PEMNA
Public Expenditure
Management Network in Asia

2021 PEMNA B-CoP In-Depth Research

Fiscal Sustainability: Debt Management and Fiscal Rules

Country Cases: Indonesia, the Republic of Korea, and Vietnam

Research Team:
Jin-Yeong Kim, Vid Adrison, Deockhyun Ryu, and Le Quang Thuan

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The research team prepared this paper in cooperation with Kyoungsun Heo, the Head of PEMNA Secretariat at the Korea Institute of Public Finance, and Oleksii Balabushko, Lead Governance Specialist of the World Bank.

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Abbreviations and Acronyms

ADB	Asian Development Bank
BI	Bank Indonesia
BOK	Bank of Korea
CDC	Center for Disease Control
CIT	Corporate Income Tax
CPI	Consumer Price Index
ECOS	Economic Statistics System
EMMIE	Emerging Market and Middle -Income Economies
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GVC	Global value chain
IMF	International Monetary Fund
KDI	Korea Development Institute
LSI	Lingkaran Survey Indonesia
NABO	National Assembly Budget Office
ODA	Overseas Development Assistance
OECD	Organisation for Economic Co-operation and Development
PEMNA	Public Expenditure Management Network in Asia
PEN	National Economic Recovery Program
PFM	Public Financial Management
PIT	Personal Income Tax
SCT	Special Consumption Tax
SME	Small and medium-sized enterprises
TFP	Total Factor Productivity
VAT	Value-added tax
VND	Vietnam Dong
WB	World Bank
WDI	World Development Indicators
WHD	Western Hemisphere Department

Executive Summary

The COVID-19 pandemic has prompted an unprecedent fiscal response worldwide. It is difficult to overemphasize the important role of fiscal policy in mitigating the various negative impacts of the COVID-19 pandemic. The objectives of this paper are: (i) to explore the tools that governments have used to maintain fiscal sustainability in member countries of the Public Expenditure Management Network in Asia (PEMNA); and (ii) to explore the impact of the fiscal policies taken to tackle the COVID-19 pandemic on fiscal sustainability in PEMNA member countries. The main contents of the research are a comparison of fiscal sustainability issues prior to and during the COVID-19 pandemic, and the future prospects of selected member countries' action plans in managing fiscal sustainability going forward.

Three countries—Indonesia, the Republic of Korea, and Vietnam—were selected for in-depth case studies. The selection criteria were the size of the country in terms of population, the level of development in terms of GDP per capita, and the structure of the economy. All three countries have populations of over 50 million. In terms of GDP per capita, they show a wide range, from as low as under US$4,000 to as high as about US$40,000. They also show wide variety in terms of their major industries, and the labor force composition between the agriculture, manufacturing, and services sectors.

These three PEMNA member countries have been relatively successful in protecting the lives and livelihoods of their populations during the pandemic and major efforts have been made through fiscal policies such as tax cuts, stimulus expenditure, and compensation for companies that followed certain policies, to achieve this impressive performance. However, these fiscal efforts have also adversely affected the fiscal balance of the three member countries, and these case-study countries have each undertaken their own measures to restore fiscal stability.

Indonesia

Indonesia has experienced sustained growth of about 5 percent over the past decade, with stable inflation of under 4 percent, with the exceptions of 2013 and 2014. However, tax revenue performance has been weak relative to output growth, which resulted in a downward trend of the tax-to-GDP ratio, from 11.16 percent in 2011 to 9.75 percent in 2019. A large informal economy outside the tax system is deemed to be responsible for sluggish revenue. As a result, Indonesia's debt-to-GDP ratio increased from 23 percent in 2011 to 31 percent in 2019.

The first COVID-19 case was identified in Indonesia on March 2, 2020. To limit the transmission of the virus, the Government of Indonesia implemented social mobility restrictions, which negatively affected the economy and revenue collection. To prevent a greater contraction of the economy, an expansionary fiscal policy was undertaken, resulting in a higher budget deficit. The budget deficit was expected to breech the level of 3 percent of the GDP, the maximum amount permitted under the Law on State Finance. In anticipation of this, the Government issued a regulation temporarily removing the 3 percent budget deficit-to-GDP cap. The maximum 3 percent budget deficit-to-GDP cap will become effective again from 2023 onwards. Despite the Government's plans to restore the budget deficit to a maximum of 3 percent of GDP, a higher budget deficit from 2020 to 2022 caused the public debt-to-GDP to rise. Although the public debt-to-GDP ratio is currently still well below the 60 percent threshold set by the Law of State Finance, it is important to note the implications of higher debt levels on government interest payments. With an upward trend in the share of interest payments in total public expenditure, the Government will need to improve revenue collection and simultaneously improve spending efficiency to avoid having to take on additional debt in the future. Indeed, the Government has tried to improve revenue collection by enacting the Law on Harmonization of Tax Regulations, although government efforts to improve spending efficiency have been less successful.

Given that the end of the COVID-19 pandemic remains uncertain due to the continuing mutations of the virus, it is challenging to provide specific policy recommendations at this stage. However, if the pandemic ends soon, then the Government will be able to reduce some spending on economic clusters, such as business incentives and financing, while spending on the health sector should be kept in place to ensure that effective testing, tracing, and treatment can still be provided. Given that millions of people have lost their jobs during the pandemic, it will be important to improve their capacity so that they will be well placed to return to the workforce in the post-pandemic period. Thus, the Government should consider allocating increased spending to improving human capacity to adapt to the new working environment in the post-pandemic period. In addition, fiscal and monetary authorities should be aware of the potential for significantly higher inflation in the post-pandemic period, especially once consumption and demand start to pick up.

If the pandemic proves to be prolonged, in addition to addressing the needs of the health sector through effective testing, tracing, and treatment, the Government should also make continued efforts to increase the vaccination rollout. The sooner the outbreak is brought under control, the sooner the economy can start to grow again. To prevent a greater economic contraction, the Government should focus on policies that effectively boost demand. Workers whose incomes were negatively affected by the pandemic still need to spend on basic goods. This means that an adequate cash transfer will be beneficial not only to prevent a greater economic contraction also to help workers from resorting to risky work activities outside that could potentially prolong the pandemic.

Republic of Korea

The Korean economy entered the COVID-19 pandemic with sound macroeconomic fundamentals and high levels of income, albeit with sluggish economic growth. Public debt and borrowing costs were low and external vulnerabilities were well contained, with a net international creditor position, adequate reserves, and a flexible exchange rate. While GDP per capita exceeds US$30,000, growth slowed to an average of just 2.8 percent over the five years prior to the pandemic, reaching only 2.0 percent in 2019. The public debt-to-GDP ratio was 30.3 percent in 2011, and this increased gradually to 37.6 percent by 2019.

The Republic of Korea, which was one of the first countries to be hit by the COVID-19 pandemic, has suffered major financial loss. However, a prompt and effective policy response helped to contain the spread of the virus and avoided the worst of the economic fallout. Together with government measures to protect the most affected industries and households, the damage suffered by the domestic economy has been less severe than in other major economies. The Korean economy's GDP growth rate contracted by 0.9 percent in 2020—the first year of the pandemic—but rebounded to 4.0 percent in 2021, making the country one of only two among the advanced economies in which economic growth has recovered to its pre-COVID-19 crisis level prior to the end of the pandemic.

The Rep. of Korea maintained its expansionary fiscal policy and passed seven supplementary budgets to cope with the aftermath of the COVID-19 pandemic. The 2022 budget bill remains expansionary, although the stance appears moderate compared with previous years. The budget deficit is expected to be slightly reduced, but will continue to support economic recovery and the engines of economic growth. The newly elected Government in 2022 has continued with the vaccination program, while simultaneously easing quarantine rules. As such, fiscal policy should focus more on selective support for the affected segments of the population and economic structural transformation, as opposed to continued economic stimulus programs.

Under these circumstances, the Government recently announced new fiscal rules that will take effect from 2025 after a transition period of three years. The new rules propose a formula limiting public debt to 60 percent of GDP and the consolidated budget deficit to 3 percent of GDP, providing a degree of flexibility. While there are concerns over the recent rapid increase in public debt compared with previous years, it is in the author's view that it is premature to introduce fiscal rules within such a short period of time, in view of the current level of institutional maturity and sustainable fiscal outlook. As recommended by international organizations such as the IMF and the OECD, it would be more appropriate to introduce effective measures to ease the pace of public debt growth in the short term and operate such measures as "implicit fiscal rules."

Given that the effectiveness of monetary policy has significantly weakened since the global financial crisis in 2008/09, the following expansionary fiscal policy stance seems to be necessary in the case of the Rep. of Korea. (i) The fiscal policy needs to be more focused on restoring the engines of economic growth, expanding investment to lay the foundation for future growth, such as corporate support, innovative infrastructure construction, and data science-related support. (ii) Since unemployment and income inequality are likely to worsen after the COVID-19 crisis, it will also be necessary to further expand social safety nets, such as supporting employment and welfare.

