OECD/ADB, 2020).

The government is also strengthening vocational training. This is important notably to reach those who left schools early in order to improve their skills. Vocational training is carried out in public and private vocational training centres (VTC) and directly in companies. There are more than 400 public VTCs, 5 000 private VTCs and about 1 800 VTCs in companies.

The authorities also put in place the IQF (Indonesian Qualifications Framework) in 2012. It aims to provide a unified reference for qualifications from year 9 of schooling to TVET and higher education and includes formal, non-formal and informal education as well as work experience (MoEC, 2012). The intention was to address the fragmentation of education and training provision, so that the system provides a clear path to upgrade an individual's qualifications. Across countries, national qualifications frameworks appear to be beneficial for labour market outcomes, especially in the long term (Allais, 2017). However, implementation is challenging, notably regarding quality assurance in Indonesia where information over competencies as required by employers is still limited (ACDP, 2016). While the IQF can boost long-term outcomes, it is crucial that the authorities also continue improving schools, curricula and the quality of teachers.

Another issue is to guarantee the curriculum includes skills aligned with market needs and opens good employment opportunities. The involvement of local government is crucial to integrate medium-term local planning parameters into education and training content. For example, in the tourism industry, the authorities opened vocational institutions in Lombok, Medan and Palembang to meet the demand of the sector in line with a masterplan to boost tourism (OECD, 2018a). Donors can also help develop TVET through co-operation such as Switzerland's support in tourism (*ibid.*). In 2019, Switzerland extended its support in Lombok through training of 21 professionals (SwissContact, 2019). The creation of a special directorate within the Ministry of Education and Culture in charge of the relationship with the business sector aims to favour the involvement of industries (Antaranews, 2020). The link with the private sector is essential but needs to be regulated to ensure the education system serves student needs.

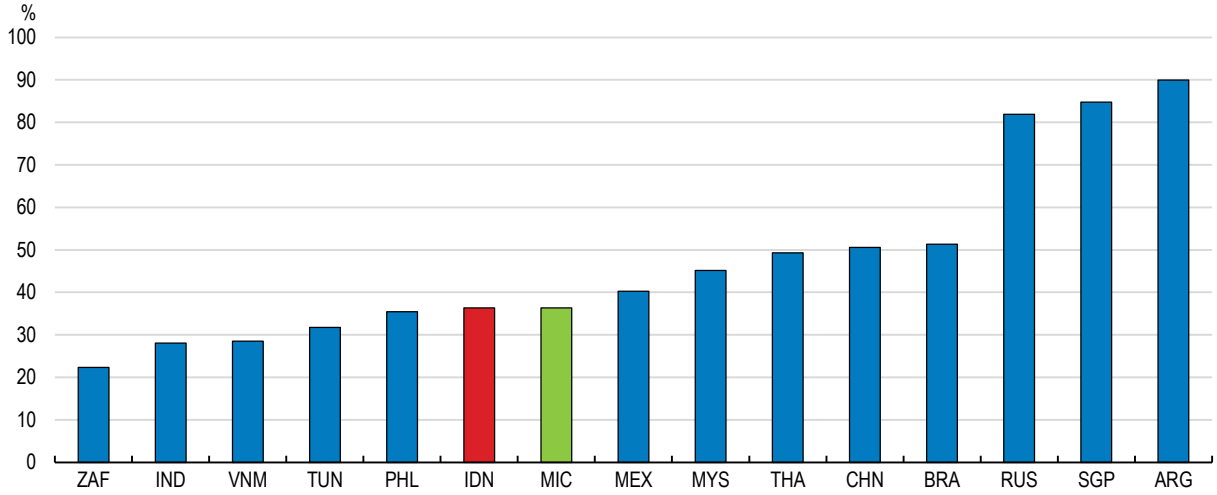
Despite the rapid expansion of TVET, employers report that many graduates lack relevant skills (Kadir et al., 2016). Employers and students alike express concerns about the lack of employers' input in the curriculum, limited hands-on training and low teacher quality (Das et al., 2018). Greater flexibility and transparency, as well as stronger consultation mechanisms with employers, would improve the quality of TVET. For example, Malaysia has taken steps to improve the connection between businesses and the education system with the former having a role in TVET programmes accreditation (OECD, 2019e). In addition, the *2u2i* programme of the Ministry of Education in collaboration with firms aims to provide students with real work experiences before graduation. Promoting local networks of employers could also facilitate their involvement in skills training (OECD/ADB, 2020).

Access to tertiary education has expanded but the quality of universities is uneven

At other levels of education, the enrolment rate in tertiary education has progressively risen, from 8.4% in 1990 to 36.3% in 2018. It is now close to the average level in middle-income countries (Figure 2.15). The premium to university attainment is considerable: 3.5 years of additional schooling are associated with a 26.6% increase in hourly wages, larger than what is observed on average across OECD countries (OECD, 2016d).

Figure 2.15. Enrolment in tertiary education is close to the average for middle-income countries

Gross enrolment ratio, tertiary education, in percentage of the official school-age population, 2018 or latest



Note: MIC stands for the average of middle-income countries according to World Bank Income Groups classification.
Source: UNESCO Institute for Statistics, Education database.

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In the absence of an equivalent of PISA to gauge the quality of tertiary education, an alternative is to examine the lists of the world's top 500 universities. Three Indonesian universities are included in the QS World University Rankings 2021 (QS, 2020), up from two in 2015. Their position improved slightly in the past five years, but the first one (Gadjah Mada University) is only 254th, notably because of the low number of citations of the research output. As a term of comparison, in other emerging countries the best local universities are ranked 15th in China, 59th in Malaysia, 74th in the Russian Federation, 115th in Brazil, 172nd in India, 208th in Thailand, and 220th in South Africa. The government seeks to increase the number of Indonesian global universities and their ranking, something that will require substantial improvements in the quality of teachers, infrastructure and governance. Most university lecturers only hold a master degree, and in some cases, it is possible to teach with a bachelor (Srivastava, 2020). The number of high-education institutions (HEI) is high – twice as many as in China, which has a population five times as large (*ibid.*) –, but many of them, mainly private, suffer from low quality. The rapid growth in students outpaced capacity and many HEIs are underfunded (Logli, 2016). Quality assurance should raise, notably by enforcing minimum standards in the private sector and improving accreditation mechanisms (see OECD, 2019f for Mexico's approach). The government is promoting the merger of private HEIs to create synergies and economies of scale, but with little success.

The structure of HEI fees tends to be regressive and so is government support for tertiary education, which disproportionately benefits students from higher socio-economic backgrounds. Students and their families have been paying an increasing share of the overall HEI budget as the result of low government funding (Logli, 2016). The burden is equivalent to a third of annual expenditure for an average household (OECD/ADB, 2015). Since the early 2010s, the government has expanded the number of scholarships (*Bidik Misi*) and financial assistance with the target of reaching 20% of students. Inequality, however, remains high with an overrepresentation of students from Java (including Jakarta), urban areas and wealthier families (31% of students from top quintile households). Lack of information and the difficulty and costs of relocating also explain low access for disadvantaged groups. Recent reforms, namely the revision to the entry system in public universities (to better target support of socio-economically disadvantaged groups), the *Akademi Komunitas* programme (one to two years of high vocational education at district level), as well as the opening of universities in underserved areas, could improve the situation. Continued monitoring of the situation of students from disadvantaged socio-economic backgrounds is crucial to fight dropping out. Subsidised loans could also benefit students and have broader medium-term benefits (Elmira and Suryadarma, 2018).

The experience of other Asian countries shows the positive contribution that foreign investment in HEI could play in boosting domestic competition and education outcomes. For example, in Viet Nam, FDI has complemented the domestic offer of education services (Box 2.3). Foreign HEIs can operate in Indonesia since 2012, under the condition of partnering with local universities through student exchanges, grants and scholarships, dual degree programmes, joint research and publications. However, there was resistance from Indonesian HEIs to allowing a foreign university to open a full-fledged campus (Rosser, 2018). The Comprehensive Economic Partnership Agreement (CEPA) with Australia (ratified in mid-2020) allows an Australian investor to own the majority of a university in Indonesia (and vice versa). Melbourne's Monash University, which already operates a campus in Malaysia, has announced its intention of investing in Indonesia.

Box 2.3. FDI in Viet Nam's education sector

Viet Nam has experienced rapid economic development with GDP growth averaging 6.4% over the past 15 years. Concomitantly, net FDI inflows have surged, from under USD 2 billion per year over 1995-2005 to USD 15.5 billion in 2018 (about 6.3% of GDP).

Human capital is the major factor limiting the development of Viet Nam (OECD, 2020; WEF, 2019). Despite important public expenditures in education (above 4% of GDP), the surge in demand led to the opening of many low-quality private universities (Trines, 2017). Student net outflows, according to UNESCO, went from 17 000 in 2005 to about 90 000 in 2017, in the face of access limitations and quality problems in Viet Nam. Five international universities opened branches while there are 13 international high schools (Vietnam Economic Times, 2018). With the demand for foreign-language schooling booming, domestic investors launched three more international schools.

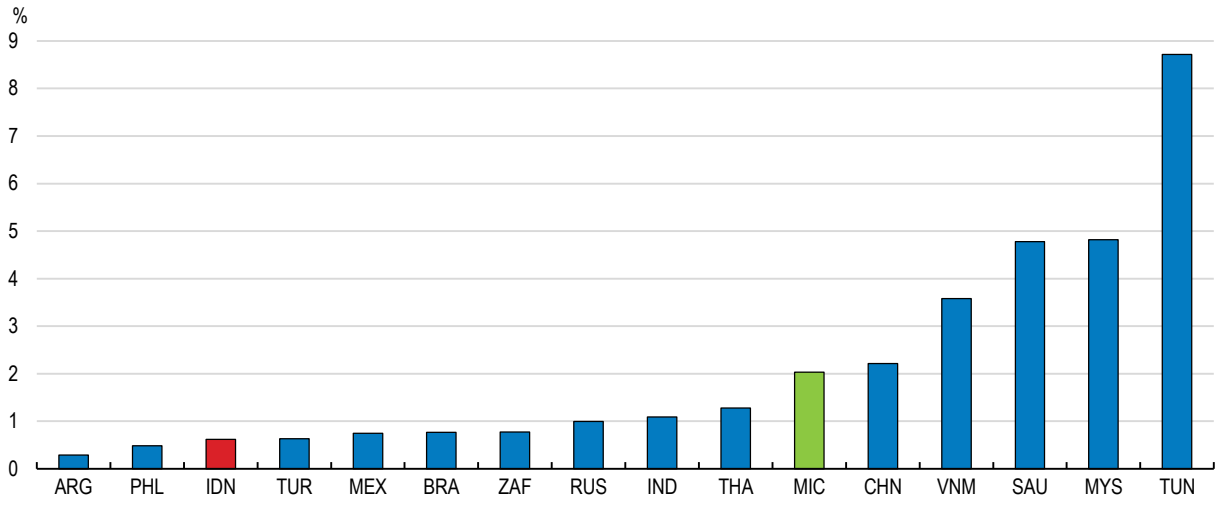
A 2018 decree eased regulations so that foreign-owned schools and universities can enrol more students. A subsequent decree, in 2019, allows foreign investors to own 100% of education institutions, subject to minimum capital requirements depending on the education level: for example USD 21.5 million for universities. This new regulation also grants more autonomy to higher education institutions regarding academic activities, staff, training and education structure (Vietnam Briefing, 2020).

