ISSUE: 2024 No. 85
ISSN 2335-6677

PERSPECTIVE

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Singapore | 16 October 2024

An Accommodative Transitional 2025 Budget for Indonesia

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A general view shows the business district during the evening rush hour in Jakarta on 5 June 2024. (Photo by BAY ISMOYO/AFP).

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ISSUE: 2024 No. 85
ISSN 2335-6677

EXECUTIVE SUMMARY

- The 2025 budget is a negotiated outcome between the current and incoming administrations. It accommodates both Jokowi's legacy and some of Prabowo's priority programmes.

- The budget's revenue assumption is based on a projection of income tax growth at an ambitious 14%. This is optimistic, especially given the slow global economic recovery and declining purchasing power of Indonesia's middle class.

- The new administration may be tempted to raise debt to create more fiscal room for itself, but with growing interest payments, this could further worsen the country's debt service burden. Moreover, lifting the fiscal deficit ceiling above three per cent of GDP may lower Indonesia's sovereign rating, making government bonds less attractive to investors.

- A more prudent strategy is to reallocate funds—from fuel subsidies, for instance—to finance priority programmes, including the free school lunch programme. This requires complementary policies to cushion the inflationary effects.

- While the formation of this 2025 "transition" budget is driven by the Jokowi administration, the new administration may, once it is in charge, still revise the budget in accordance with Prabowo's policy priorities.

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INTRODUCTION

Those looking to get an early view of President-elect Prabowo Subianto's economic policy direction eagerly scrutinized last month's 2025 budget proposal to parliament. However, most would have been disappointed. The budget formulated by President Jokowi's economic ministers and Prabowo's transition team appears to be an "accommodative" budget, with funding being received by a broad spectrum of projects favoured by the two leaders, albeit with allocations that are less than anticipated. The document highlights Jokowi's key legacy projects, such as the new capital (Ibu Kota Negara Nusantara or IKN) and infrastructure projects, while also allocating funds for Prabowo's campaign pledges, particularly programmes aimed at free school lunches, food and energy security, and military modernization. Revenue and spending growth are kept subdued at respectively 8% and 6% to ensure the budget deficit comes below the 3% cap threshold and the country's debt to Gross Domestic Product (GDP) ratio is kept at a manageable level of 38%.

This brief will assess the budget's composition, and identify the new government's economic priorities. It reviews the macro-economic assumptions behind the proposed budget, before assessing the size and changes in revenue and spending components. The budget has limited fiscal space, given the sizable routine spending and debt service payments, making clear prioritisation of programmes and adjustments of their completion schedule necessary. Finally, an assessment is made on whether the revenue shortfall will provide enough flexibility to raise more debt when needed without hurting the country's debt ratings.

THE GOVERNMENT'S 2025 MACROECONOMIC OUTLOOK

The 2025 economic projections, which closely follow those of this year's estimates (see Table 1) limit the new government's spending on some of its key programmes. Growth at 5.2% is equal to this year's estimate. The country's growth is comparable to G20 and ASEAN counterparts, with India's at 7.8%, Vietnam's at 5.9%, the Philippines' at 5.8%, Turkey's at 5.7% and China's at 5.3%. But it needs at least to reach the 6-7% growth level if it is to meet its high-income-country goal by 2045.[1] The country has to address its structural challenges and accelerate regulatory reforms to raise its GDP per capita from around $5,200 currently to $22,000 within the next two decades.[2]

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Table 1: Macroeconomic indicators

Indicator	2019	2020	2021	2022	2023	2024	2025*
GDP growth (%, yoy)	5	-2.1	3.7	5.3	5.05	5.2	5.2
Inflation (%, yoy)	2.7	1.7	1.9	5.5	2.61	2.8	2.5
Rupiah exchange rate (US$/Rp)	14146	14577	14312	14871	15255	15000	16100
Govt 10-year bond interest rate (%)	5.6	5.9	6.4	7	6.63	6.7	7.1
Crude oil price (US$/barrel)	62	40	68	97	78.43	82	82
Crude oil production (000 barrel per day)	746	707	660	612	604.71	635	600
Gas production (000 barrels of oil equivalent per day)	1057	983	995	954	999.88	1033	1005

Note: *) 2025 figures are assumptions in the draft budget

Source: Ministry of Finance

Inflation for 2025 is projected at a subdued 2.5% compared to 2.8% this year. This year, the government has been able to stabilize food prices.[3] With the easing of inflationary pressure, there is room for the monetary authority to cut interest rates, following the expected move of the US Federal Reserve to further cut interest rates by the end of 2024.[4]

The government was unprepared for a strengthening Rupiah at Rp 15,500 per USD towards the end of August. It set the Rupiah at Rp 16,100 for the 2025 budget, while estimating Rp 15,000 for this year. Yet, the Rupiah has been quite volatile recently (Figure 1), driven by news about the US Fed's expected rate cuts.[5] The Rupiah may continue to be under pressure next year due to debt maturity reaching Rp 800 trillion in 2025.[6] Nonetheless, the government seems worried about weak investors' sentiment and wants to maintain flexibility to raise funds, thus setting its bonds at a reasonably high 7.1% for 2025 while estimating 6.7% for this year.