With the inevitable increase in government expenditure, an action plan to achieve fiscal sustainability for the Rep. of Korea can be summarized as follows: (i) The perspective of government debt management has shifted from ensuring fiscal soundness to maintaining sustainable finance. (ii) It will be necessary to set a temporary limit on fiscal expenditure on the non-welfare sectors to provide space for additional expenditure on the welfare sectors. (iii) In establishing a welfare system through increasing the tax burden, it will be necessary to legislate in order to present an annual financing plan.

Vietnam

Before the COVID-19 pandemic, Vietnam was an economy with one of the highest growth rates in the world. Average annual GDP growth in the period 2011–2019 reached 6.3 percent, and the annual budget deficit decreased from an average of 5.4 percent of GDP in the period 2011–2015 to 3.5 percent of GDP in the period 2016–2019. As an open economy, Vietnam has suffered significant adverse impacts during the pandemic. By December 31, 2021, Vietnam had recorded about 1.7 million cases of COVID-19 infection and about 32,000 fatalities.

Since the first outbreak of the disease, the Government of Vietnam identified two main tasks: (i) The protection of the population's health by aggressive contact-tracing, targeted testing and isolation of suspected cases to limit the spread of the infection. (ii) Support for economic growth and ensuring social welfare, using flexible and expansionary fiscal and financial policies to support businesses and low-income families. Major fiscal measures implemented by the Government included: (i) additional health spending; (ii) tax exemptions and deferrals; and (iii) cash transfers. Thanks to this prompt and effective policy response, in 2020 Vietnam achieved a GDP growth rate of 2.91 percent. Nonetheless, as of 2021, Vietnam continued to be affected by the pandemic, and the GDP growth rate in 2021 was only 2.58 percent as opposed to the 6 percent target.

In the context of the pandemic, Vietnam's fiscal sustainability faces challenges both in terms of budget revenue and expenditure. Budget revenue decreased due to: (i) the slowdown in economic growth and disruptions in production and businesses, with the most adversely affected industries being tourism, the retail trade, and aviation transportation; (ii) external economic activities faced many difficulties due to the weak global consumption and supply; and (iii) world oil prices fell sharply and remained at low levels in 2020. Meanwhile, central and local governments were required to increase spending on health care, and on ensuring environmental sanitation, together with the prevention and control of the COVID-19 pandemic, and spending to ensure social security and other forms of support for people and businesses. Despite all these pressures, Vietnam's public debt in 2020 and 2021 remained relatively stable and at a safe level.

Along with the implementation of strong measures to control the pandemic, the Government is currently implementing a program of economic recovery and sustainable development. Although Vietnam's economic growth and fiscal sustainability prospects are forecast to be positive in the medium term, fiscal sustainability in Vietnam still faces many challenges: (i) budget revenue is not sustainable, with the room to increase revenue being limited; (ii) the pressure on budget expenditure is still a concern; and (iii) there are challenges in public finance management (PFM), especially in improving efficiency in social security and public investment.

Faced with these challenges, the Government should consider the following: (i) continue to implement strong measures for pandemic prevention and control, ensuring adequate financial resources for pandemic prevention and control; (ii) closely coordinate fiscal policy with monetary policy to control inflation and support economic recovery and sustainable development, and ensure the goal of fiscal sustainability in the medium and longer term; (iii) improve the management mechanism and control of budget expenditure commitments in line with international best practice; (iv) reform institutions and policies on public debt management; (v) strengthen the effectiveness of public financial supervision, inspection and control institutions, promoting public financial transparency and accountability; and (vi) strengthen the supervisory role of elected bodies in PFM and apply the relevant sanctions for violations of PFM and corruption.

Concluding Remarks

The COVID-19 pandemic continues to be a huge challenge in terms of financial management. In view of the current situation, more fiscal effort will be needed to save lives and support people and economic sectors that are vulnerable to shocks. At the same time, the pandemic could be an opportunity to improve fiscal management in many countries. The current crisis could provide the necessary momentum for them to make greater efforts to expand their tax bases and improve tax administration. The current crisis adds a sense of urgency to this effort. In terms of spending, appropriate public investment is required in social infrastructure, and the education and health sectors. To secure fiscal sustainability, all countries should maintain solid economic growth, while adjusting to the changing global economic environment in the post-pandemic world, which will be characterized by rapid technological change toward the so-called 4th industrial revolution. All these challenges place considerable burdens on fiscal management. However, the pandemic could provide the necessary impetus for reform in both fiscal revenue and expenditure in PEMNA member countries, and that the case studies provided here can serve as a source of policy recommendations for other countries.

Introduction

1. Background and Objectives of the 2021 PEMNA B-CoP In-Depth Research Project

2. Selection of Countries

3. Contents of Each Chapter

Introduction

1. Background and Objectives of the 2021 PEMNA B-CoP In-Depth Research Project

The COVID-19 pandemic has prompted an unprecedent fiscal response worldwide. According to International Monetary Fund (IMF) estimates,[1] the large fiscal packages announced or approved by the European Union and the United States could add a cumulative US$4.6 trillion to global GDP between 2021 and 2026. Fiscal policy has been, and is expected to remain, a key policy tool in saving lives and reviving economies. It is difficult to overemphasize the important role of fiscal policy in mitigating the various negative impacts of the pandemic. While the inevitable fiscal measures at a time of crisis have been indispensable, surging public debt during the pandemic period naturally leads to concerns over fiscal sustainability. In October 2021, the IMF estimated that average global government debt would remain at record high levels, at close to 100 percent of GDP in 2021.

While fiscal sustainability has undoubtedly become a major global issue, a wide range exists between countries in terms of government expenditure and increased levels of debt during the pandemic period. The impact of the pandemic, the fiscal response, and the resulting fiscal conditions are different in, and specific to, each country. For example, many PEMNA member countries maintained relatively low government expenditure-to-GDP and public debt-to-GDP ratios compared with the United States and the countries of the European Union prior to the pandemic. The impacts of pandemic, in terms of cumulative COVID-19 cases of infection and the number of fatalities were also relatively small in many PEMNA member countries, at least up to the end of 2020. But given that many PEMNA member countries are small open economies and the impact of the pandemic has proven to be prolonged, the negative economic impacts have nonetheless been felt by these countries. Given that the urgency and the need for an active fiscal policy response was similar across PEMNA member countries—similar to other parts of the world—the issue of fiscal sustainability follows on from these active fiscal policy responses.

The objectives of this paper are: (i) to explore tools that governments have used to maintain fiscal sustainability in PEMNA member countries; and (ii) to explore the impact of the fiscal

1 IMF, Fiscal Monitor, October 2021.

policies taken to tackle the pandemic on fiscal sustainability in PEMNA member countries. The main contents of the research are a comparison of fiscal sustainability levels prior to and after the pandemic, and the future prospects of member countries' action plans in managing fiscal sustainability going forward.

More specifically, this paper aims to answer the following questions:

i. What kinds of fiscal sustainability tools did PEMNA member countries use prior to the COVID-19 pandemic?

ii. What were governments' responses to the COVID-19 pandemic in terms of fiscal policy, and how much did these responses change the fiscal balance of their budgets?

iii. What fiscal measures were taken by governments during the pandemic in terms of supporting fiscal sustainability? Have these measures/tools been effective?

iv. Was there a clear change in the role of fiscal rules between the pre- and post-pandemic phases?

v. What strategies were taken to secure funds for the fiscal measures?

vi Have PEMNA member countries' economic characteristics (for example, main industries/sectors) affected their resilience to the pandemic?

vii. Did the pandemic change fiscal management plan in the PEMNA member countries? If so, how did they change?

2. Selection of Countries

Three countries—Indonesia, and the Republic of Korea, and Vietnam—were selected for in-depth case studies. The selection criteria were the size of the country in terms of population, the level of development in terms of GDP per capita, and the structure of the economy.

In terms of size, all three countries have populations in excess of 50 million. As for the GDP per capita, a wide range of development levels were covered, ranging from as low as under US$4,000 to as high as about US$40,000. The three countries also show a wide variety in terms of major industries and the share of the workforce in the agriculture, manufacturing and services sectors. One country is well-known for its high-tech industry, while two are still transforming their economic structures from being largely agriculture-base to becoming manufacturing-based. These three countries also show diversity on the fiscal side. Tax revenues ranged from 13 to 24 percent of GDP, while public debt-to-GDP ratios ranged from 28.8 to 58.5 percent of GDP pre-pandemic. The following table summarizes the main economic characteristics of the three selected countries.