Source: OECD (2020), *Multi-dimensional Review of Viet Nam*, OECD Publishing; WEF (2019), *The Global Competitiveness Report*, World Economic Forum; Trines, S. (2017), *Education in Vietnam*, WENR; Vietnam Briefing (2020), *Education in Vietnam: Opportunities and Challenges*, Dezan Shira & Associates.

Some skills shortages may result from the absence or low supply of certain types of training in Indonesia and can therefore be tackled through studies abroad. Fewer Indonesians study abroad than in most comparable countries (Figure 2.16) and the rate has trended downwards – it was above 1% in the early 2000s. This contrasts with the large number of Indonesians between age 13 and 18 considering studying abroad (81%, according to Banov et al., 2017). Affordability is the main barrier, as nearly half of the surveyed population would need a full scholarship. The Indonesia Endowment Fund for Education – providing scholarships for studying both domestically and abroad – has increased in recent years but remains insufficient: in 2018, there were only 825 additional awardees for overseas scholarships (LPDP, 2019). Other sources of funding, including domestic philanthropy, and international co-operation could support more scholarships for students in need, as advocated by President Joko Widodo (UWN, 2017). In this regard, the ASEAN International Mobility for Students (AIMS), akin to Erasmus+ in Europe, is welcome as it supports one-semester study at participating institutions.

Figure 2.16. Few Indonesians study abroad

Number of students studying abroad, as a share of total tertiary enrolment, 2018



Note: MIC stands for middle-income countries according to World Bank Income Groups classification.
Source: UNESCO Institute for Statistics, Education database.

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Digitalisation is playing an increasing role in the education system

COVID-19 has tested the ability of education systems worldwide to adapt and reinforced the incentive for faster digitalisation, while also magnifying inequalities across and within countries. Making the most of digitalisation in education requires sufficient ICT infrastructure in schools, providing specific training to teachers, and incorporating ICT in curricula (OECD, 2019a). In general, administrations, teachers, parents and students were ill-prepared for the anti-pandemic measures, notably school closures and physical distancing, and education delivery proved difficult for many pupils (Gouëdard et al., 2020). Remote learning also proved challenging, especially for students from poor or otherwise disadvantaged backgrounds. In addition to the direct costs in terms of failure to acquire competencies, there are losses in marginal future earnings that, cumulated over time, can be substantial. However, the efforts spent to find ways to learn and teach remotely have the potential to improve pedagogical efficacy in the future (Reimers and Schleicher, 2020).

Schools in Indonesia started to close in mid-March and have remained shut until end-December in most cases. Soon after the first school closures, the Ministry of Education set up a website to provide information, guidelines and news to students facing COVID-19 (see https://bersamahadapikorona.kemdikbud.go.id). The difficulties for the education system in such a situation are numerous: reaching all students, who may lack the necessary infrastructure (internet access, computer, printer, even electricity); poor self-learning capacities; a breakdown in communication between parents and teachers; nutrition, health and housing challenges for many low-income families; and technological challenges for teachers (Gouëdard et al., 2020). Some 90 000 additional children may drop out of school due to COVID-19 – especially in remote areas – and the first four months of schools' closure may have reduced Indonesia's PISA score by 11 points (Yarrow et al., 2020).

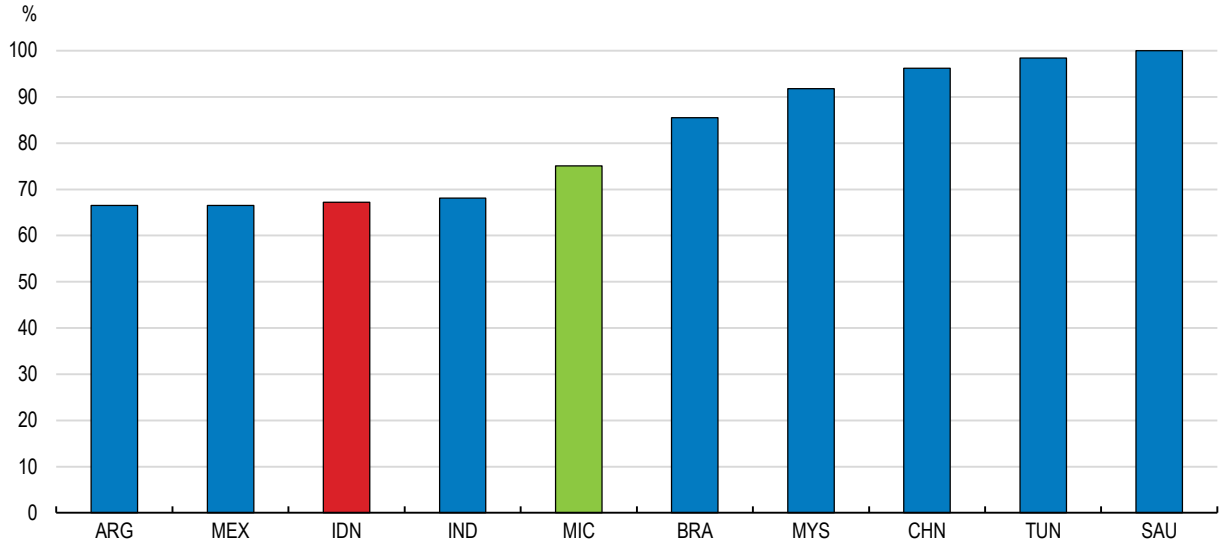
Computers (for pedagogical purposes) are available in only 40% of primary and 67% of upper-secondary schools – a lower incidence than in Brazil, China, and Malaysia (Figure 2.17). More broadly, developing digital skills at school is made difficult by poor integration of ICT in the curriculum, lack of expertise and education gaps in some provinces (Hermawan et al., 2018). Inequalities amongst students have thus

widened with COVID-19 (Alifia et al., 2020). In the end, the crisis can bring new ways to teach and to learn, which can speed up the transition of the Indonesian education system to the digital world. However, this outcome is dependent on teachers' continuous professional development giving them the skills needed to use ICT tools. In the short-term, it is important that teachers and school principals monitor students, notably to detect those with significant difficulties (including in accessing or using online tools) and guide them. A survey conducted by the Ministry of Education in April 2020 showed that on average teachers worked nine hours per week, compared to the standard 18 hours, making monitoring teachers very important (Zamjani et al., 2020). With support from central and district governments, it will be important to develop teaching methods and materials adapted to students' needs in order to fight inequalities. The issuance of an emergency curriculum during COVID-19 contributed to hasten adaptation of teaching. As soon as schools reopen, it will be also important to target students who were especially hard hit. Postponing student assessments could provide time to rebalance differences across these students.

The use of ICT in teaching was made compulsory by a revision of the curriculum in 2004. Low and uneven implementation resulted in a less ambitious 2006 revision (Hermawan et al., 2018). In 2004, the government decided to use free and open source software (FOSS) in all government administrations, until 2006 when the Ministry of Education signed a MoU with Microsoft. In 2011, it was decided to substitute FOSS with Microsoft software, a decision that was confirmed with the 2013 revision of the curriculum. Because computer science is constantly evolving, teachers need to be trained continuously and it is important that the curriculum does not promote particular vendors. The 2020 New Zealand Curriculum for pupils aged up to 13 may be a good model: it is neutral regarding software, and provides opportunities for all learners to become digitally capable, with content designed to be flexible to respond to new developments and technologies as they emerge (NZMoE, 2020).

Figure 2.17. A third of upper-secondary Indonesian schools lack access to computers

Percentage of upper-secondary schools with access to computers for pedagogical purposes, 2018 or latest



Note: MIC stands for middle-income countries according to World Bank Income Groups classification.
Source: UNESCO Institute for Statistics, Education database.

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Digitalisation eases distance learning and teachers' training, which can support the education system, especially in countries like Indonesia where reaching remote areas is a distinct challenge. It also facilitates collaboration with foreign institutions. However, with distance learning, students tend to lose teacher

contact time, and online systems thus rely much more on parents, resulting in poorer average learning outcomes in the case of US online charter schools (CREDO, 2015). Additionally, possessing a computer is still rather uncommon in Indonesia: only 34% of 15-years-old students have access to a computer for schoolwork (according to the latest PISA survey). This is particularly difficult for students living in remote areas: about half of them do not have an internet connection (according to the Ministry of Education). Since the outbreak of the COVID-19 crisis, several initiatives – for example BisaBelajar in Yogyakarta – have sought to collect older smartphones and donations for mobile data plans, in order to distribute them to students from low-income families. The government has also launched a mobile data subsidy programme worth IDR 7.2 trillion (about USD 550 million) for September-December 2020 to support online learning.

Start-ups have begun to propose new tools to ease learners' and teachers' work, building on the increasing number of mobile users (nearly a third of the population). For example, the CoLearn platform has been used by 200 000 students after its launch in September; *ruangkelas*, launched in July, has already reached 17 000 teachers. Funding of the education technology sector (USD 200 million in 2019, according to Redseer) remains low and below India for example (USD 2.5 billion) but is picking up, notably thanks to the development of services to other businesses (Riaz et al., 2020). The government has promoted free access to several online learning platforms during COVID-19. It will be important to guarantee a conducive business environment for new forms of e-services and preserve the level playing field with incumbent business.

Labour market rigidities are holding back the potential of the economy

Indonesia's labour market is characterised by strong dualism. Jobs in the formal economy are relatively well protected, whereas informal workers (about 80% of the workforce) face poor working conditions. Some regulations are particularly strict and prevent workers and employers from adapting quickly to labour market needs. Annually over 2015-19, the labour force and employment grew by over 2 million and nearly 2.5 million people respectively (according to Statistics Indonesia) but labour productivity is low (about 73% below the OECD average). In addition, Indonesia's labour market performs relatively poorly with regard to job quality and inclusiveness, even compared to other emerging market economies (Table 2.1). The COVID-19 crisis is magnifying some of the weaknesses of the current system. The momentum for ambitious labour market reform, as envisaged before COVID-19, should not vanish, and the OECD Jobs Strategy offers a template (OECD, 2018b). The recently-passed Omnibus Bill could be a milestone in that regard (see below).