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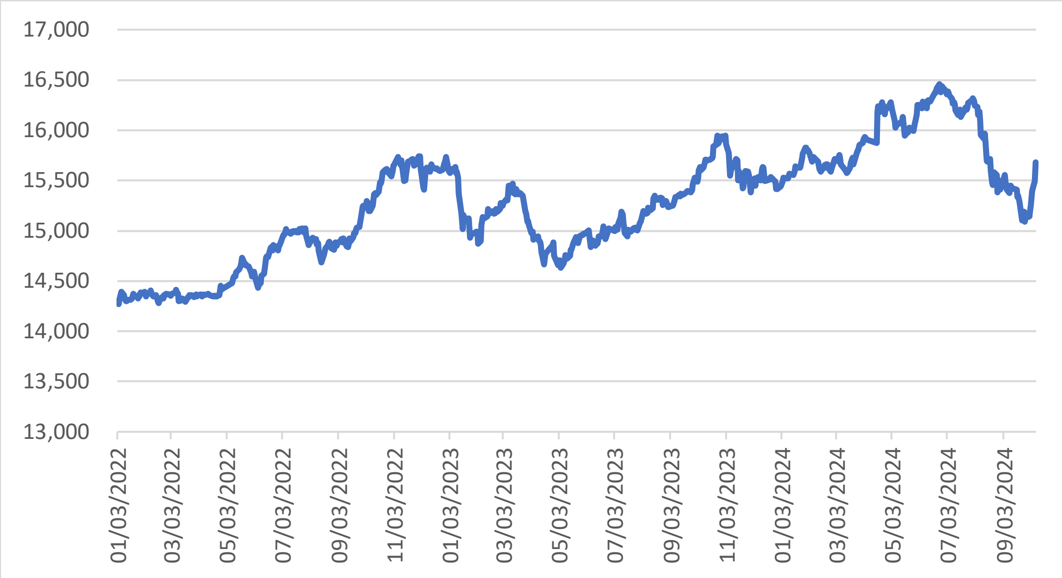
Figure 1: Exchange rate volatility (US$/Rp)



Source: Bank Indonesia

Continued global geo-political tensions are projected to keep energy prices high. Oil prices are expected to stay at the current level of USD 82 per barrel. The country's coal prices normally follow in line with oil, and although coal prices have dropped from its peak, it should keep steady at the current level, supporting coal companies and their exports to two major markets, India and China. Given these macroeconomic assumptions, the country's proposed 2025 budget is tabulated as below, in Table 2.

Table 2: Indonesia's budget, 2022-2025 (in Rp trillion)

	2022	Change (2021-2022)	2023	Change (2022-2023)	2024*	Change (2023-2024)	2025**	Change (2024-2025)
Revenue	**2,636**	**+31%**	**2,767**	**+5%**	**2,803**	**+1%**	**2,997**	**+8%**
-Tax	2,034	+31%	2,154	+6%	2,218	+3%	2,491	+12%
-Non-Tax	602	+49%	629	+5%	584	-7%	505	-13%
Expenditure	**3,096**	**+11%**	**3,121**	**+1%**	**3,412**	**+9%**	**3,613**	**+6%**
-Central Gov	2,280	+13%	2,240	-2%	2,558	+14%	2,693	+5%
-Provinces	816	+4%	881	+8%	854	-3%	920	+8%
Deficit	**460**	**-**	**336**	**-**	**609**	**-**	**616**	**-**
-Deficit/GDP	2.4%	-	1.6%	-	2.7%	-	2.5%	-

Source: Ministry of Finance, Notes: * "Outlook" and ** "Proposed"

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CENTRAL GOVERNMENT REVENUE

After the COVID-19 pandemic, there was a surge in economic activity from a low base as the country recovered. The government's 2022 revenue growth was a remarkable 31%. But getting into 2023 and the outlook for 2024, revenue growth has slowed down to 5% and 1%, respectively. The rise in food prices due to low harvests dampened consumers' purchasing power, which is reflected in weakening household spending and, thus, industrial demand. This in turn has an adverse impact on government revenue.[7]