Table 1. Economics characteristics of the three case-study countries

	Indonesia	Rep. of Korea	Vietnam
Population (Million, 2021)	267.4	51.3	98.2
GDP per capita (Current US$, 2020)	3,871	31,598	3,526
GDP per capita (PPP US$, 2020)	12,335	44,011	8,397
Some of major industry	petroleum and natural gas, textiles, automotive, electrical appliances, apparel, footwear, mining, and tourism	electronics, telecommunications, automobile production, chemicals, shipbuilding, steel	food processing, garments, shoes, machine-building; mining, coal, steel; cement, chemical fertilizer, glass, tires, oil, mobile phones
GDP: composition (2017)	agriculture: 13.7% industry: 41% services: 45.4%	agriculture: 2.2% industry: 39.3% services: 58.3%	agriculture: 5.3% industry: 33.3% services: 51.3%
Labor force composition (2017)	agriculture: 32% industry: 21% services: 47%	agriculture: 4.8% industry: 24.6% services: 70.6%	agriculture: 40.3% industry: 25.7% services: 34%
Tax and other revenues (2017)	13%	23.20%	24.80%
Budget balance (2017)	-2.70%	1.40%	-6.70%
Public debt (2017)	28.80%	39.50%	58.50%
Gini coefficient (2015 to 2018)	37.8	35.4	41

Source: World Bank and CIA Factbook; Vietnam data provided by the Vietnam Ministry of Finance.

These three PEMNA member countries have been relatively successful in protecting the health and wellbeing of their populations during the pandemic. The numbers of cases of infection were 10,881 for Vietnam, 1,919,547 for Indonesia, and 148,647 for the Rep. of Korea as of June 15, 2021, at the start of this project. The numbers of death were 59 for Vietnam, 53,126 for Indonesia, and 3,248 for the Rep. of Korea, as of the same date.

Much of this impressive performance is thanks to the crucial efforts made through fiscal policy responses, such as tax cuts, stimulus expenditure, and compensation to businesses for following various policy measures, among others. However, all of these fiscal efforts have adversely affected governments' fiscal balance, and the three case-study countries have each followed their own policy measures to restore fiscal stability.

It should also be noted that the pandemic is still not over. The cumulated numbers of cases of infection had increased to 2,286,750 for Vietnam, 4,353,370 for Indonesia, and 884,310 for the

Rep. of Korea, as of early February 2022, when the project was in its closing stages. While these three countries are still fighting the various negative effects of the pandemic, they also need to plan for the post-pandemic period, which will need to be characterized by a green transition and a digital transformation. Well-designed fiscal policies will be vital for these transitions. This paper provides an analysis of the future prospects and policy recommendations.

3. Contents of Each Chapter

The following chapters contain the in-depth analysis of each country's fiscal management, both prior to and during the COVID-19 pandemic, together with their future prospects. To maintain consistency, each chapter has the same section titles and the following contents.

Section 1. General Macroeconomic and Fiscal Conditions before the COVID-19 Pandemic

- Introducing the macroeconomic conditions of each country after the global financial crisis
- Trends in the fiscal balance and public debt before the COVID-19 pandemic
- Introduction of existing fiscal sustainability tools implemented by the government
- Fiscal rules (if there are any) and their effectiveness

Section 2. The Impact of the COVID-19 Pandemic and the Fiscal Response

- Economic and social impacts of the COVID-19 pandemic
- Fiscal measures and policies implemented by the government during the pandemic

Section 3. The COVID-19 Pandemic and Fiscal Sustainability

- Changes in government revenues and expenditures
- Immediate, mid-term, and possible long-term effects of the fiscal measures on the fiscal balance
- Debt management policies after the pandemic, especially domestic discussions or debate on new or revised fiscal rules (for example, changes in or the relaxation of the fiscal rules during the pandemic)

Section 4. Next Steps in the Post-COVID-19 Period

- The government's roadmap to fiscal sustainability after the pandemic
- Evaluation and policy recommendations

Country Case: Indonesia

1. General Macroeconomic and Fiscal Conditions before the COVID-19 Pandemic

2. The Impact of the COVID-19 Pandemic and the Fiscal Response

3. The COVID-19 Pandemic and Fiscal Sustainability

4. Next Steps in the Post-COVID-19 Period

Country Case: Indonesia[2]

1. General Macroeconomic and Fiscal Conditions before the COVID-19 Pandemic

1.1. Macroeconomic conditions before the COVID-19 pandemic

Over the past decade, Indonesia's average annual growth rate has been about 5 percent (Figure 1). During the 2007–2012 period, Indonesia enjoyed a growth rate of between 6.01 and 6.34 percent (with the exception of 2009). Since 2013, Indonesia's economy has never grown at a rate of over 5.5 percent annually. Such a reduction in economic growth is normal as the economic base becomes larger and (theoretically) the economy approaches its steady state.

During the 2011–2020 period, inflation remained stable, at below 4 percent, the only exceptions being in 2013 and 2014. Exchange rate depreciation and fuel price hikes were two major factors that led to inflation of 8.38 and 8.36 percent in 2013 and 2014, respectively. From 2013 to 2015, the Indonesian rupiah continued to depreciate against the US dollar by at least 11 percent annually (Figure 2). In addition to exchange rate depreciation, the Government of Indonesia also decided to cut the subsidy on fuel, raising the price by 44 percent in June 2013 and then again by 31–36 percent in November 2014.

Tax revenues have contributed between 72 and 82 percent of total government revenues in the past decade. The two major tax sources are the personal and corporate income taxes, and value-added tax (VAT). The share of income tax in total government revenues rose from 35 percent in 2011 to 39 percent in 2019,[3] while the share of VAT rose from 23 to 27 percent in the same period (Figure 3). Despite an upward trend in government revenues over the past decade, the tax-to-GDP ratio shows a decreasing trend, from 11.16 percent in 2011 to 9.75 percent in 2019. This implies that the extent of economic activities that lie outside the tax system has increased.

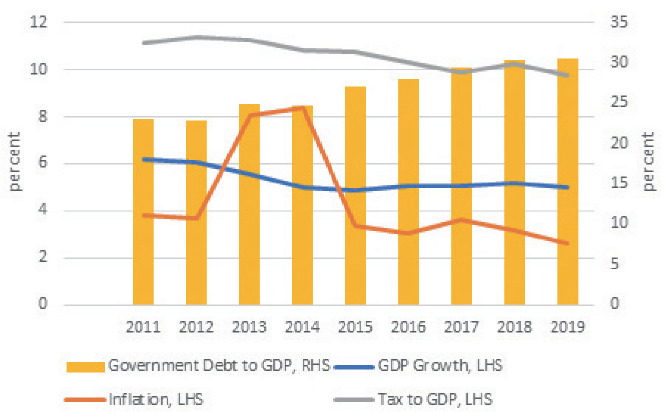
The share of registered taxpayers in the total working population provides information on the

2 Vid Adrison, Faculty of Economics and Business, Universitas Indonesia, vid.adrison@ui.ac.id
3 It reached the highest point of 43 percent when the government implemented Tax Amnesty in 2016.

extent of activities outside the tax system. As shown in Figure 4, only 30 percent of the 128 million workforce in 2019 were registered taxpayers. The number of registered taxpayers is significantly less than the number of workers in the two sectors with the largest employment (i.e., the wholesale and retail trade and agriculture) (Table 2).

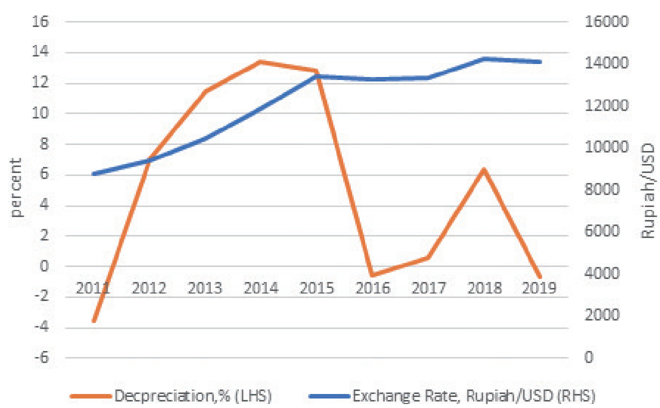
The low cost of noncompliance may be contributing to the low share of registered taxpayers in Indonesia. Citizens without a tax ID can still enjoy the same public services as registered taxpayers, as the tax ID (known as NPWP) is not a required document in many cases. For instance, nonregistered taxpayers can still apply for a driving license, a passport, and send their children to school, and also participate in national health insurance (BPJS), and many other public services. For those working in the informal sectors (or owning micro/small enterprises), being a nonregistered taxpayer may increase their competitiveness (as they avoid tax).

Figure 1. Selected macroeconomic indicators, 2011–2019 (%)



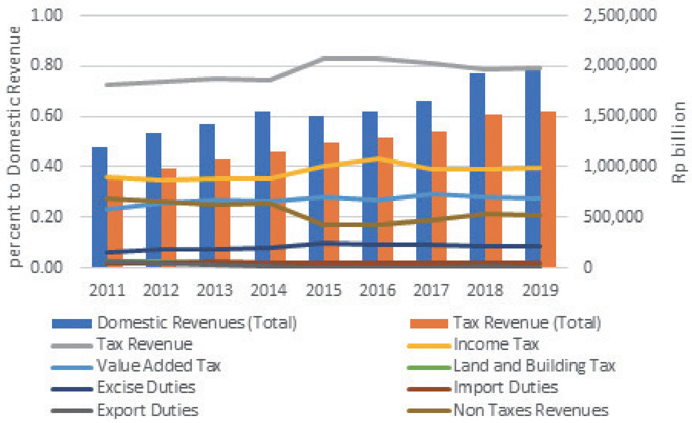
Source: World Economic Outlook, World Development Indicators.