Higher educational attainment tends to increase the likelihood of being employed (OECD, 2020b). In Indonesia, while completing upper secondary education does not materially improve the employment rate for 25-34 year-olds, having a tertiary education degree does increase the employment rate by more than 10 percentage points. This highlights the aforementioned quality shortcomings of secondary education.

The consequences of COVID-19 are dramatic

As result of the COVID-19 pandemic and the associated economic contraction, the government estimates that 1.8 to 4.8 million people may fall into poverty in 2020, while 3 to 5.2 million may lose their job. Other estimates are higher: one study concludes that the poverty rate may increase from 9.2% pre-crisis to 16.6% (nearly 20 million more poor people), back to the level observed in 2004, in the most severe recessionary scenario (Suryahadi et al., 2020). By August, the unemployment rate stood at 7.1% of the labour force, 1.8 percentage points above the August 2019 reading, while the share of informal (national definition) and part-time workers increased by 4.6 and 3.4 percentage points, respectively. In total, nearly 30 million workers were directly affected by the crisis (either losing their job, leaving the labour force or involuntarily working fewer hours). At the peak of the crisis, in April, the impact on employment was particularly large

for six sectors: accommodation, food and beverages; trading; transportation and warehousing; construction; processing industry; and other services (Rahman et al., 2020).

In June 2020, Statistics Indonesia released a survey of nearly 90 000 workers, reporting that over a third of those still working said that their income decreased. The impact was particularly strong for informal and low-income workers (Rahman et al., 2020). Many did not have enough savings and government support to cope with an activity stop. Some turned to illegal mining or to a previous activity, for example seaweed harvesting. The long-term consequences of lower income will be disastrous too and may *inter alia* reduce life expectancy by up to 1.7 year (Gibson and Olivia, 2020). The crisis had also a larger impact on women given their role in the most affected sectors (*ibid.*). Taking care of children during school closure affected also them disproportionately (UNESCO, 2020).

Notwithstanding the authorities' numerous economic policy measures, the crisis revealed shortcomings in Indonesian public administration. Bureaucratic processes delayed counter-cyclical fiscal spending, including for social safety nets for which only a third of budgeted expenditures were spent by end-June (Bloomberg, 2020). In addition, the list of recipients in need was not up-to-date. Difficulties in social assistance distribution were one of the main causes of dissatisfaction in public opinion polls (Indo Barometer, survey between 12 and 18 May). The Indonesian Ombudsman received numerous complaints about the distribution of social aid, suggesting corruption cases. For example, in Papua and Jambi, data manipulation altered the number and names of recipients. It is important that the Supreme Audit Institution (BPK) quickly reviews government interventions related to COVID-19 and intervenes when needed to ensure accountability (IDI, 2020).

Before the crisis, the government initiated an ambitious reform to promote training for adults: the "pre-employment card" programme (see also below). It ingeniously adapted it to COVID-19, accelerating and widening implementation to provide cash aid as well as a training subsidy to the growing ranks of job-seekers. Each recipient is to get IDR 600 000 per month for four months, IDR 150 000 if they fill in three surveys plus IDR 1 million to pay for optional training. Partnership with online training platforms allowed beneficiaries to respect distancing rules. In June, almost 11 million people had registered, 5.6 million had passed the first validation process and slightly more than 680 000 actually received a pre-employment card. Despite registration issues and design weakness – for example, control of trainee attendance was irregular or there was no open tender for procurement of the education platform and courses (KPK, 2020) – it was a rapid way to support the unemployed during the crisis. However, the number of beneficiaries has remained relatively small. In the medium term, a comprehensive unemployment insurance system (see below) would be preferable.

The duration of the crisis and the capacity of the economy to rebound will be crucial for future labour market outcomes. Skills erode without practice and many temporary lay-offs may become permanent and produce scarring effects. Evidence from earlier crises in the United States suggests that the detrimental effects of losing and/or not finding a job can last (Kahn, 2010; Rothstein, 2019). The costs are particularly high for first-time jobseekers, who may be compelled to accept positions for which they are overqualified and then find their successive career path compromised. Youth who have recently or will soon graduate are more at risk, as they face a depressed labour market (ILO, 2020a). A potential solution is to help them continue studying or to propose vocational and soft-skills training, including through online services.

Conversely, there could be opportunities in the longer term. The crisis could help formalise the informal sector if welfare recipients enjoy automatic registration to social security (without penalties for informal activities) and be an opportunity for Indonesia to create a database of informal workers consolidating different sources such as district administrations, grassroots organisations and the social security agency (Octavia, 2020).

High informality reduces the productivity and potential of the labour force

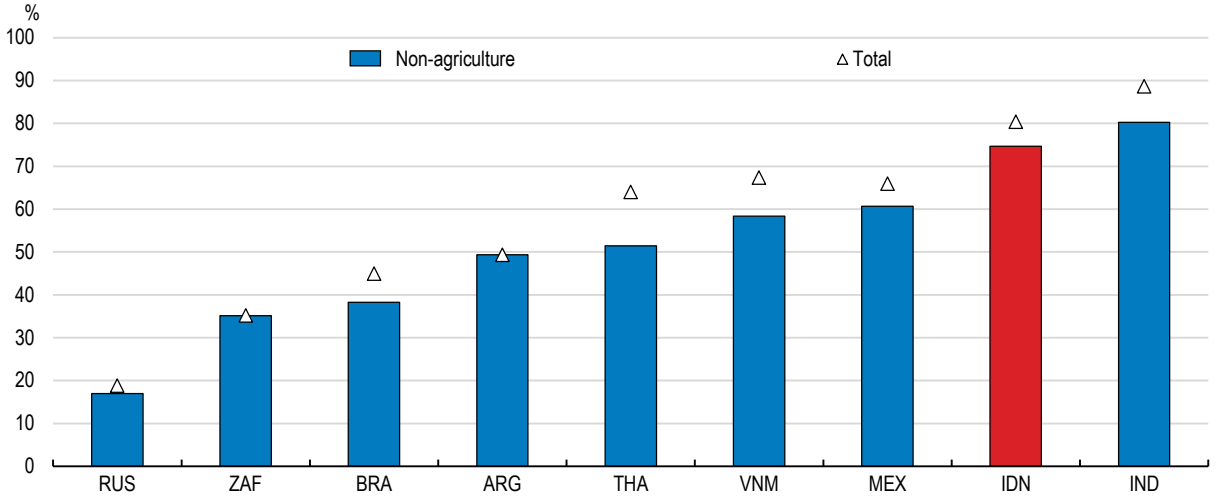
Extent of informality

Informality, i.e. activities performed outside legal and regulatory frameworks, accounts for the bulk of job creation in many emerging-market economies. While providing flexibility and creativity, informality is also associated with poor working conditions, child labour, and lack of access to social protection, finance and appropriate technologies. This hampers the accumulation of human capital for workers and their children. In addition, firms operating in the informal economy tend to be inefficient as they remain small and have limited access to banking services and consumers; productivity is between 25 and 75% lower than economy-wide (Loayza, 2018). Informal workers are also more difficult to reach and fall easily into poverty, as the COVID-19 crisis shows (Yu, 2020).

In Indonesia, the share of informal workers in total employment is higher than in neighbouring countries and other large emerging-market economies (Figure 2.18). Across countries, the incidence of informality is inversely correlated with GDP per capita and the observed value for Indonesia is higher than what its level of development would imply (Loayza, 2018). Encouragingly, the share of informal workers has decreased by over 10 percentage points between 2007 and 2019 (OECD estimates based on Sakernas). The share of informal workers varies across provinces, and is about 25 percentage points higher in East Nusa Tenggara than in the Riau Islands, while four provinces – including Jakarta – have a share below or around 70% (Figure 2.19). To some extent, industry specialisation, notably in agriculture, accounts for this pattern. Most informal firms have less than five employees, are managed by individuals with low educational attainment, cater mainly to local markets and do not seek to expand (Rothenberg et al., 2016). According to World Bank Enterprise Surveys, formal private Indonesian firms consider the practices of informal firms (such as not paying taxes) to be the main constraint for their activities (at 37%), much more than on average across East Asia and the Pacific.

Figure 2.18. Informality is pervasive in Indonesia

Informal as a percentage of total employment, 2019 or latest



Note: For the Russian Federation, the definition covers employment outside of the formal sector.
Source: ILO.

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Table 2.1. Labour market performance in G20 countries

2018 or latest available year

	Quantity			Quality			Inclusiveness		
	Employment	Unemployment	Broad labour underutilisation	Earnings quality	Labour market insecurity	Quality of working environment	Low-income rate	Gender labour income gap	Employment gap for disadvantaged groups
	Share of working-age population (20-64 years) in employment (2018)	Share of persons in the labour force (15-64 years) in unemployment (2018)	Share of inactive, unemployed or involuntary part-timers (15-64) in population, excluding youth in education (2018)	Gross hourly earnings in USD adjusted for inequality (2016)	Expected monetary loss associated with becoming and staying unemployed as a share of previous earnings (2016)	Share of workers experiencing job strain (2015)	Poverty rate after taxes and transfers, poverty line 50%, working-age population (18-64) (2017)	Difference between average earnings of men and women divided by earnings of men (2018)	Average employment gap as a percentage of the benchmark group (prime-age male workers) (2018)
Japan	81.8	2.6	24.0	16.1	2.7	31.2	13.6	54.2	25.9
Germany	79.9	3.5	19.6	26.5	1.4	28.5	10.2	40.5	21.4
UK	78.0	4.3	22.4	19.0	3.3	20.7	10.6	42.9	23.4
Canada	76.6	5.9	24.2	20.1	3.8	..	12.2	34.0	20.8
Australia	76.6	5.5	27.6	23.0	3.1	25.6	9.6	38.9	22.0
USA	74.3	3.9	24.1	18.5	4.2	25.8	15.4	38.5	25.6
France	71.8	8.8	31.0	21.9	3.1	25.8	8.3	34.0	33.1
Korea	71.4	3.9	29.1	11.1	2.9	..	12.7	55.0	35.1
Mexico	66.9	3.4	..	4.9	4.0	28.9	13.8	56.4	46.0
Italy	63.0	10.8	41.5	18.9	8.6	29.6	14.0	45.6	39.7
Turkey	55.6	11.2	42.9	7.4	13.0	42.9	13.5	61.9	55.8
Argentina	69.3	9.4	36.2	7.4	7.5	..	..	45.7	40.9
Brazil	66.4	12.3	37.3	4.8	6.6	..	17.3	42.4	36.6
China	79.0	2.9	..	..	5.8	28.9	26.0	..	28.9
India	52.7	9.0	..	2.7	3.6	30.7	17.1	78.8	70.3
Indonesia	72.6	5.6	29.6	1.6	8.2	..	..	58.1	42.1
Russia	75.6	4.8	22.1	6.8	5.1	33.4	..	37.0	32.3
S. Arabia	61.4	5.7	..	..	..	..	..	74.9	73.2
S. Africa	49.6	27.1	50.3	2.5	22.6	26.7	..	47.5	47.4
OECD	72.8	5.5	25.2	17.1	5.1	27.6	10.5	37.9	28.4
	Top-third performers	Mid-third performers	Bottom-third performers						

Note: Countries in descending order by the employment rate. Youth, aged 15-29 years, in education and not in employment are excluded from both the numerator and the denominator of broad labour underutilisation. The groups considered in the last column are youth, women, and older men. Data on earnings quality for non-OECD countries are provisional estimates.
Source: OECD (2018), *Good Jobs for All in a Changing World of Work: The OECD Jobs Strategy*, OECD Publishing, Paris.