Table 3: Government Revenue Breakdown, 2022-2025 (in Rp trillion)

	2022	**2023**	**2024***	**2025****	**Change (2021-2022)**	**Change (2022-2023)**	**Change (2023-3034)**	**Change (2024–2025)**
Revenue	**2,636**	**2,784**	**2,803**	**2,997**	**+31%**	**+5%**	**+1%**	**+8%**
-Tax	2,035	2,154	2,218	2,491	+31%	+6%	+3%	+12%
-Income Tax	998	1,061	1,062	1,209	+43%	+6%	+0%	+14%
-Value Added Tax (VAT)	688	764	819	945	+25%	+11%	+7%	+15%
-Land Tax	23	33	33	27	+21%	+50%	+0%	-18%
-Excise Tax	227	222	230	244	+16%	-2%	+4%	+6%
-Other	98	74	73	65	+15%	-24%	-1%	-11%
-Non-Tax	**(3,096)**	**(3,121)**	**(3,412)**	**(3,613)**	**+11%**	**+1%**	**+9%**	**+6%**
-Oil/Gas	(2,280)	(2,240)	(2,558)	(2,693)	+13%	-2%	+14%	+5%
-Non-oil/gas	(816)	(881)	(854)	(920)	+4%	+8%	-3%	+8%
Grant	**(460)**	**(336)**	**(609)**	**(616)**	**-**	**-**	**-**	**-**

Source: Ministry of Finance, Notes: * "Outlook" and ** "Proposed"

Although the proposed 2025 budget's revenue growth looks subdued, the two largest components in tax revenue, income tax and Value Added Tax (VAT), are aggressively projected to grow by 14% and 15%, respectively. In 2025, the VAT rate will increase from 11% to 12%. The rise in transactions driven by a 5.2% economic growth should help efforts to accommodate this VAT target. This assumes that consumption can be maintained even with the inflationary impact of the VAT's rise.[8] However, income tax growth projection at 14% might be a challenge, especially given that the rise in income tax for 2023 and 2024 was only 6% and flat, respectively, when economic growth held steady at 5.1% and 5.2%.[9] The sizable 43% income tax growth in 2022, as noted earlier, was mainly a reflection of a recovery from a low base after the COVID-19 pandemic, while in 2023, income tax only grew by 6%, before projecting flat in 2024.

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To be sure, we are dealing with a transitional post-election budget constrained by macro-economic realities and at the same time shaped by campaign promises and influenced by the existing government, given their strong support in getting the new government elected.

GOVERNMENT SPENDING ON PRABOWO'S CAMPAIGN PROMISES

During the 2024 Presidential campaign, Prabowo-Gibran promised an economic growth target of 8%. Apart from that, Prabowo-Gibran also promised to reduce the poverty rate significantly to below 5% within five years. Currently, the poverty rate is around 9.4%.[10]

One of Prabowo-Gibran's key strategies for pursuing those economic targets relies on state spending for several priority programmes. Prabowo-Gibran proposed a free lunch and milk programme for millions of children and mothers, expecting this to stimulate local economic activities through the production and provision of food and services.

The free lunch programme will tag the targets of previous programmes at the Ministry of Health, focusing on children below five years old and school-age. In total, there are around 70.5 million school children targeted to benefit from the programme. Prabowo's team has estimated that the free school lunch budget will cost around US$ 30 billion (Rp 471 trillion), or about 14% of state spending.[11]

The Jokowi government has included a free lunch programme in the upcoming 2025 budget, amounting to Rp 71 trillion. Given the amount being smaller than the total estimate for running the programme at full scale, one may expect that it will likely target select groups, such as those from disadvantaged and outermost areas first before being expanded to other areas.

While Prabowo himself promised continuity, there is the likelihood that he will choose his own priority programmes rather than continue Jokowi's legacy projects. One way to distinguish Prabowo's priorities from Jokowi's is to look at the budget distribution among key ministries. Based on the budget data from the Directorate General of Budget of the Ministry of Finance, one can observe a large increase in the Ministry of Defense's budget from Rp 139 trillion in 2024 to Rp 165 trillion in the 2025 budget allocation (Table 4). This increase reflects Prabowo's plan to modernize the defence system. This sizable rise in spending will require closer oversight. The source of funds for the free lunch programme is not yet known, but will likely be taken from budget re-allocation from other ministries. This includes allocation from the education budget; in fact, the Ministry of Education budget is cut from Rp 99 trillion in 2024 to Rp 83 trillion in the 2025 budget (Table 4). With the exception of the Ministry of Defence, many ministries will experience budget cuts to finance a new agency, the National Nutrition Agency (Badan Gizi Nasional), a government institution established by the President to carry out the free lunch programme.