Figure 2. Indonesian rupiah versus US dollar, 2011–2019 (%)



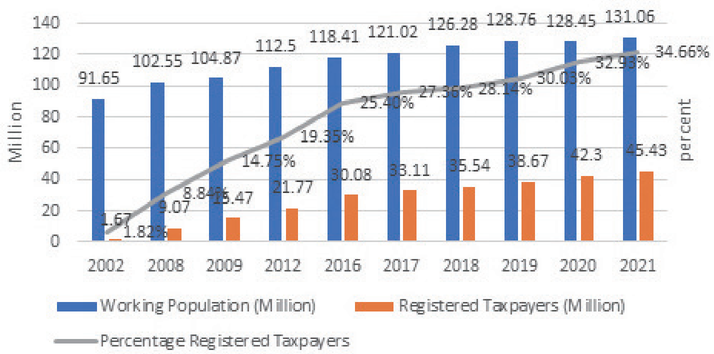
Source: World Development Indicators.

Figure 3. Government revenues by source, 2011–2019



Source: Authors' calculation from the Indonesia Financial Statistics, Bank Indonesia.

Figure 4. Number of workers and registered individual taxpayers, 2002–2021



Source: Presentation Material from Tax Audit Committee, Ministry of Finance (unpublished).

Table 2. Number of workers in the six largest GDP contributors, 2019

Classification	Agriculture	Mining and Quarrying	Manufacturing	Construction	Wholesale and Retail Trading	Information and Communication	Others	Total
Self Employee	6,291,771	198,493	2,850,126	253,038	8,287,863	208,513	8,035,677	26,125,481
Self Employee assisted by unpaid workers	10,734,878	51,538	1,595,879	117,530	4,277,950	42,973	2,119,270	18,940,018
Self Employee assisted by paid workers	943,737	50,426	841,814	396,977	1,242,912	27,595	959,624	4,463,085
Employee	3,457,082	862,415	11,631,771	4,054,759	7,034,076	616,081	24,685,038	52,341,222
Free lance in agricultural	5,258,741	145	10,323	2,958	5,754	-	1,960	5,279,881
Free lance in non agricultural	756	216,395	879,610	3,786,471	395,973	2,998	1,562,624	6,844,827
Unpaid family worker	8,763,326	49,144	1,388,392	63,716	2,919,403	23,031	1,553,745	14,760,757
Total	**35,450,291**	**1,428,556**	**19,197,915**	**8,675,449**	**24,163,931**	**921,191**	**39,917,938**	**128,755,271**

Source: Statistics Indonesia (Badan Pusat Statistk, BPS) https://www.bps.go.id/statictable/2016/04/05/1911/penduduk-berumur-15-tahun-ke-atas-yang-bekerja-selama-seminggu-yang-lalu-menurut-status-pekerjaan-utama-dan-lapangan-pekerjaan-2008---2021.html

1.2. Trend in the Fiscal Balance and Public Debt before the COVID-19 Pandemic

As the largest revenue source, with a share ranging between 72 and 82 percent of total government revenue, generating tax revenue in line with the target set in the budget is crucial. However, the ratio of revenue realization to the budget in Indonesia shows a downward trend (Figure 5). Since 2011, the actual tax revenue has never achieved the target set in the budget. The lowest realization of the budget target was in 2015, when only 83 percent of the target was collected.[4]

The poor performance of tax revenue collection must be compensated by non-tax revenues to finance government spending. However, although non-tax revenues increased from 2011 to 2014, they fell by 35 percent in 2015. During 2015–2017, total non-tax revenues remained below the 2011 level. As shown in Figure 6, more than 50 percent of the non-tax revenues came from natural resources rents between 2011 and 2014. Oil and natural gas rents are the two top contributors to natural resources rents in Indonesia. As a result, global prices of oil and natural gas have a significant impact on the Government's revenues from natural resources rents. Until September 2014, the global crude oil price remained at more than US$100 per barrel, before falling significantly to about US$60 per barrel in 2015.[5] The oil price continued

4 It is important to note the fall in the ratio of realization to target in 2015 was mainly because of a significant increase in the target not because of the fall in the tax revenue. In the approved state budget, the government set a 19.5 percent increase in the tax revenue in 2015, the highest percentage increase ever. Despite the tax revenue growing at 8.6 percent in 2015, the ratio of tax revenue realization to target fell to its lowest point of the decade.

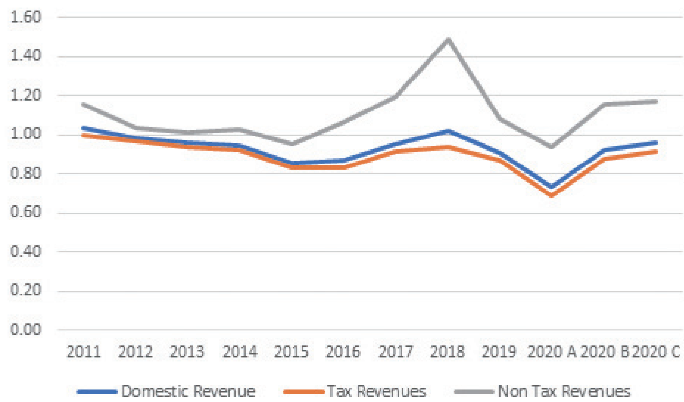
5 The price for West Texas Intermediate (WTI). Data can be accessed from https://www.macrotrends.net/1369/crude-oil-price-history-chart

to fall and reached a low of US$40 per barrel in January 2016, before returning to a positive trend. Accordingly, government revenue from natural resources followed a similar trend to the global crude oil price (Figure 6).

While tax revenue collection remained below the target and non-tax revenues fluctuated from 2011 to 2019, government spending continued to increase. As shown in Figure 7, the share of three major spending categories (i.e., personnel expenditure, goods expenditure, and interest payments) has increased over the past decade. This comes at the cost of other expenditures, including capital expenditure. As shown in Figure 7, the amount of capital expenditure has been consistently less than interest payments since 2016. As capital expenditure can increase the production capacity of the economy, a greater gap between capital expenditure and the top three spending categories may reduce the effectiveness of the government budget in increasing economic output (and tax bases).

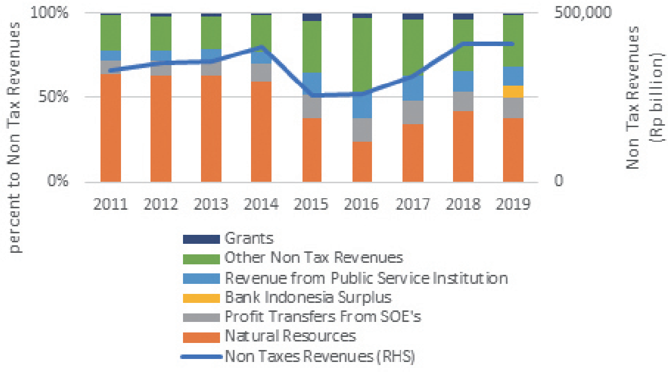
The inability to meet the tax revenue target caused the Government to raise more public debt to finance government spending. As shown in Table 3, the Government has always had a budget deficit, from Rp 84 trillion in 2011, to Rp 349 trillion in 2019. However, the budget deficit has been maintained below 3 percent, which is the threshold set by the Law on State Finance (Law No. 17/2003).

Figure 5: Ratio of revenue collection to revenue target



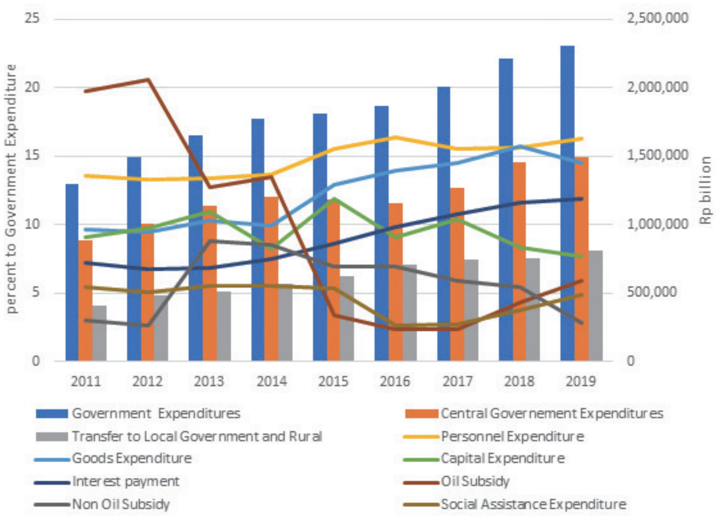
Source: Authors' calculation from MoF data (http://www.data-apbn.kemenkeu.go.id/Dataset/Details/1011)

Figure 6. Non-tax revenues collection, 2011–2019



Source: Authors' calculation from the Indonesia Financial Statistics, Bank Indonesia.