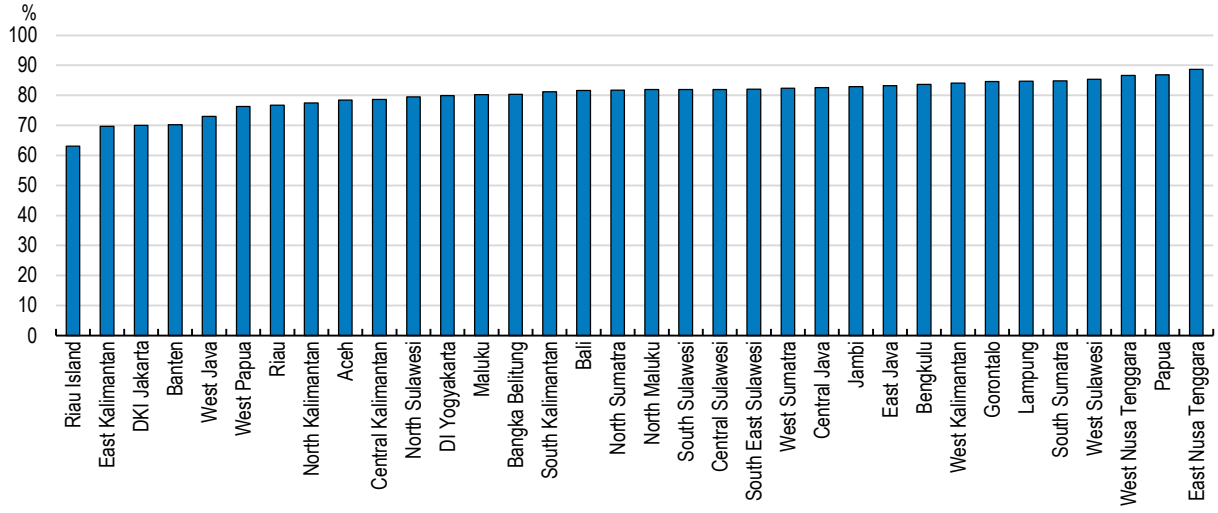
Child labour is common, particularly in the informal sector. Following international conventions, in Indonesia the standard minimum age for employment is 15, even though children between age 13 and 15 may engage in light work; hazardous work is prohibited before age 18. In the absence of official data, it is estimated that in 2010 about 3.5% of the 10-14-year-old population was working, while 2.1% combined work and school (ILAB, 2018). Children mostly worked in agriculture (notably tobacco, palm oil and rubber plantations) and domestic help. For example, some 85 000 children aged 10-14 were employed as domestic workers in 2015 and around 1.5 million children aged 10-17 were employed in agriculture, working long hours with exposure to extreme temperatures, pesticides and organic dust, and using heavy and dangerous machinery and tools (ILO, 2018a). Child labour is a violation of Indonesian laws and deprives working children of future opportunities. There should be more law enforcement, notably through more frequent labour inspector visits. Parents' education and promotion of the benefits of schooling should continue, especially in rural areas where attendance is lower.

Several factors drive informality

Informality results from barriers to formal employment, disincentives to formal activities, lack of perceived benefits from registration and insufficient skills (OECD, 2018a). In Indonesia, firms choose to remain in the hidden economy because they are not expecting to expand and to borrow through formal financial channels and in order to evade taxes (Rothenberg et al., 2016). Some barriers to formalisation have been substantially eased: for example, the number of days to start a business has decreased to 10 – close to the average of high-income OECD countries – from around 25 in 2017 and 76 in 2013 (World Bank, 2020b). The launch in 2018 of the Online Single Submission system, aimed at centralising administrative procedures in one place, has dramatically reduced the burden of certain tasks (https://oss.go.id/portal/) (OECD, 2018a). The government is also encouraging alternative sources of financing, using for instance financial technology (fintech) development, to provide informal firms with opportunities to grow or to become formal. Recent improvements in payment system data infrastructure can for example compensate for the lack of credit history and let such firms access financial services.

Figure 2.19. The importance of informality varies across provinces but is high everywhere

Share of informal workers, 2019



Note: ILO definition.
Source: OECD calculations and Statistics Indonesia, Sakernas.

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Nonetheless, administrative complexity endures. In particular, there are co-ordination issues between central and local governments, either because of overlapping responsibilities and colliding regulations, or because of subnational government capacity limitations. In addition, corruption and bribery continue to affect relations between private and public actors, notably at the local level (OECD, 2018a). In 2016, the President announced that the government would revoke over 3 000 local regulations. In 2017, the constitutional court prohibited the central government from revoking local bylaws, on the grounds that only the Supreme Court could do it. Therefore, as mentioned in the previous *Survey,* improving co-ordination and building capacity are key.

Product market regulation and employment protection legislation are quite restrictive in Indonesia compared with other emerging G20 economies, which weighs on formal sector activity (see Chapter 1 and previous *Survey*). At the beginning of 2020, the government launched an ambitious reform agenda – the Omnibus Bill on Job Creation – to improve the business environment. The bill, passed by Parliament in October, replaces 79 existing laws in order to harmonise and simplify the legal framework, attract more investment and boost job creation in the formal sector (Box 2.4; Chapter 1). Decrees are not yet published and will provide much-needed details with regard to funding of the unemployment fund and conditions for beneficiaries. Surveys show that public opinion has reacted rather unfavourably to the reform, notably in relation to employment protection. The participation of labour unions is crucial, notably to ensure the new unemployment fund is an effective mechanism to protect dismissed workers. More generally, wide-ranging and meaningful stakeholder consultations and communications campaigns should be ensured (OECD, 2020c).

Box 2.4. Labour reforms in the Omnibus Law on Job Creation

On October 5, the Parliament passed a wide-ranging law, intended to boost investment and job creation. Regarding the labour market, the main points are:

- Reduction of maximum severance payments to 19 months of salary (from 32 months);
- Establishment of an unemployment fund to provide six months of salary and pay for training;
- Exemption from the minimum wage for labour-intensive sectors;
- Revision of minimum wage adjustments to follow either inflation or GDP growth, but not both as currently;
- Abolition of mandatory paid leave for family weddings, childbirth and bereavement, and replacement with contract agreements between employers and employees;
- Removal of the three-year limit for fixed contracts;
- Relaxation of obstacles to outsourcing;
- Opening of all positions to foreign workers and easing of immigration procedures.

Internal migration eases job or education access, thereby reducing poverty (Wajdi et al., 2017), but it has also contributed to boosting informality in the services sector. Most migrants find employment as urban informal workers, who in turn are mostly migrants (Octavia, 2020). The share of workers paid below the minimum wage is higher in other services (ISIC sectors R, S, T and U), and accommodation and food service activities (J), even compared with agriculture, forestry and fishing (A), traditionally a source of informality (OECD calculation based on Sakernas data). The development of manufacturing would help reduce the prevalence of informality. The so-called Industry 4.0 roadmap launched by the government in 2018 (Agarwal et al., 2018) targets a contribution of 21-26% to GDP from manufacturing industry by 2030, up from around 18%, which would boost the share of formal activities. The manufacturing share has actually declined by around ½ percentage point since 2016. Investing in skills, as suggested in this chapter,

would help achieving a manufacturing recovery, as would other actions recommended in previous *Surveys*, such as trade liberalisation (OECD, 2018a).

New forms of business tend to boost the incidence of informality, but employment could still be formalised. This is the case in particular for the emerging "sharing economy" – peer-to-peer activities that rely on community-based internet platforms to match supply and demand. A well-known example are online transportation services, which rely on self-employed drivers who must comply with company rules governing registration, fares, safety, insurance (for passengers and drivers) and quality checks. Nonetheless, in terms of working conditions, social security coverage and bargaining power, drivers can be assimilated with informal workers (Schwellnus et al., 2019). Thus, there may be scope to encourage self-employed in this sector to register formally. For example, a first step would be to require self-employed workers to officially register with the social security agency, at least for health insurance.

The role of minimum wages

While informality can be a way out of poverty, it may also condemn many to in-work poverty, holding back human capital development. About 36% of the employed population lives with less than USD PPP 1.9 per day (according to the ILO). Regional statutory minimum wages are in place to reduce the risk of in-work poverty and have helped reduce wage inequalities in the past two decades (Chun and Khor, 2020). However, they have had no impact on informal workers' wages (*ibid.*).

In fact, when set too high, minimum wages may contribute to informality (see for instance Mora and Muro, 2017 in the case of Colombia). This seems to be the case in Indonesia. About 38% of workers are paid less than the minimum (Table 2.2), while foreign firms consider the sharp increases in wages (in the formal sector) the main impediment to investment in Indonesia. Labour costs increases, which are driven to some extent by minimum wage hikes over 2013-20, were among the highest in ASEAN (JETRO, 2020). Past reforms limited minimum wage revisions to nominal GDP growth, reducing the imbalance with productivity (OECD, 2016b). However, the ratio of minimum to median wages remains high by international standards: at 85%, it is well above the level in Turkey (73.5%), Brazil (73%), Mexico (40%) and China (28%) (OECD, 2018a). Adjustments should follow productivity developments more closely. The recently-legislated Omnibus Law sets a new adjustment formula that uses either inflation or GDP growth. For example, in 2020, the minimum wage increased by 8.5% in DKI Jakarta. It will grow by 3.3% in 2021 (firms can ask for an exemption) using the new formula, despite a central government circular calling for freezing minimum wages to help keep businesses afloat. Because minimum settings are seldom applied in labour-intensive industries, the recent reform that exempts them from applying minimum wages is welcome given that sufficient protections exist for those workers (OECD, 2020c).