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Table 4: Select Ministries' Budget (Rp trillion)

		2022	2023	2024	2025	Change (2024-2025)
1	Ministry of Defense	134.7	134.3	139.3	165.2	18.6%
2	Indonesian National Police	111.0	111.1	117.4	126.0	7.3%
3	Ministry of Health	96.9	85.5	90.5	90.6	0.1%
4	Ministry of National Education	73.0	80.2	99.0	83.2	-16.0%
5	Ministry of Religious Affairs	66.5	70.4	74.1	78.0	5.3%
6	Ministry of Social Affairs	78.3	78.2	79.2	77.2	-2.6%
7	Ministry of Public Works	100.6	125.2	147.4	75.6	-48.7%
8	Ministry of Finance	44.0	45.2	48.7	53.2	9.2%
9	Ministry of Transportation	32.9	33.4	38.6	24.8	-35.8%
10	Ministry of Law and Human Rights	17.5	18.6	18.6	21.2	13.8%
11	Ministry of Foreign Affairs	8.0	8.7	8.9	9.9	11.7%
12	Ministry of Agricultrure	14.5	15.3	14.7	7.9	-46.3%
13	Ministry of Forestry	7.1	6.9	7.7	6.2	-19.1%
14	Ministry of Home Affairs	3.0	3.0	3.3	4.8	42.9%
15	Ministry of Energy & Mineral Resources	5.9	5.5	6.8	3.9	-42.5%
16	Ministry of Industry	2.9	3.2	3.8	2.5	-33.4%
17	Ministry of Development Planning	1.4	1.6	2.1	2.0	-6.5%
18	Ministry of Culture and Tourism	3.8	3.4	3.5	1.8	-50.0%
19	Ministry for Youth and Sports	1.9	2.5	2.0	1.8	-9.5%
20	Ministry of Trade	2.4	2.3	2.0	1.7	-16.0%

Note: *) 2025 figures are the proposed budget

Source: DG Budget, Ministry of Finance

Under Jokowi, a significant budget was allocated for infrastructure projects. However, under Prabowo's administration, infrastructure development will likely be given lower priority. This can be seen in the significant decline in the 2025 budget for the Ministry of Public Works, from Rp 147 trillion in 2024 to Rp 76 trillion (Table 4). The budget for IKN is down from Rp 44 trillion in 2024 to Rp 15 trillion in 2025.[12] Deputy Finance Minister Thomas Djiwandono reported that the adjustment is made to provide some space for President Prabowo's priority programmes. He also gave assurances that the next government would find more private investment for IKN development and make it less reliant on the state budget. This trend may affect the speed of IKN development.

OTHER KEY SPENDING ITEMS

Due to Indonesia's decentralized system of governance, the central government must allocate a significant portion of the budget to the regional governments. The budget is allocated through regional transfers, which are expected to increase from Rp 759 trillion in 2024 to Rp 824 trillion in 2025 (Table 5). This amount is more than 20% of the total budget.

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One worrying concern is the significant rise in interest payments, especially after the COVID-19 pandemic. This year, the central government has had to allocate more funds, amounting to Rp 497 trillion for interest payments, higher than the expenditure for personnel (Table 5). In 2025, it will have to allocate Rp 553 trillion, or around 15% of the total budget, for interest payments.

Table 5: Government spending by type (Rp trillion)

Item	2019	2020	2021	2022	2023	2024	2025	Change (2024-2025)
Social Assistance	102	108	161	147	149	157	153	-3%
Capital	189	209	247	199	209	247	191	-23%
Subsidies	224	188	175	207	298	286	309	8%
Interest Payment	276	295	373	406	441	497	553	11%
Personnel	382	416	421	427	443	484	513	6%
Regional Transfer	725	747	689	673	739	759	824	9%

Note: *) 2025 figures are the proposed budget

Source: DG Budget, Ministry of Finance

Table 5 also shows that spending on subsidies will increase in 2025, driven primarily by fuel and electricity subsidies. The government estimates that energy subsidies will increase to Rp 204.5 trillion due to higher energy prices.[13] Subsidies for fuel and Liquid Petroleum Gas (LPG) will reach Rp 114 trillion, an increase from the outlook for 2024, which reached Rp 112 trillion. Meanwhile, electricity subsidies in the 2025 budget are being increased to Rp 90.2 trillion from the 2024 outlook estimated at Rp 80.7 trillion.