Figure 7. Government expenditure by category, 2011–2019



Source: Authors' calculation from the Indonesia Financial Statistics, Bank Indonesia.

Table 3. Realization of government revenues and expenditures, 2011–2020

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Value (Trillion Rupiah)										
Total Revenue	**1,211**	**1,338**	**1,439**	**1,550**	**1,508**	**1,556**	**1,666**	**1,944**	**1,961**	**1,648**
Tax Revenues	874	981	1,077	1,147	1,240	1,285	1,344	1,519	1,546	1,285
Non Tax Revenues	331	352	355	399	256	262	311	409	409	344
Grants	5	6	7	5	12	9	12	16	6	19
Expenditure	**1,295**	**1,491**	**1,651**	**1,777**	**1,807**	**1,864**	**2,007**	**2,213**	**2,309**	**2,595**
Central Government	884	1,011	1,137	1,204	1,183	1,154	1,265	1,455	1,496	1,833
Regional Transfer	411	481	513	574	623	710	742	758	813	763
Surplus/Deficit	**(84)**	**(153)**	**(212)**	**(227)**	**(298)**	**(308)**	**(341)**	**(269)**	**(349)**	**(948)**
Share in Revenue (%)										
Tax Revenues	72.19	73.28	74.87	73.97	82.25	82.59	80.63	78.14	78.86	77.99
Non Tax Revenues	27.38	26.29	24.65	25.71	16.95	16.84	18.68	21.06	20.86	20.87
Grants	0.43	0.43	0.47	0.32	0.79	0.58	0.70	0.80	0.28	1.14
Share in Expenditure (%)										
Central Government	68.24	67.76	68.90	67.72	65.50	61.90	63.04	65.76	64.80	70.62
Regional Transfer	31.76	32.23	31.10	32.28	34.49	38.10	36.96	34.24	35.20	29.38
Share in GDP (%)										
Tax Revenues*	11.16	11.38	11.29	10.84	10.75	10.34	9.88	10.23	9.75	8.33
Expenditure	17.71	18.84	19.08	18.61	17.48	16.82	16.56	16.63	16.38	18.60
Surplus/Deficit	**1.14**	**1.86**	**2.33**	**2.25**	**2.59**	**2.49**	**2.51**	**1.82**	**2.34**	**5.60**
Annual Growth (%)										
Total Revenue		**10.53**	**7.53**	**7.76**	**(2.74)**	**3.18**	**7.10**	**16.64**	**0.87**	**(15.96)**
Tax Revenues		12.20	9.87	6.46	8.16	3.59	4.56	13.04	1.80	(16.88)
Non Tax Revenues		6.13	0.84	12.36	(35.87)	2.48	18.80	31.52	(0.08)	(15.94)
Grants		10.14	18.07	(26.32)	137.82	(24.93)	29.40	33.84	(64.66)	242.41
Expenditure		**15.17**	**10.67**	**7.67**	**1.65**	**3.20**	**7.67**	**10.25**	**4.35**	**12.39**
Central Government		14.35	12.53	5.84	(1.68)	(2.47)	9.65	15.01	2.82	22.50
Regional Transfer		16.85	6.79	11.78	8.62	13.98	4.47	2.13	7.28	(6.20)
Surplus/Deficit		81.64	38.08	7.10	31.67	3.30	10.58	(20.98)	29.40	171.82

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Average Growth (%)		2012-2015				2016-2019				
Total Revenue		**5.77**				**6.95**				
Tax Revenues		9.17				5.75				
Non Tax Revenues		(4.13)				13.18				
Grants		34.93				(6.59)				
Expenditure		**8.79**				**6.37**				
Central Government		7.76				6.25				
Regional Transfer		11.01				6.96				
Surplus/Deficit		**39.62**				**5.57**				

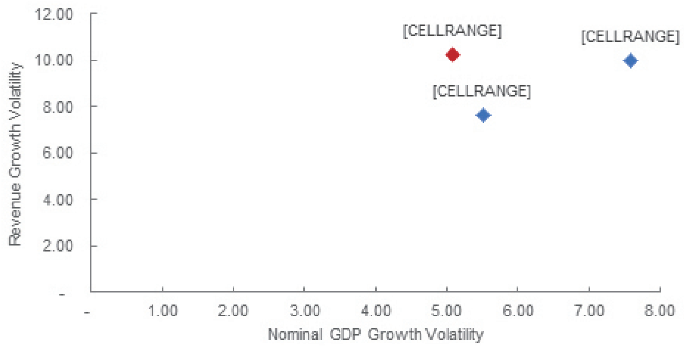
Source: Authors' calculation from MoF data and World Development Indicators.
MoF data: http://www.data-apbn.kemenkeu.go.id/Dataset/Details/1011
2020A: Ratio of realization to the initial budget.
2020B: Ratio of realization to the first budget change (Perpres No. 52/2020).
2020C: Ratio of realization to the second budget change (Perpres No. 72/2020).
*World Development Indicators (WDI).

1.3. Introduction of existing fiscal sustainability tools implemented by the Government

The volatility of Indonesian GDP growth is lower than both the Western Hemisphere Department (WHD) and the Emerging Market and Middle-Income Economies (EMMIE). However, the volatility of government revenues in Indonesia exceeded both the WHD and EMMIE economies (Figure 8). Although Indonesia experienced higher revenue volatility, together with a shortfall in tax revenues, its public debt-to GDP ratio is nonetheless still lower than those of the WHD and EMMIE economies (Figure 9).

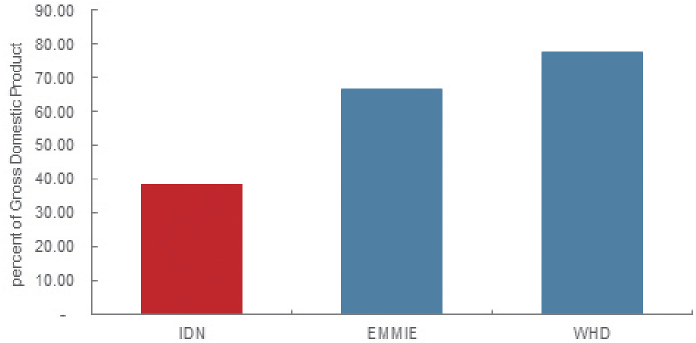
The average term to maturity of government debt in Indonesia was 8.37 years in 2019. In the same year, non-residents held about 57 percent of government debt. While a higher share of non-residents is associated with a lower yield, it can also lead to greater volatility.

Figure 8. Volatility of nominal GDP growth vs revenue growth, 2000–2019



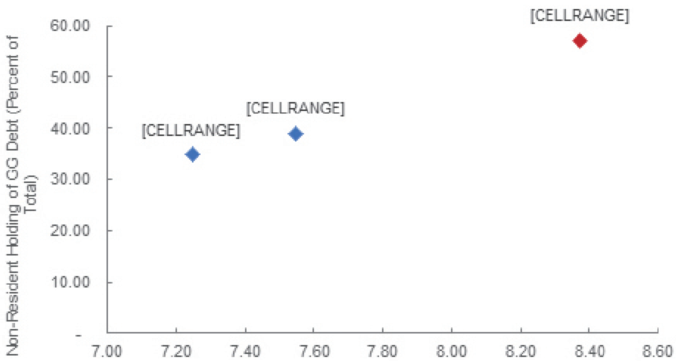
Source: IMF, World Economic Outlook

Figure 9. General government gross debt (% of GDP), 2019



Source: IMF, World Economic Outlook

Figure 10. Average term to maturity vs non-resident holdings of general government debt, 2019



Source: IMF, World Economic Outlook

1.4. Fiscal rules and their effectiveness

The Law on State Finance (Law No. 17/2003) contains two fiscal rules. First, the Government is allowed to run a budget deficit of a maximum 3 percent of GDP. Second, the maximum amount of cumulative public debt is 60 percent of GDP.[6] As shown in Table 3, the budget deficit has been maintained below the 3 percent limit.

A continued budget deficit has caused public debt-to-GDP to rise over time. As shown in Figure 1, the debt-to-GDP ratio rose from 24.9 percent in 2011 to 31.4 percent in 2016.[7] Until the end of 2019, the ratio did not change significantly (30.23 percent to GDP).[8] But by December 2020, the debt-to-GDP ratio had increased to 38.68 percent.[9] The Government argues that the debt-to-GDP ratio is sustainable, not only because it remains well below the 60 percent threshold set in the Law on State Finance but also because it is much lower than the ratios of other countries.