Minimum wages vary widely across provinces, with a ratio of 1 to 2.5 between the province with the lowest (DI Yogyakarta) and the highest level (DKI Jakarta), which is not explained by different levels of income (Figure 2.20). The difference between minimum and median wages varies significantly across provinces (Table 2.2). In nearly a third of the provinces, more workers are paid below the minimum wage than above. In addition, inside provinces, some districts/municipalities impose higher minimum wages: for instance in North Sumatra, statutory minimum wages in Medan are 30% higher than for the province – already the third highest in Indonesia. A thorough review of minimum wage levels would contribute to align regional minimum wages with local needs to avoid incentivising informality. This should be accompanied by clear communication on the consequences of overly high minima.

Supporting young workers in finding jobs in the formal sector is important to reduce informality over the medium term. An informal first job increases the probability of an informal career, not least because the individual loses opportunities to acquire better skills (ILO, 2020b). There is evidence of such a "low-skill trap" in OECD countries (OECD, 2017b). In addition, minimum wages in Indonesia may be too high for the younger population given their productivity level, keeping them out of formal jobs. In Chile, *Subsidio al Empleo Joven* gives a subsidy to firms hiring 18-24-years-old workers from the 40% most vulnerable

households, provided they are formalised (OECD, 2021). Alternatively, as envisaged in the previous *Survey*, a lower minimum wage for young workers could be tried out in special economic zones, to incentivise both formality and employment. If successful, this provision could be extended across the country. Boosting apprenticeship can be another, complementary strategy (see below).

Digitalisation can foster development but calls for new skills

The digital revolution offers important opportunities to boost productivity and well-being. It can also increase inequalities if part of the population does not manage to master the new skills (OECD, 2019g). Like elsewhere, Indonesians increasingly have access to digital equipment: for example, the share of the population using internet rose by about 20 percentage points during the 2010s (Figure 2.21). However, internet use still concerns a minority and remains less common than in peer countries. Digital literacy is also low. Smartphone penetration was 31% in 2019 and only India among G20 emerging economies had a lower rate (Newzoo, 2020). Few firms have a website − only 1% in a panel of entrepreneurs (TEN, 2018). Internet and high-speed broadband are unavailable in some areas, with internet access in rural areas less than half of that in urban areas (Hadi, 2018). By late 2019, 3G and 4G mobile signals covered only around half of Indonesia (MCIT, 2020). It is important to promote principles such as open and competitive markets and technology neutrality and set the right framework for investment and public-private partnerships that improves internet access both in urban and rural areas. Subsidies to encourage deployment in rural areas, on the other hand, should only be introduced after a review of market settings, since they are likely to further distort competitive outcomes.

Basic skills help in using digital tools. Overall, Indonesia performs better with respect to adult skills than peer countries, although rather poorly globally: the Global Competitiveness Report ranks Indonesia 65th for skills, above the Philippines (67), Thailand (73), Turkey (78), Mexico (89), South Africa (90), Viet Nam (93), Brazil (96), and India (107) (WEF, 2019). Recent increases in secondary and tertiary enrolment rates (see above) will gradually expand adults' basic skills. However, to avoid a widening of inequalities due to digitalisation and other forces, the government must continue to improve the affordability of education and the access to pre-primary education.

Table 2.2. The share of workers paid below the minimum wage differs across provinces

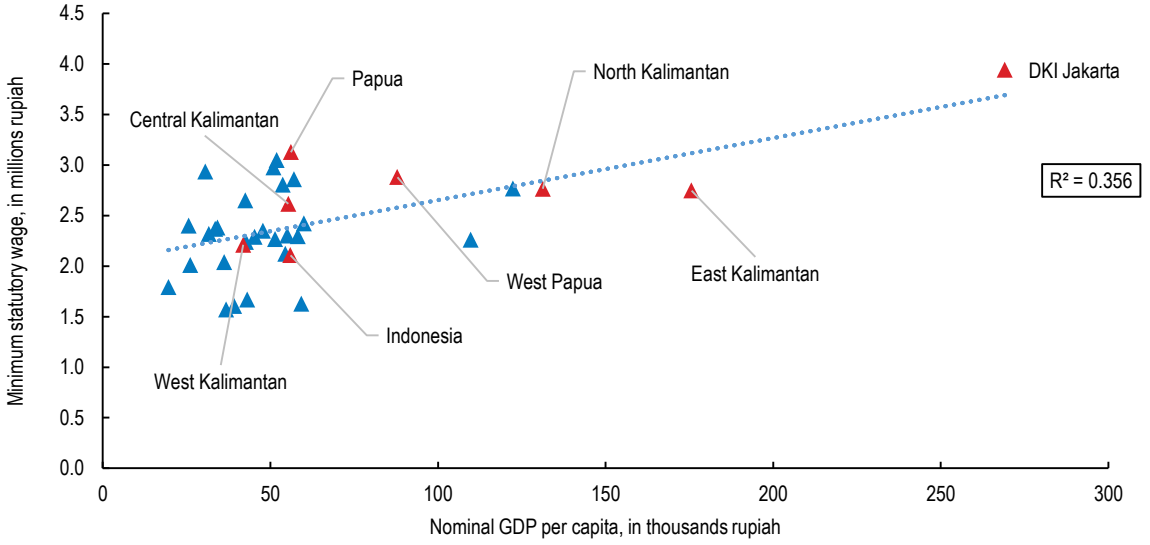
Full-time and full-month employees (excluding casual workers) aged 15-64 with a job tenure of at least one year, 2019, in percentage

Provinces	Minimum wage as % of median wage	Share of workers paid less than the minimum wage
Indonesia	**83.8**	**37.7**
Bali	88.4	33.6
Banten	63.0	20.4
Bengkulu	97.2	49.0
Gorontalo	113.5	58.1
DKI Jakarta	101.1	50.4
Jambi	101.0	51.0
West Java	59.6	21.8
Central Java	89.2	38.6
East Java	74.1	32.2
West Kalimantan	89.9	40.0
South Kalimantan	96.4	47.7
Central Kalimantan	87.2	38.3
East Kalimantan	78.5	27.4
North Kalimantan	92.2	39.8
Bangka Belitung	104.4	56.9
Riau Island	72.9	28.0
Lampung	101.9	51.8
Maluku	88.9	42.5
North Maluku	77.3	35.7
Aceh	117.4	62.5
West Nusa Tenggara	98.6	49.8
East Nusa Tenggara	96.9	45.9
Papua	88.9	38.1
West Papua	96.0	41.9
Riau	96.8	45.8
West Sulawesi	96.7	48.9
South Sulawesi	114.4	59.4
Central Sulawesi	94.4	47.9
South East Sulawesi	87.1	39.5
North Sulawesi	100.0	51.0
West Sumatra	110.9	60.0
South Sumatra	115.9	63.7
North Sumatra	92.1	46.4
DI Yogyakarta	89.3	34.1

Note: Minimum wages used in the calculations correspond to levels set at the province level.
Source: OECD calculations based on Statistics Indonesia, Sakernas.

Figure 2.20. The correlation between the minimum wage and provincial GDP per capita is weak

2019



Source: Statistics Indonesia; WageIndicator Foundation.

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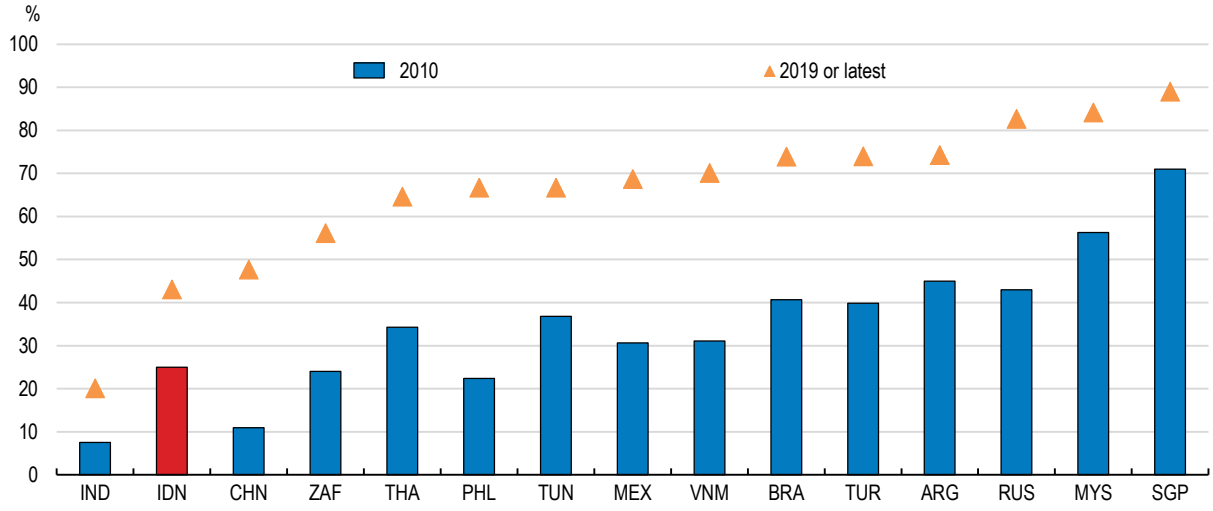
As seen above, digital skills gaps start at school, highlighting the imperative to target adults. Outreach through the workplace can facilitate identification of needs as it can be part of a standard exercise (see below). Community-based programmes can also facilitate the integration of low-skilled adults. In Argentina, community leaders disseminate information on available courses to help early-school leavers gain qualifications (OECD, 2019h). Mobile outreach services, e.g. using a truck, can help reach those with limited connection with work and community. More broadly, it is useful to set up one-stop shops and establish partnerships with other organisations serving adults with low skills to ensure that they get holistic advice. Alternatively, Indonesia could intensify online training opportunities. In Thailand, massive open online courses (*Thai-MOOCs*) are offered through an open platform for education and learning under the concept of 'lifelong learning space for all' (OECD, 2020a). When courses meet official requirements, trainees receive an accredited certificate.

Automation is expected to disrupt all sectors and workers will need to adapt to new jobs and new tasks. The current level of skills may not hamper Indonesia's economy today because of its specialisation in low-skill industries. However, it could become a more important issue in the future, as advanced technologies are increasingly replacing the routine tasks of low-skilled workers. In OECD countries, 14% of jobs are highly automatable while an additional 32% could change radically due to automation (OECD, 2019i). For example in Turkey, up to 60% of jobs may be affected. In Indonesia, 16% of hours worked could be automated (Das et al., 2019). The distribution of jobs and qualifications will change drastically in the next decade. The net balance of job creation/destruction will depend on the capacity to provide the necessary skills to the population. Over 2005-15, the net balance from technological change was negative in Asian developing economies, highlighting the risk for the future (Bertulfo et al., 2019).

