

## Executive summary

- *The policy framework has been improving rapidly*
- *Boosting the efficiency of public spending would free up resources for more productive uses*
- *The performance of sub-national governments could be improved*



MAIN FINDINGS	KEY RECOMMENDATIONS
<b>Setting macro policies for stable and sustainable growth</b>	
<i>Sound macroeconomic policy frameworks have allowed impressive performance, but important challenges remain.</i>	
Growth is likely to continue at a near-5% pace, although downside risks predominate, mainly on the external side.	If growth disappoints, employ a prudent monetary response to stabilise output without endangering financial stability.
Tax revenues are low, even relative to peer countries, which is constraining the government's role in the development.	Raise revenue by increasing the number of taxpayers through better compliance and improving the efficiency of tax collection.
<b>Facilitating structural change</b>	
<i>To accelerate structural change towards high-value-added, high-productivity sectors, fundamental reforms are required.</i>	
Employment protection discourages formal jobs and skills investment and reinforces labour-market segmentation.	Reduce impediments to hiring and dismissal, and provide incentives for investment in skills.
Despite good progress, corruption is still holding back growth and well-being.	Continue the fight against corruption by all means. Support the Corruption Eradication Commission (KPK), and provide it with more resources and authority.
<b>Ensuring the sustainability and inclusiveness of economic growth</b>	
<i>Environmental, health and other issues remain serious impediments to sustainability and inclusiveness.</i>	
Energy subsidies represent about 7% of public spending. They encourage pollution-intensive activities and are poorly targeted. Coal-fired power generation is still expanding.	Phase out all remaining energy subsidies. To meet rising power needs, invest in low-carbon generating capacity, including renewables and geothermal sources.
Deforestation continues, as enforcement of laws against clearing forest land by burning is poor.	Tighten and strengthen enforcement of laws on forest clearing. Improve productivity in the palm oil and timber industries.
Food resilience measures often protect large and inefficient farmers, to the detriment of low-income consumers. Food prices tend to be relatively high and volatile.	Liberalise the importation of food. Refocus National Logistics Agency (BULOG) activities on managing emergency supplies. Phase out fertiliser subsidies.
Poor nourishment and exposure to disease have left over one third of all children under five stunted.	Expand existing programmes to tackle stunting, including by encouraging breastfeeding.
<b>Enhancing regional development</b>	
<i>Large inter-regional disparities persist. Regional development is increasingly determined by sub-national governments.</i>	
The administrative burden on firms varies significantly across regions.	Work with the sub-national governments to move the regulation of business to best practice.
More special economic zones (SEZs) are to be established, in spite of their limited success to date.	Experiment with different incentives in special economic zones, including more flexible labour regulation, with a view to extending proven good practices to the whole economy.
Sub-national governments, which now account for half of all public spending, often underspend their budgets, impeding infrastructure investment in particular.	Expand assistance to help regions to improve budget planning and implementation capacity. In the interim, make greater use of special allocation funds to prioritise sub-national spending.

MAIN FINDINGS	KEY RECOMMENDATIONS
<b>Boosting the efficiency of public spending</b>	
<i>Increasing the efficiency of public spending would allow more resources to be allocated to priority areas.</i>	
<p>Government spending in key areas is shaped by performance-specific targets: for example, 20% for education and 5% for health. While this provides ring-fencing, controls on how funds are spent are inadequate.</p>	<p>Move ahead with the implementation of performance-based budgeting (“money follows the programme”). Improve evaluation of existing and future programmes, and reinforce links with medium-term objectives.</p>
<p>Central government transfers cover the entire cost of sub-national governments’ public service payroll.</p>	<p>Revise the system of transfers from central to sub-national governments to remove the link with payroll.</p>



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