2. The Impact of the COVID-19 Pandemic and the Fiscal Response

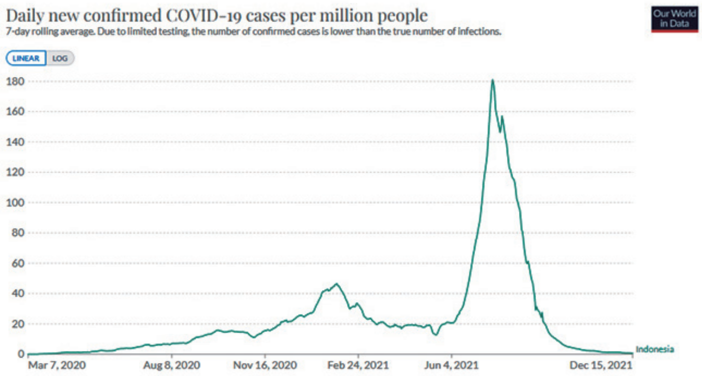
2.1. Economic and social impacts of the COVID-19 pandemic

2.1.1. COVID Cases

The first confirmed COVID-19 case in Indonesia was announced by the President on March 2, 2020. As shown in Figure 11, Indonesia had two waves of confirmed cases from 2020 to 2021. However, it is important to note that the low number of confirmed cases in 2020 was primarily due to a low testing rate in Indonesia. Since March 2021, the testing rate has increased significantly.[10] The number of daily confirmed cases reached a high in mid-July 2021 and has fallen consistently since then. With more daily testing (Figure 12) and an increased share of the vaccinated population (Figure 13), Indonesia has managed to reduce the number of daily cases and the positivity rate (Figure 14).[11]

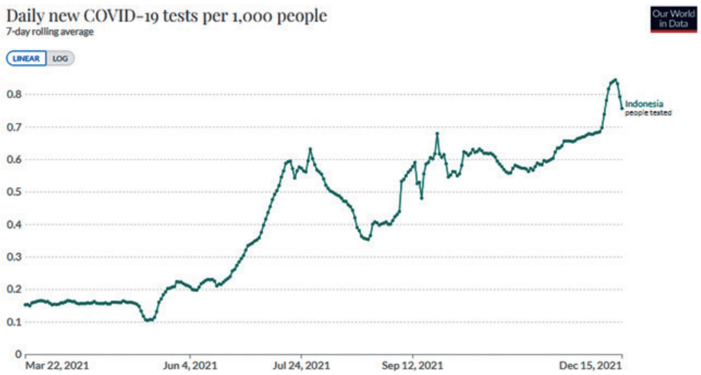
6 The fiscal rules are described in the elucidation to article 12 of the law.
7 Post 2016 data is unavailable in the World Development Indicators.
8 https://money.kompas.com/read/2020/07/14/185303226/bpk-soroti-rasio-utang-pemerintah-terhadap-pdb-di-2019-yang-capai-3023-persen
9 https://www.kompas.com/tren/read/2021/01/18/071000665/utang-mencapai-rp-6000-triliun-kapan-indonesia-bisa-melunasinya
10 The data on the testing rate prior to March 2021 for Indonesia is no longer accessible in www.ourworldindata.org
11 As of the submission of the manuscript (January 30, 2022), Indonesia experienced a sharp increase in the daily confirmed cases due to the recent omicron variant. The positivity rate rose from 0.27 percent in January 1 to 2.27 in January 27, 2022

Figure 11. Seven-day rolling average confirmed cases per million people, 2020–2021



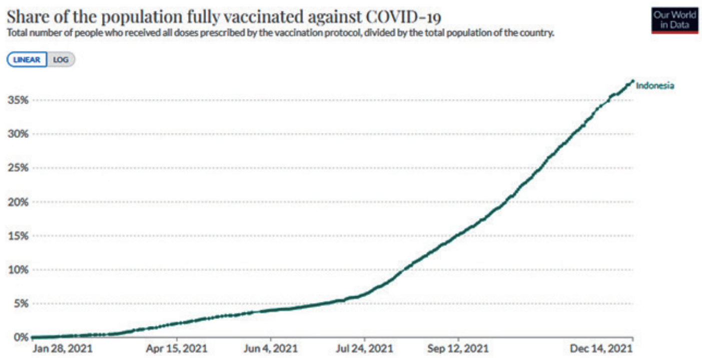
Source: www.ourworldindata.org

Figure 12. Daily new COVID-19 tests per 1,000 people



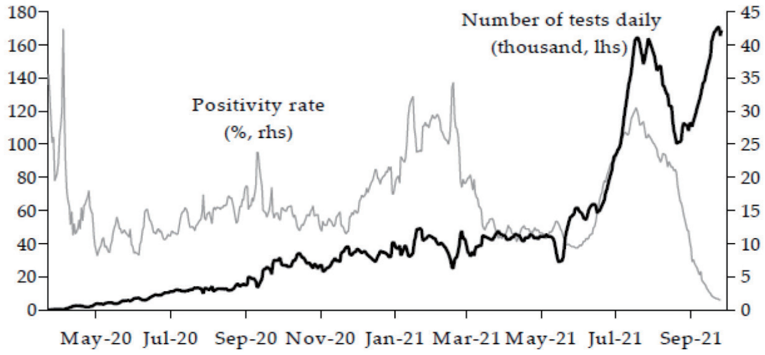
Source: www.ourworldindata.org

Figure 13. Percentage of fully vaccinated population



Source: www.ourworldindata.org

Figure 14. Positivity rate and the number of tests daily



Source: Ritchie et al. (2020)

2.1.2. Economic Impact of the COVID-19 Pandemic

Quarterly economic growth by sector is presented in Table 4. Negative growth began in the second quarter of 2020, with a 5.3 percent contraction (year-on-year). Negative growth continued until the first quarter of 2021. As a result, instead of growing at a 5.3 percent rate as expected by the Government in the absence of the COVID-19 pandemic, the economy contracted by 2.07 percent in 2020. The economy grew by 7.1 percent in the second quarter of 2021. Despite the good news of this rebound in positive economic growth, it is important to note that the high 7.1 percent rate is due to the low base effect from a 5.3 percent contraction in the second quarter of 2020.

Only five sectors have avoided experiencing any negative growth since the start of the pandemic, namely agriculture, water and sanitation, ICT, real estate, and health. Except for real estate, the positive growth in those sectors is a logical consequence of the pandemic. People tend to reduce their activities, as the risk of COVID-19 infection is positively correlated with physical activities. But a reduction in activities results in a fall in demand for non-essential products/activities. On the other hand, people still need to spend on essential products/activities. Therefore, demand for agricultural, water and sanitation products and health services did not fall. The need for information and communication products/services also increases because many activities could be performed online.

Table 4. Quarterly economic growth by sector, 2018–2021

	2018				2019				2020				2021		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
All Sector	5.1	5.3	5.2	5.2	5.1	5.1	5.0	5.0	3.0	-5.3	-3.5	-2.2	-0.7	7.1	3.5
Agriculture	3.3	4.7	3.6	3.8	1.8	5.3	3.1	4.2	0.0	2.2	2.2	2.6	3.4	0.4	1.3
Mining and Quarrying	1.1	2.6	2.7	2.2	2.3	-0.7	2.3	0.9	0.4	-2.7	-4.3	-1.2	-2.0	5.2	7.8
Manufacturing	4.6	3.9	4.4	4.2	3.9	3.5	4.1	3.7	2.1	-6.2	-4.3	-3.1	-1.4	6.6	3.7
Gas and Electricity	3.3	7.6	5.6	5.5	4.1	2.2	3.7	6.0	3.9	-5.5	-2.4	-5.0	1.7	9.1	3.9
Water and Sanitation	3.7	4.3	6.2	7.9	8.9	8.3	4.9	5.4	4.4	4.4	5.9	5.0	5.5	5.8	4.6
Construction	7.4	5.7	5.8	5.6	5.9	5.7	5.6	5.8	2.9	-5.4	-4.5	-5.7	-0.8	4.4	3.8
Wholesale and Retail Trading	5.0	5.2	5.3	4.4	5.2	4.6	4.4	4.2	1.6	-7.6	-5.0	-3.6	-1.2	9.4	5.2
Transportation and Warehouse	8.5	8.7	5.7	5.5	5.4	5.9	6.7	7.6	1.3	-30.8	-16.7	-13.4	-13.1	25.1	-0.7
Hotel and Restaurant	5.2	5.6	5.9	6.0	5.9	5.5	5.4	6.4	1.9	-22.0	-11.8	-8.9	-7.3	21.6	-0.1
Information and Communication	7.8	5.1	8.1	7.1	9.1	9.6	9.2	9.8	9.8	10.8	10.7	10.9	8.7	6.9	5.5
Finance and Insurance	4.3	3.1	3.1	6.2	7.2	4.5	6.2	8.5	10.6	1.1	-0.9	2.4	-3.0	8.3	4.3
Real Estate	3.1	3.0	3.7	4.2	5.4	5.7	6.0	5.9	3.8	2.3	2.0	1.2	0.9	2.8	3.4
Corporate service	8.0	8.9	8.7	8.9	10.4	9.9	10.2	10.5	5.4	-12.1	-7.6	-7.0	-6.1	9.9	-0.6
General Government	5.7	7.2	7.9	7.1	6.4	8.9	1.8	2.0	3.1	-3.2	1.8	-1.5	-2.9	9.6	-10.0
Education Services	4.8	5.0	6.6	5.0	5.6	6.3	7.8	5.4	5.9	1.2	2.4	1.4	-1.5	5.9	-4.4
Health Services	6.0	7.1	7.6	7.8	8.7	9.1	9.2	7.8	10.4	3.7	15.3	16.5	3.4	11.7	14.1
Other Services	8.4	9.2	9.1	9.0	10.0	10.7	10.7	10.8	7.1	-12.6	-5.5	-4.8	-5.2	12.0	-0.3