Figure 2.21. Access to internet is increasing rapidly but remains elusive for more than half of Indonesia's population

Percentage of individuals using the internet



Note: Data refer to 2017 for Argentina and South Africa, to 2018 for India, and to 2020 for China.
Source: International Telecommunication Union.

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Re-training and up-skilling of workers can smooth the transition to the future economy. It is especially important to focus resources on young workers as they face higher automation risk (Nedelokoska and Quintini, 2018). However, workers in fully-automatable jobs are much less likely to participate in training (*ibid.*). Indonesia's government is planning to boost lifelong learning. In particular, the government has launched the pre-employment card programme in early 2020 (see above). However, the original programme lacked funds to fulfil its ambitious objective to develop jobseekers' skills. Before its adaptation to COVID-19, two millions unemployed – out of seven millions – were expected to receive IDR 5 million (USD 333) for training. When the programme returns to its original purpose, a higher individual budget for fewer beneficiaries – with better targeting – would trigger a more significant increase in skills. A close monitoring of recipients is also necessary, crosschecking with other sources of information. This would help evaluate and improve the programme on the fly.

Skills anticipation exercises help policymakers identify skills in need but demand considerable efforts to coordinate a variety of stakeholders. To reduce this burden, information collection can focus on priority sectors, as in Finland (CEDEFOP, 2019). Training participants and employers can help identify areas where updates of regulations, frameworks and standards are most needed. Setting up a coordinating body can also help assemble information and streamline the process. The involvement of social partners is essential (OECD, 2019h).

Digitalisation also opens opportunities to reduce search costs in the labour market. In the absence of comprehensive government services, the private sector has launched several websites dedicated to job advertisements. Recently, the Ministry of Manpower launched a new website (www.kemnaker.go.id) that facilitates matching and monitoring of the labour market, provides information on training and career opportunities, and expedites work permits for foreigners. The website should be further promoted and be responsive to user needs and requests. In particular, it should contain a list of occupations with acute skills shortages to guide young people in their education and training choices. Malaysia publishes one such list

of occupations that are skilled, in high demand and of strategic importance to economic development (OECD, 2019e).

Competencies, skills and talents are also fundamental for an innovation-driven economy. The incidence of innovation in early-stage entrepreneurial activity is relatively low in Indonesia (GEM, 2018). The start-up rate is also particularly low at 0.6 per million people, versus 6.2 in Malaysia, 1.5 in India and 0.9 in Thailand (Das et al., 2018). This is partly due to the dearth of highly skilled personnel as well as weak ICT infrastructure (TEN, 2018). Investment in R&D is also particularly low, at 0.2% of GDP in Indonesia (of which 90% is public spending) compared with 0.5% in Viet Nam, 0.6% in India, 1% in Thailand and 1.3% in Brazil. Overall, Indonesia ranks 85th in the Global Innovation Index, the last amongst its peers, driven notably by weak outcomes in human capital and research (Cornell University, INSEAD and WIPO, 2019). Promoting innovation is essential to boost GDP growth and overcome the middle-income trap, as shown in the past by the experience of successful developing countries (OECD, 2012). More public spending on R&D (direct funding or through tax incentives) would develop high-end skills and can spill over to business R&D (Guellec and van Pottelsberghe de la Potterie, 2000).

The early-stage total entrepreneurial activity rate is above the Asian regional average in 2018, thanks to high perceived opportunities and capabilities (GEM, 2018). However, entrepreneurs do not anticipate creating many jobs, suggesting that they expect to remain small. In addition, many youth use self-employment to compensate for the lack of opportunities in the formal economy; SMEs account for 97% of total employment (OECD, 2018c). There is an opportunity to encourage the development of entrepreneurial skills at school to equip future entrepreneurs (and existing micro-firm owners) with the skills needed to succeed and scale up (TEN, 2018). Devoting more and specific resources to improve teaching of entrepreneurship, for example classroom lectures, case studies, business games and on-site visits, would improve entrepreneurial activity (OECD, 2018c).

Firms are key to boost apprenticeship

As seen above, availability of skills is not the main concern of firms overall, but it is in some sectors or firms, notably the export-oriented ones (di Gropello et al., 2011). The gap with non-exporters is especially large for critical thinking, and computer and English-language skills. Exporting firms seek a higher educational profile that is difficult to find, dragging down productivity in key sectors. With a high share of youth neither employed, in education or training (see above), the government set up the National Apprenticeship Programme in 2016 to smooth school-to-work transition and address skills shortages. Some sectors are prioritised including tourism and hospitality, manufacturing, agribusiness, healthcare and the digital economy. Apprenticeships are essential to bridge the gap between prospective employees' abilities and firms' needs, to the benefit of both parties. Cooperation between employers, government and training institutions is key. For example, thanks to cooperation with a public training centre, Toyota's apprenticeship programme trained 700 apprentices in 2020, who will be certified after six months if they pass company tests; Schindler had its first graduated apprentices in 2019.

However, outcomes from the government project to boost apprenticeships are disappointing (ILO, 2018b). Several challenges remain: Indonesian society does not yet properly value the contribution of apprenticeships to employability; competency standards are lacking in some sectors, and so are follow-up and monitoring (ILO, 2020c). Giving business associations and trade unions a greater role could reinforce the quality and quantity of apprenticeships, in the same vein as the cooperation underlying the 2015-18 InSIGHT Project (The Global Deal, 2020). Even though trade unions membership has decreased to around 7% of the labour force, they are still essential to make sure workers' voice is heard. In Germany, the social partners participate in discussions regarding VET at all government levels (Apprenticeship Toolbox, 2019).

Pre-employment training institutions are also insufficient in quantity and quality (Lindsay et al., 2016). The situation forces firms to invest in internal and external on-the-job training, collaborating with either government institutions or the private sector. Those programmes tend to be more responsive to needs,

but also to focus on the short-term rather than longer-term development of the person (di Gropello et al., 2011). In addition, firms generally do not train enough. Financial incentives can help increase demand for training, and focus more on long-term competencies. A 2019 regulation offers firms a gross income deduction of 100% for internships and training activities. An additional 100% deduction is available in case the skilling activities concern validated competencies and are offered in co-operation with a government institution. While this measure is welcome, a proper evaluation would help ensure value for money.

Most adult learning takes place at work. However, the population that engages in life-long learning hardly coincides with the most in need. Among OECD countries, there is an inverse relationship between skills and participation in learning, even though low-skilled workers need more up- and re-skilling (OECD, 2019i). Workers in high unemployment sectors also tend to participate less. Recognition of prior learning is also difficult to get while it would help workers change job and is particularly important for low-skilled workers. In Indonesia, as in OECD countries, social partners have an important role to play to adapt the learning system as they hold vital information on training needs, priorities and best practices (*ibid.*). This can be facilitated if, following the United Kingdom, specific training is offered to union representatives who then help workers identify training needs and arrange training opportunities (OECD, 2019h).

Enhancing well-being and protecting workers is crucial

Creating jobs is necessary for well-being, but far from sufficient. Countries that have policies and institutions that promote job quality and inclusiveness perform better than countries that solely focus on market flexibility (Box 2.5). A core principle of the OECD Jobs Strategy to be more inclusive is to follow a preventive rather than remedial approach, which means seeking equality of opportunities, adopting a life-course perspective, making work pay, protecting workers rather than jobs, and providing sufficient social protection (OECD, 2018b). In Indonesia, social safety nets are important to help the poor and provide them with a vital minimum, notably with regard to health and education, thus limiting long-term consequences on children. There are fewer issues with targeting thanks to the use of an updated database of beneficiaries and of electronic cards in programmes such as PKH (Box 2.6). A further improvement would be to introduce benefit schedules, which could gradually decline with additional income. This could contribute to limiting benefit dependency and poverty traps. However, those programmes do not adequately smooth the transition into work. They do not prevent people from not falling into poverty in case of individual shocks or systemic crises, leaving Indonesia without a proper counter-cyclical social protection mechanism (OECD, 2019b).

The government needs to continue addressing poverty through social assistance while renewing efforts to support displaced workers. The current system of severance pay is insufficient. Its generosity (30 months of salary for 20 years of service) exceeds the level observed in peer countries, but the compliance rate could be as low as 10% (OECD, 2019b; OECD, 2018a). On paper, employees enjoy protection in Indonesia – with minimum wages too (see above) – but only formal workers, a small share of the workforce, are actually protected. Regulations make Indonesia's labour market one of the least flexible among neighbouring or large emerging-market economies, except for Brazil (Figure 2.22). Excessive and inefficient employment protection affects productivity (notably because it encourages informality) and formal employment (Chun and Khor, 2020). It would be much more efficient and inclusive to protect workers, rather than jobs (OECD, 2018b).

Expanding the recently-introduced unemployment insurance scheme (Box 2.4) would increase flexibility and protection. With the current approach, a lump sum of at most six months of wages is provided at the time of dismissal as compensation for the reduction in severance payments. The system should gradually be improved via negotiations between social partners. It should be designed so as to minimise the unintended effects of benefit receipt on incentives to work, while maximising support to job losers in their search for quality work. One avenue would be to give individuals more responsibility for the cost of unemployment benefits through individual saving accounts, collective schemes with limited generosity, or

a combination of the two (ibid.). Promoting the reallocation of workers between firms, industries and regions would enhance economic development. As the nature of work evolves, notably because of digitalisation, workers will likely change job or need re- or up-skilling more often.

Box 2.5. Good jobs for all in a changing world of work: The OECD Jobs Strategy

Low productivity growth, high levels of income inequality in many countries, as well as rapid economic change related to technological progress, globalisation and demographic changes raise new policy challenges for good labour market performance. The aim of the new OECD Jobs Strategy is to help countries address these challenges.

The OECD Jobs Strategy goes beyond job quantity and considers job quality and inclusiveness as central policy priorities, while emphasising the importance of resilience and adaptability for good economic and labour market performance in a changing world of work. It recognises that flexibility-enhancing policies in product and labour markets are necessary but not sufficient. Policies and institutions that protect workers, foster inclusiveness and allow workers and firms to make the most of ongoing challenges are also needed to promote good outcomes.

