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Don't Waste Expanding Fiscal Room

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The steep fall (over 50 percent) in oil prices since the middle of last year to as low as US\$45 per barrel now has brought great benefits for Indonesia as a net oil importer, allowing for broader fiscal space for the government of President Joko "Jokowi" Widodo following the slash in fuel subsidies.

The amendments to the 2015 state budget proposed by Jokowi to the House of Representatives will reduce energy subsidies from Rp 344.7 trillion (\$27.5 billion) to Rp 158.4 trillion, thereby saving almost Rp 187 trillion that can be used for more productive programs.

The government was able to twice lower the prices of fuel, notably the widely used Premium gasoline, from Rp 8,500 per liter in November to Rp 6,600 at present.

But though the economic cost of fuel might be lower now, the government policy to reduce domestic fuel prices is misguided for several reasons.

First, reducing domestic fuel prices will not automatically reduce the inflation rate. Transportation costs for distributing goods and services, the components that are presumably most sensitive to domestic fuel prices, will not decline. The economic adage of "price rigidity" seems to apply so that the policy goal of reducing inflation is not always successful.

Meanwhile, reducing domestic fuel prices might be perceived as a political move to seek popularity. The decision of the previous Susilo Bambang Yudhoyono administration, which decided to cut fuel prices to gain popularity, should not have been repeated by President Jokowi.

To raise and then cut prices within a very short time also creates an impression that the government is playing games with this basic need. Jokowi's bold move to make the unpopular decision to scrap fuel subsidies was appreciated by most economists.

With the current flip-flop policy, however, many start to question his commitment to structural reform.

Second, the downward trend in international energy prices may not continue for various reasons. Aside from the booming energy supply from the shale gas produced by the US, there are three factors explaining why international crude oil prices have recently slumped: the agreement among the OPEC countries to maintain the level of

their production, increasing production volume in Russia to the extent of more than the market needs and an economic slowdown in China and most European countries. All these factors can eventually change.

A report from Energy and Capital (2015) stated that it was a matter of time before OPEC as the biggest oil cartel would cut oil production so that the price would not decrease further. Russia might continue supplying the world with a high volume of oil but Vladimir Putin will not let oil prices fall too low as this commodity is a strategic part of his country's economy. At the same time, when economic growth in China, Europe and the emerging markets get back on track, the need for crude oil will eventually increase and international oil prices will follow suit.

The third argument for scrapping the fuel subsidy in Indonesia is fundamental: cheap fuel prices will only increase the dependency on this non-renewable energy source.

Since 2004, Indonesia has become an oil-importing country, and the fact is that cheap oil will give an additional impetus to ownership of private cars and motorcycles that have already created so much air pollution and traffic congestion in most cities.

Indonesian policymakers should be smarter in dealing with non-renewable resources. The country has abundant energy sources such as geothermal, gas, bio-fuel, solar, wind and hydro-power. Unfortunately, as most of the people have become accustomed to using hydro-carbons, alternative non-polluting energy is not widely used and investment in the distribution infrastructure of these renewable-energy resources remains unattractive. The government tends to take the easy way out of just importing whatever is required to meet the fuel deficit we have.

A comprehensive energy policy should not only refer to economic costs. There are more than enough facts that show fuel subsidies are poorly targeted.

The Economist magazine frequently dubbed the policy of subsidizing fuel as "subsidizing cars and pollution". We could actually learn from countries that have substantial disincentives for using oil. In China, amid the amazing economic growth that needs more energy, the domestic oil price is higher than in Indonesia at about \$1.15 per liter.

In Turkey, the current price is \$2.06. Norway is an extreme example; although they have abundant oil deposits and its population is only 5.2 million, the fuel price is set at nearly \$2.5 per liter in order to reduce the use of private cars, reduce pollution and mitigate global warming.

The biggest challenge of the expanding fiscal space is how to direct government expenditure to strategic development programs. We might enjoy the fiscal advantages of the declining international oil price for only a short time, and it is

important not to waste this tail wind.

The Jokowi vision that has been laid out in his Nawacita policy basically implies expansionary spending. The additional Rp 230 trillion in the revised 2015 budget may not be enough to finance all the ambitious programs.

In the infrastructure sector, for example, the government plans to build and repair thousands of kilometers of roads, build dams, new railways, seaports, industrial estates and airports.

The cash transfers to eradicate poverty are one of the biggest challenges for the Jokowi administration. There is a high expectation that the KIS (health cards), KIP (education cards) and KSS (Family Welfare Fund) will not repeat the mistakes of similar poverty-alleviation programs under the previous administration. The 86.4 million poor people (15.5 million households) are desperately waiting for government assistance to lift them out of absolute poverty.

In the short term, it is essential to ensure that the KIS, KIP and KSS schemes do not duplicate social security schemes under the BPJS (Social Security Implementing Body). President Jokowi has initiated cash transfers under these three schemes to be made using cellular phone numbers as beneficiary identities and can be cashed at state-owned Bank Rakyat Indonesia (BRI) branches and convenient post offices. The new system is aimed at ensuring accuracy and avoiding misappropriation.

Still, officials have to take note that many poor families reside in remote areas that are far from any banking and postal facilities. Practical experience also suggests that most of the poor obtain the Rp 200,000 monthly cash transfers through agents or ask bank officials to help them cash the subsidy. This makes beneficiaries vulnerable to fraud.

There are also cases of lost SIM-cards, forgotten PIN numbers or double registration. Loopholes and possible misappropriation under the new system need to be seriously tackled by government officials.

The government bureaucratic machinery has to ensure that scrapping the fuel subsidies and reallocating them more productive programs are not just empty political slogans.

The Jokowi administration has got an advantage from the expanding fiscal room but it should not fall back into popular yet unproductive fuel subsidies.

Instead, the government should focus on using the broader fiscal room to finance

strategic programs in infrastructure, public transportation and agriculture while ensuring that social security programs are properly undertaken.

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