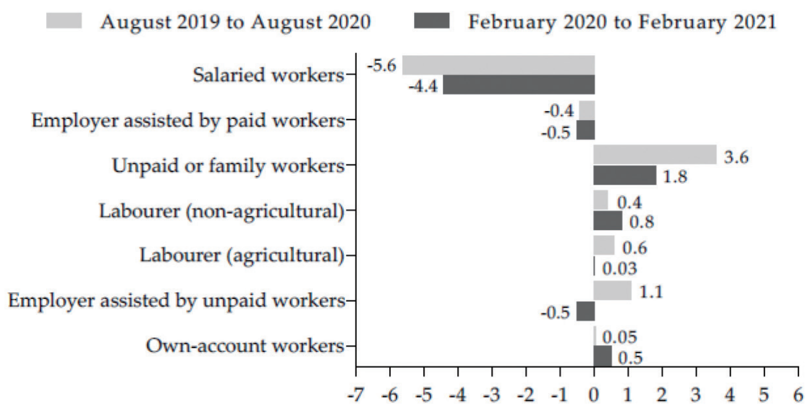
Source: Authors' calculation from Bank Indonesia data.

2.1.3. Changes in employment and poverty

As shown in Figure 15, the economic shock in Indonesia caused the number of salaried workers to fall by 4.4 million (Suryahadi, Al Izzati, and Yumna 2021). On the other hand, the number of unpaid workers and laborers increased. Such changes in employment status contribute to changes in the poverty rate. Before the pandemic, the poverty rate showed a steady decline and reached 9.2 percent in September 2019. During the pandemic, the poverty rate rose, reaching 10.2 percent in September 2020, before declining slightly to 10.1 in March 2021 (Figure 16). The increase in the poverty rate in urban areas was larger than that seen in rural areas.

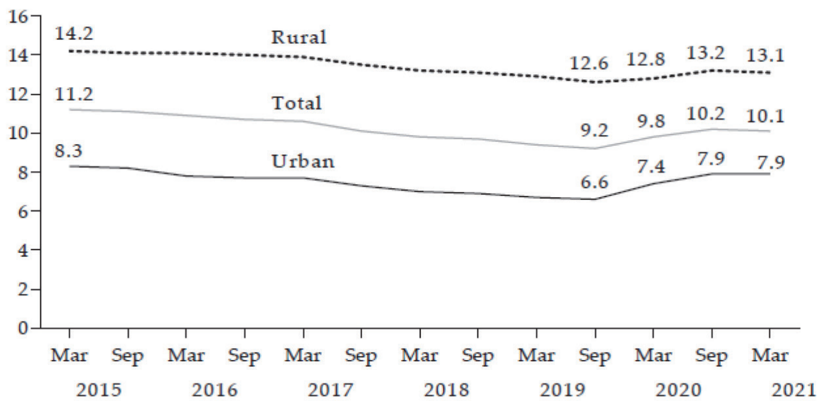
To protect vulnerable groups, the Government resorted to implementing various social protection programs. The four major programs are: (i) the Family Hope Program (PKH), which is a conditional cash transfer; (ii) electronic vouchers for food (BPNT); (iii) unconditional cash transfers (BST); and (iv) unconditional cash assistance from the Village Fund program (BLT DD). The amount of social assistance received by each beneficiary is US$264 and US$168 per year for the PKH and BPNT programs, respectively. For both BST and BLT DD, each recipient receives US$252 over nine months. The presence of social protection programs eases the severity of the pandemic's impact on poor households. In the absence of these social protection programs, the poverty rate would have increased to 14 percent (Suryahadi, Al Izzati, and Yumna 2021).

Figure 15. Changes in employment status (million)



Source: BPS (https://bps.go.id/statictable/2009/04/16/971/penduduk-15-tahun-ke-atas-menurut-status-pekerjaan-utama-1986---2021.html)

Figure 16. Poverty rate in Indonesia, 2015–2021



Source: BPS (https://bps.go.id/indicator/23/192/1/persentase-penduduk-miskin-menurut-provinsi.html)

2.2. Fiscal measures and policies implemented by the Government during the pandemic

2.2.1. Temporary removal of the 3 percent deficit-to-GDP rule

Curtailing physical activities was necessary to limit the spread of the COVID-19 virus. On the other hand, the reduction in activities had a negative effect on the economy, the government budget (both on the revenue and the expenditure sides), and the stability of the national financial system. Therefore, the central government in Indonesia issued a Law-replacing Government Regulation (known as Perpu) No. 1/2020. One of the important aspects regulated in Perpu No. 1/2020 was the temporary removal of the 3 percent deficit-to-GDP ratio cap. The maximum 3 percent deficit-to-GDP will become effective again starting in 2023.

A higher deficit is required for two reasons. First, the COVID-19 outbreak and the social mobility restrictions policy reduce demand in many sectors. Lower demand implies lower bases in both direct and indirect taxes, and therefore lower tax revenues. Second, the Government should prepare for significant additional expenditure to control the virus outbreak, spending that did not exist in the initial 2020 budget.

One of the implications of Perpu No. 1/2020 was that the Government needed to reallocate the budget.[12] In 2020, the Government changed the budget twice. The Government issued Government Regulation No. 54/2020 on April 3, 2020. As seen in Table 5, the Government expected total revenue to fall by 21 percent compared with the initial budget, while spending increased by 3 percent. As the Government expected a further reduction in revenues and a need for higher expenditure, it made a second amendment to the budget by issuing Government Regulation No. 72/2020 on June 24, 2020.

12 Budget reallocation applies for central government as well as subnational governments.

Table 5. Changes in the central government budget, 2020

	Budget (Trillion Rupiah)			Realization (Trillion Rupiah)	Ratio		
	Initial	First Change (Perpres 54/2020)	Second Change (Perpres 72/2020)		First Change/ Initial	Second Change/ First Change	Realization/ Second Change
Total Revenue	**2,233.20**	**1,760.88**	**1,699.95**	**1,647.78**	**0.79**	**0.97**	**0.97**
Domestic Revenue	2,232.70	1,760.39	1,698.65	1,628.95	0.79	0.96	0.96
Tax Revenue	1,865.70	1,462.63	1,404.51	1,285.14	0.78	0.96	0.92
Non Tax Revenue	367.00	297.76	294.14	343.81	0.81	0.99	1.17
Grants	0.50	0.50	1.30	18.83	1.00	2.61	14.49
Expenditure	**2,540.42**	**2,613.82**	**2,739.17**	**2,595.48**	**1.03**	**1.05**	**0.95**
Central Government	1,683.48	1,851.10	1,975.24	1,832.95	1.10	1.07	0.93
Regional Transfer	856.95	762.72	763.93	762.53	0.89	1.00	1.00
Primary Balance	(12.01)	(517.78)	(700.43)	(633.61)	43.10	1.35	0.90
Surplus/Deficit	**(307.23)**	**(852.94)**	**(1,039.22)**	**(947.70)**	**2.78**	**1.22**	**0.91**
Financing	**307.23**	**852.94**	**1,039.22**	**1,193.29**	**2.78**	**1.22**	**1.15**

Source: Authors' calculation from MoF weekly report (https://pen.kemenkeu.go.id/in/page/data-realisasi)

2.2.2. National Economic Recovery Program

The temporary removal of the fiscal rule limiting the budget deficit allowed the Government to implement a countercyclical policy. To prevent a greater economic contraction, the Government allocated Rp 695.2 trillion to the National Economic Recovery Program (known as PEN). To finance the deficit, the Government, in cooperation with Indonesia's central bank (Bank Indonesia, or BI), implemented a burden-sharing mechanism. Burden-sharing is based on the distinction between financing for public goods/benefits and non-public goods/benefits. The public goods/benefits categories include: health, social protection, and governmental institutions financing. The financing for these categories is through BI's purchase of government bonds. Financing for non-public goods/benefits is aimed at helping economic agents recover. Included in this category are financing for small and medium enterprises and other non-public benefits. For non-public goods/benefits, government bonds are sold directly to the market, with BI contributing the difference between the market rate and the 3-month central bank repo rate minus 1 percent. Other non-public goods/benefits are borne by the Government at the market rate of government bonds.[13]

There were six clusters in the 2020 PEN and five clusters in the 2021 PEN (Tables 6 and Figure 17). In 2020, about 57 percent of the budget was allocated for financing public goods/benefits

13 https://www.kemenkeu.go.id/publikasi/siaran-pers/siaran-pers-burden-sharing-pembiayaan-penanganan-pandemi-covid-19-antara-pemerintah-dan-bank-sentral/

(health, social protection, and sectoral institutions/subnational governments). Although the total funds allocated did not change in 2020, there were some changes in various allocations over the course of 2020. The details of spending in each cluster (and its amount as of June 2020) are presented in Figure 17.