The OECD actively supports countries with the implementation of the OECD Jobs Strategy through the identification of country-specific policy priorities and recommendations. This is done through the preparation of chapters in the OECD Economic Surveys as well as more analytical background papers on the implementation of the OECD Jobs Strategy in specific countries. The process will be concluded with a synthesis report that will draw lessons from the country reviews and highlight good practices across the full range of policy tools identified by the OECD Jobs Strategy.

Since the outbreak of the COVID-19 crisis, the implementation of the Jobs Strategy has become a key activity through which the OECD can provide tailored support to countries for the development of policies and institutions that promote resilient labour markets (OECD, forthcoming).

For further details, see http://www.oecd.org/employment/jobs-strategy/.

Source: OECD (forthcoming), Implementing the OECD Jobs Strategy: An Update.

Box 2.6. Indonesia's conditional cash transfer programme (Keluarga Harapan)

Indonesia has made great progress in recent years towards establishing a social protection system that covers a wide range of risks. One major achievement has been the development and expansion of the Program Keluarga Harapan (PKH), which provides poor households with cash conditional on accessing specified health and education services. This programme has proven effective not only in reducing poverty but also in improving longer-term health and education outcomes, notably a reduction in stunting. The programme was launched in 2007, and coverage almost doubled between 2016 and 2018 to reach 10 million households.

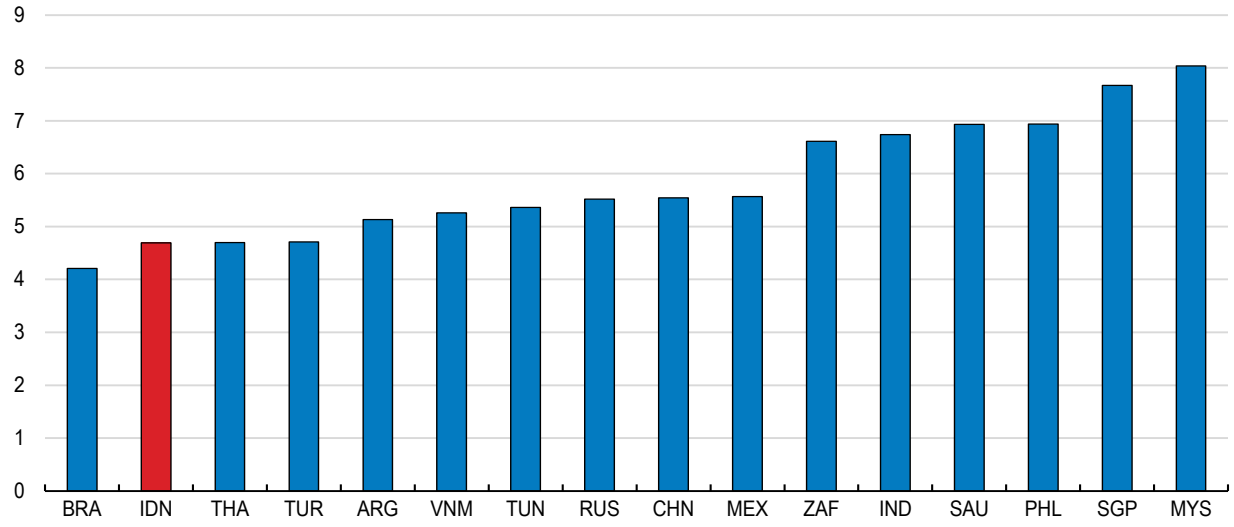
Source: OECD (2019), *Social Protection System Review of Indonesia*, OECD Development Pathways, OECD Publishing, Paris.

Health and safety at work are also major factors to maintain well-being and productivity. For example, health prevention can reduce sick leave and the trend deterioration of productivity in some occupations. With the outbreak of COVID-19, risks suddenly rose in all workplaces and firms proved ill-prepared to offer

sufficient protection to their workers. In April 2020, for instance, 30% of firms could not secure necessary physical distancing among workers (ILO, 2020d).

Figure 2.22. Labour regulations are restrictive

Index of labour market flexibility



Source: Gwartney, J. et al. (2019), *Economic Freedom of the World: 2019 Annual Report*.

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The universalisation of health insurance is welcome, even if it is taking longer than expected (OECD, 2018a). More broadly, occupational health services in Indonesia only focus on curative intervention while promotion and prevention are neglected (ILO, 2020e). Reporting of accidents and diseases is compulsory but actual data coverage is poor. Despite comprehensive laws and regulations to protect worker safety and health, the lack of compliance and awareness undermines their effectiveness. The gap could be addressed by developing guidelines for firms, supported by active participation from employer associations, trade unions and labour inspectors. Co-ordination between actors would also improve with a national strategy.

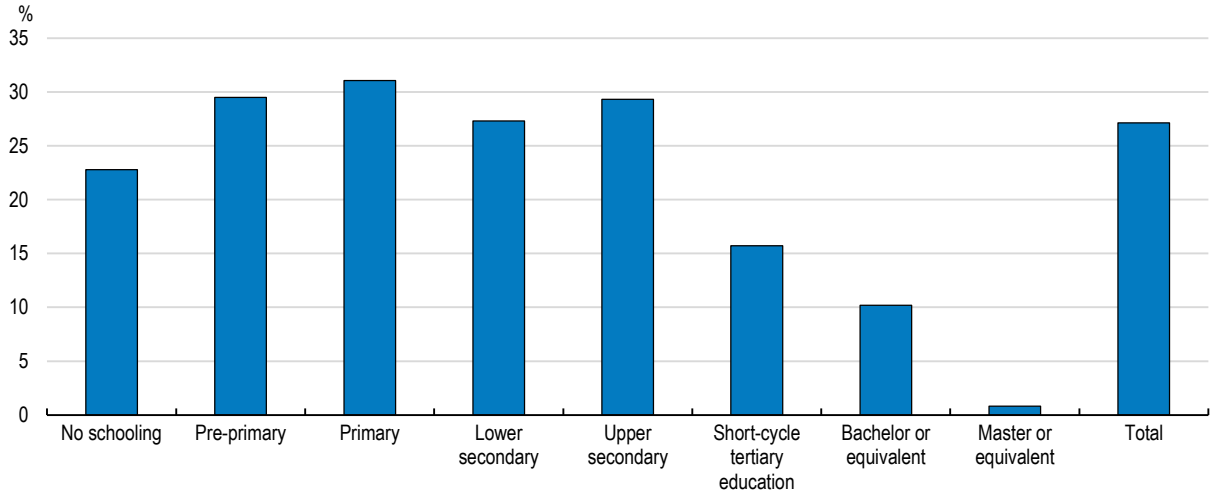
The coverage of the social security system for old-age and work accidents has not improved as much as for health insurance. It covered only 30 million workers – mostly formal – at the end of 2018 (OECD, 2019b). Both pension and health schemes suffer from short- and long-term funding issues as contribution rates are low. Furthermore, the statutory pension age is low, at 56. More coordination between the two pillars could help bridge the coverage gap. A thorough review of contribution rates, including from employers, would be needed, with a view to ensure financial sustainability. A higher share of formal workers would also help improve funding as they tend to contribute more. With rising longevity, increasing the retirement age would also improve social security financing.

There are untapped sources of skilled workers

The employment rate of women (around 52%) is significantly below men's (79%). By comparison, the respective rates across the OECD are 64% and 71%. The gap is much smaller for higher-educated women (Figure 2.23). A promotional campaign, involving both the government and social partners, could encourage higher participation in the labour market among women with primary to secondary education.

Figure 2.23. At similar educational attainment, women's employment rate is lower

Difference between male and female employment-to-population ratio by educational attainment, 2019



Source: ILO.

StatLink https://stat.link/mlo57t

Despite a significant gender gap, the female labour force participation rate has remained stable in recent decades (Figure 2.24, Panel A). The broadly unchanged level actually hides two offsetting evolutions. While social norms are now supporting higher female participation, structural economic changes have worked in the opposite direction, notably the diminishing importance of agriculture (Cameron et al., 2019). The importance of agriculture was indeed the reason for higher female participation in rural areas (Panel B). Women are now increasingly working in urban areas. Like in many countries, marriage and maternity reduce female participation, but the younger generation appears to participate more, notably because they tend to have higher education (AIPEG, 2017). Indonesia's G20 goal to reduce the gap to 25 percentage points by 2025 is ambitious and the slight improvement in recent years is promising. The medium-term expansion of the tourism sector, intensive in female labour, could contribute to reaching the target (OECD, 2018a). Continuing the efforts to expand higher education enrolment of women, notably in rural areas, would gradually raise their participation rate. As most young children are taken care of by their family, usually women, having more childcare facilities would provide women with more flexibility regarding their labour participation.

The difference between male and female attainment is larger in Indonesia than in other regional and G20 emerging-market economies. Yet, the gap in school enrolment rates has now disappeared and female educational attainment is progressing faster than for men (7 versus 6 percentage points increase in the last ten years for the population having attained at least upper-secondary education). Despite this progress, women have lower educational attainment than men (Figure 2.25), which partly explains the significant gender labour income gap (Table 2.1). Lifelong learning programmes for adults should focus particularly on women to help them acquire the necessary skills and accelerate the convergence with men.

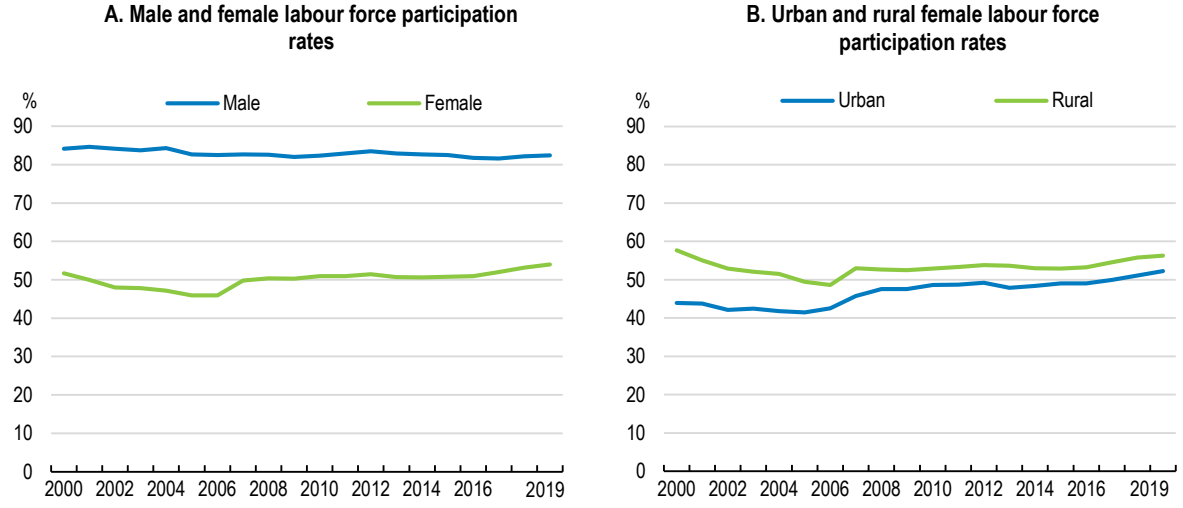
The regulatory framework is sometimes discriminating against women and disincentivising them to work. Some laws reduce female financial independence: for example, married women have to use their husband's tax file number, and husbands must assist women when signing contracts (AIPEG, 2017). Legal gender discrimination in Indonesia is higher compared to the average of both lower- and upper-middle income countries (World Bank, 2020c). There is also a lack of protection against sexual harassment while a 2017 survey reported that 57% of garment workers in Jakarta experienced sexual harassment and violence (ILO, 2020f). The wage gender gap, which is especially high for low-paid workers, appears to

have decreased over time but the discrimination component is rising (AIPEG, 2017). The authorities should thus enforce existing laws that promote gender equality and remove the legal obstacles that remain.