OPTIONS TO COVER THE DEFICIT

Given the spending plan, Prabowo's government will face difficult fiscal challenges in the first two to three years in office. It has to pay increasingly large debt interest instalments, while ensuring that his priority agendas as well as Jokowi's legacy programmes are kept running. Meanwhile, sluggish world economic conditions hold back domestic growth and limit state revenues.

Still, there are three options possible for broadening fiscal space. First, the government could raise more debt to spend on its priority programmes. However, with the rapid rise in interest payments, it will need to consider the risks involved in increasing the country's debt service burden.

In 2025, Rp 800 trillion of central government debt will mature (Figure 2). This consists of Government Securities (Surat Berharga Negara or SBN) worth Rp 705 trillion and Rp 95 trillion worth of debt in the form of loans (bilateral, multilateral and commercial). Then in the subsequent 2026 and 2027 years, Indonesia will also need to find ways to service the same

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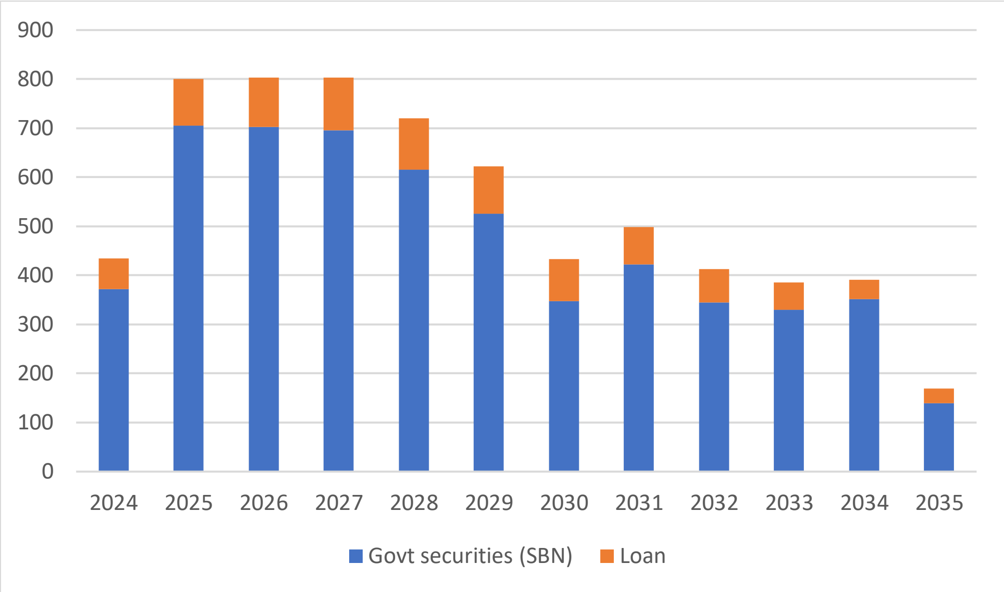
amount of debt, meaning that there will be less and less fiscal room for the government to manoeuvre in. An increase in tax collection may be the only boost the government can expect.

Figure 2: Debt maturity by year (Rp trillion)



Source: DG Debt, Ministry of Finance

Second, the government may lift the fiscal deficit ceiling above three percent of GDP. This requires a change in the state financial law which will require Parliamentary approval. However, such a change may hurt Indonesia's sovereign rating, and make government bonds less attractive to investors.

Finally, an arguably more prudent strategy is to reallocate funds from other expenditures, such as fuel subsidies, to finance priority programmes. This move will require complementary policies to cushion the consequent inflationary impacts.

CONCLUDING THOUGHTS

This 2025 "transition" budget is a relatively safe one, and accommodates the interests of both the current and incoming administrations. The resulting 2.5% budget deficit also provides some cushion for the economy, given increased uncertainty in 2025 from the continued global geo-political tensions and expected weaker growth in China. The steady hand of Finance Minister, Sri Mulyani is evident in the formation of her final budget. However, once the new administration is in charge, the budget may be revised to follow Prabowo's policy priorities. Next year, on 16 August 2025, it will be President Prabowo's turn to present his budget to parliament. It is then that we can really assess President Prabowo's real priorities, and observe whether or not he will allocate more for his own legacy projects.

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ENDNOTES

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ISEAS YUSOF ISHAK INSTITUTE

ISSUE: 2024 No. 85

ISSN 2335-6677

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