International migrants are a second pool of under-exploited skills. The number of foreign workers in Indonesia is tiny, at about 106 000 at the end of 2018 out of a labour force of 130 million, or less than 0.1%, although inflows have increased in recent years (OECD/ADBI/ILO, 2020). Peer countries show larger numbers: 3.7% in Argentina, 15% in Malaysia, 0.4% in Mexico, 38% in Singapore and 3% in Thailand. Reasons include geography, income levels, and policies. Restrictions to movements of people are relatively high, notably in services such as accounting and legal affairs (OECD, 2019j). For example, certain management and board positions are reserved for nationals and the acquisition of land and real estate by a foreigner is restricted. Given skills shortages in some occupations, there is an opportunity to lift restrictions for qualified immigrants. The recent introduction of e-visa services (visa-online.imigrasi.go.id) could potentially accelerate foreign investment and support tourism recovery. The government could also provide multi-year visas to reduce the administrative burden for foreign workers. In addition, further facilitating labour flows within ASEAN could be beneficial for all parties. The recent reform which opens more positions for foreign workers is also welcome (Box 2.4).

Figure 2.24. Female labour force participation is picking up after decades of stagnation

Labour force in per cent of the respective population



Source: ILO.

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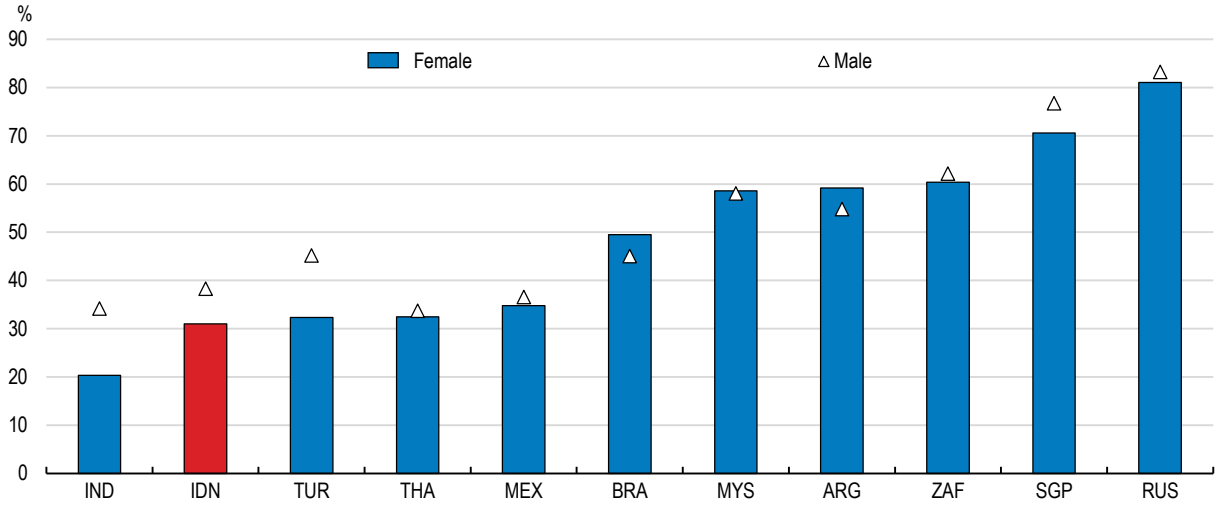
Figure 2.25. Indonesian women have received less education than men

Percentage of the population with at least upper-secondary education, 2018 or latest



Source: UNESCO Institute for Statistics, Education database.

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Many Indonesians sought work opportunities abroad in the 2000s, and by 2019 there were about 4.9 million of them employed overseas, of which 22% were considered as skilled (IOM, 2019). Migrants are important for Indonesia. Remittances amount to 3% of GDP and reduce the probability of Indonesian households being poor by 28% (World Bank, 2017). Migrants earn higher wages (six times more than in Indonesia, on average) and build up skills. It is important to lower procedural barriers for those who want to work abroad; the 2019 Law on Protection of Migrant Workers (No. 18/2019), ratifying the International Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families, is welcome in that regard. The return of Indonesian migrant workers could also be incentivised, notably when their skills are in high demand. Malaysia's TalentCorp programme offered a 15% flat tax rate on employment income for five years and tax exemptions for repatriated personal goods (OECD, 2019e). Also useful could be launching a promotion campaign and establishing a dedicated team to help returnees organise their return. The existing scholarship programme that encourages students to return when their studies are completed could be extended and incorporate elements of foreign experiences.

Policy recommendations

MAIN FINDINGS	RECOMMENDATIONS (key recommendations are bolded)
Enhancing the outcomes and inclusiveness of education	
Early childhood education can reduce the impact of socio-economic backgrounds on education outcomes and encourage female labour participation. Enrolment is low, notably in rural areas.	**Consider lowering the starting age of compulsory education**.
The increase in educational attainment came at the expense of household budgets, which cover nearly half of total education expenditures from a third a decade ago.	Further support students from disadvantaged socio-economic backgrounds notably for tertiary education through scholarships and subsidised loans.
Ratios of pupils to schools and to teachers are particularly low while infrastructure is insufficient in many schools.	Review the number of schools and envisage using multi-grade teaching.
Spending per pupil greatly varies across districts and there is not enough accountability. Intergovernmental transfers partly come as fixed block grants per district.	Collect best practices across Indonesia to introduce some performance metrics in the allocation of education funds at the school and district levels. Review government transfers to better take into account the number and characteristics of students.
Teacher performance is crucial for learning outcomes. 42% of teachers have a non-permanent contract.	Increase the number of teachers with permanent contracts. Reinforce the role of education credentials in hiring decisions for contract and honorary teachers.
Computers are available in only 40% and 67% of primary and upper-secondary schools, respectively.	**Invest more in information and communication technology infra-structure for pedagogical purposes in primary and secondary schools.**
Vocational education and training has recently expanded tremendously. Quality at some institutions, especially private ones, is dubious.	Review and improve the supervision of vocational schools and teachers.
Foreign investment in education is low. There are many low-performing high-education institutions. Australia's Monash University announced the forthcoming opening of the first full-fledged foreign campus.	Open the education sector further to foreign investors using ongoing negotiations of Comprehensive Economic Partnership Agreements with the EFTA and EU.
Fighting informality and boosting employment opportunities	
The share of youth not in education, employment or training is relatively high.	**Pilot lower levels of employment protection and discounted minimum wages for youth in special economic zones. If successful, extend them.**
Informal workers were difficult to reach during the COVID-19 crisis. The pre-employment cards programme had issues with targeting.	Intensify efforts to create a database of all workers, including informal, by cross-checking sources.
Median wages are below minimum wages in a third of provinces, incentivising informality. Different minimum wage settings are not explained by different levels of development.	**Review the level of statutory minimum wages in each province to better align them with local characteristics.**
The pre-employment card programme provides IDR 5 million (USD 333) to pay for training.	Focus the pre-employment card programme on a smaller share of the jobseekers to provide them with a bigger training budget.
Enhancing job quality and labour market inclusion	
The results of the National Apprenticeship Programme launched in 2016 are disappointing.	Increase the role of business associations and trade unions in managing and organising apprenticeships.
Firms do not train enough in general and the trained population is often not the most in need.	Encourage union representatives to train to encourage take-up of learning, help workers identify training needs and arrange training opportunities.
There is a large gender gap in employment. Female educational attainment is converging towards men's but remains below. There is evidence of gender discrimination in the labour market.	**Promote female employment through public campaigns. Target more women in lifelong training programmes. Support the construction of more childcare facilities. Enforce laws promoting gender equality.**
Skills shortages are reported but there is no close monitoring while it could help guide careers.	Use the Ministry of Manpower digital hub to share a list of occupations with acute skills shortages.
In 2019, Indonesian employed overseas were about 4.9 million, of which 22% are considered skilled.	Launch a programme to ease the return of skilled migrant workers.
Restrictions applicable to foreign workers are high and they account for less than 0.1% of the labour force.	Ease regulations that limit the recruitment of skilled foreign workers.
The recently introduced unemployment insurance scheme provides dismissed workers with a lump sum.	**Expand the unemployment insurance scheme together with business associations and trade unions.**
Mitigating the COVID-19 impact	
Inequalities between students has increased during the crisis.	Intensify monitoring of students.
Newly graduated students face a depressed labour market.	Encourage new graduates to continue studies or to follow specific training.

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INDONESIA

Indonesia experienced its first recession in over two decades in 2020, although large-scale fiscal stimulus and monetary support limited its depth and impact. The approval of an ambitious package of structural reforms, covering labour laws, taxes and ease of doing business, testifies of the authorities' commitment to attract high-quality investment that will enhance wealth and well-being. This is key at a time when Indonesia embarks in trade and investment liberalisation through the Regional Comprehensive Economic Partnership with East Asia and Oceania partners, with new opportunities and challenges. Nevertheless, the pandemic leaves behind strong headwinds. The COVID-19 impact compounds pre-existing challenges, notably a very high incidence of informality and relatively low levels of skills. Uncertainty surrounds the vaccination roll-out and the resumption of a normal life, especially for children who have been deprived of school for an unprecedentedly-long period. The crisis will have a lasting effect on some vulnerable socio-economic sectors and therefore requires improvements in the delivery of social services.

SPECIAL FEATURE: SKILLS

PRINT ISBN 978-92-64-96416-7
PDF ISBN 978-92-64-63503-6

ISSN 0376-6438
2021 SUBSCRIPTION
(18 ISSUES)

Volume 2021/4
March 2021