As shown in Figure 17, the supply-side policy dominates the program for SMEs, corporate finance, and business incentives. For business incentives, all the programs are in the form of tax expenditures (i.e., tax reductions, deferrals of tax payments, etc.). For SMEs and corporate financing, the programs include capital restructuring, assistance for investment/working capital funds, and interest subsidies (for SMEs). The demand-side policy is mostly in the social protection program, such as cash transfers (both conditional and unconditional), food assistance, electricity bill subsidies, supplements to the village fund, and pre-employment programs.[14]

The budget absorption of the economic recovery program was an important issue in 2020. As shown in Table 6 and Figure 18, only the social protection and SME clusters had absorbed more than 50 percent of the budget allocated by September 2020. The realization on the corporate finance cluster remained at 0 percent until September 2020. The unutilized funds resulted in economic inefficiencies. Starting in October 2020, the Government made gradual changes to the budget ceiling of each cluster while keeping the total budget constant.

A spike in actual spending for the sectoral and subnational governments cluster in December 2020 is no surprise. Two factors contribute to such a pattern. First, budget absorption is one of the key performance indicators of government institutions. A low absorption may result in a budget cut in the following year. As a result, government institutions (both central and subnational governments) have an incentive to speed up spending close to their target by the end of the fiscal year. Consequently, government budget absorption exhibits an exponential pattern in Indonesia (Adrison and Flukeria, 2016). Second, changes in the government budget require a lengthy process between the executive and the legislature, especially at the subnational level. Only once a budget revision is agreed upon can the subnational government move ahead and start spending on program implementation.

The problem of budget absorption continued in 2021. As shown in Table 7 and Figure 19, social protection reached only 81 percent of its target, while SME and corporate finance reached only 47.9 percent as of December 10, 2021. The absorptions were both lower than those in 2020. On the other hand, the health and business incentives clusters had a greater absorption in 2021 than in 2020.

14 Participants of the Pre employment program also receive cash transfer.

Table 6. National economic recovery spending by cluster, 2020

	June	July	August	September	October	November	December
Budget Ceiling (Trillion Rupiah)							
Health	87.6	87.6	87.6	87.6	97.3	96.2	99.5
Social Protection	203.9	203.9	203.9	203.9	234.3	230.7	230.2
Sectoral and Subnational Government	106.1	106.1	106.1	106.1	66.0	70.7	67.9
SME	123.5	123.5	123.5	123.5	114.8	115.8	116.3
Corporate Finance	53.6	53.6	53.6	53.6	62.2	61.2	60.7
Business Incentives	120.6	120.6	120.6	120.6	120.6	120.6	120.6
Ratio of Actual Expenditure to Budget Ceiling (%)							
Health	5.1	7.8	17.3	25.0	33.1	43.3	63.5
Social Protection	36.2	41.8	55.9	77.0	75.6	91.9	95.7
Sectoral and Subnational Government	5.2	13.2	16.8	25.1	48.8	51.6	98.1
SME	22.7	25.3	42.2	68.7	82.4	87.3	96.6
Corporate Finance	0	0	0	0	3.2	3.3	100
Business Incentives	11.2	13.4	15.6	23.3	31.6	38.8	46.5

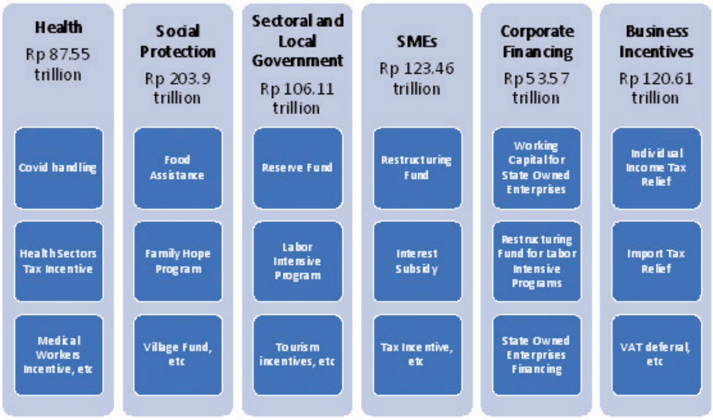
Source: Authors' calculation from MoF weekly report (https://pen.kemenkeu.go.id/in/page/data-realisasi)

Table 7. National economic recovery spending by cluster, 2021

	Q1	Q2	Q3	28-Dec	Budget Ceiling
Actual Expenditure (Trillion)					
Health	14.9	47.7	104.1	198.5	215.0
Social Protection	44.0	66.4	117.3	171.0	186.6
Priority Programs	12.6	41.8	62.5	105.4	117.9
SME and Corporation	37.7	51.3	66.7	116.2	162.4
Business Incentives	14.0	45.1	59.4	67.7	62.8
Ratio of Actual Expenditure to Budget Ceiling (%)					
Health	6.9	22.2	48.4	92.3	
Social Protection	23.6	35.6	62.8	91.6	
Priority Programs	10.7	35.5	53.0	89.4	
SME and Corporation	23.2	31.6	41.1	71.6	
Business Incentives	22.3	71.7	94.6	108	

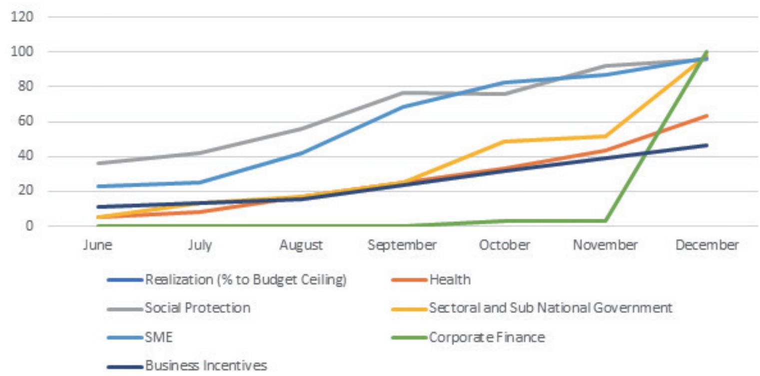
Source: Authors' calculation from MoF weekly report (https://pen.kemenkeu.go.id/in/page/data-realisasi)

Figure 17. Components of the National Economic Recovery Program by cluster (as of June 2020)



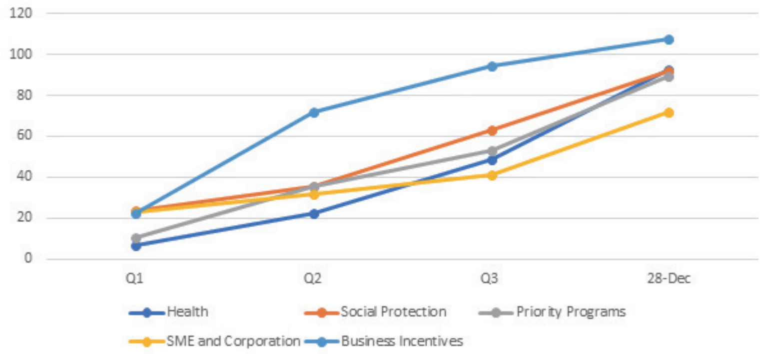
Source: MoF weekly report (https://pen.kemenkeu.go.id/in/page/data-realisasi)

Figure 18. Realization of the National Economic Recovery Program by cluster, June to December 2020 (% to budget ceiling))



Source: Authors' calculation from MoF weekly report (https://pen.kemenkeu.go.id/in/page/data-realisasi)

Figure 19. Realization of the National Economic Recovery Program by cluster, Q1 to December 28, 2021 (% to budget ceiling)



Source: Authors' calculation from MoF weekly report (https://pen.kemenkeu.go.id/in/page/data-realisasi)

2.2.3. Mobility Restriction

To control the spread of the COVID-19 virus, the Government issued a regulation restricting large-scale social activities (PSBB) on March 31, 2020, Government Regulation No. 21/2020. The policy was intended to reduce activities in at least three categories, namely: (i) school and work; (ii) religious congregation/gathering activities; and (iii) open/public space activities.

Any subnational government that intends to restrict citizens' mobility must submit a request for central government approval. The first large-scale social restriction (PSBB) was put into place in Jakarta on April 10, 2020, and was followed by other regions of the country.[15] However, social restriction policies do not significantly affect people's mobility. As shown in Figure 20, while mobility fell significantly in the early implementation, the effect diminished over time. During the first PSBB, mobility fell by only 5.4 percent compared with the pre-pandemic baseline, with the effect diminishing over time. The second social restriction (September to November 2020) was only able to reduce people's mobility by 1.8–2.9 percent, while the third social restriction (January to February 2021) was able to reduce mobility by only 0.6–2.1 percent (Khoirunurrofik, Abdurrachman, and Putri, 2022).

15 The complete list of PSBB can be seen in https://en.wikipedia.org/wiki/Indonesia_large-scale_social_restrictions

Figure 20. Aggregate change in national mobility, March 2020 – January 2021

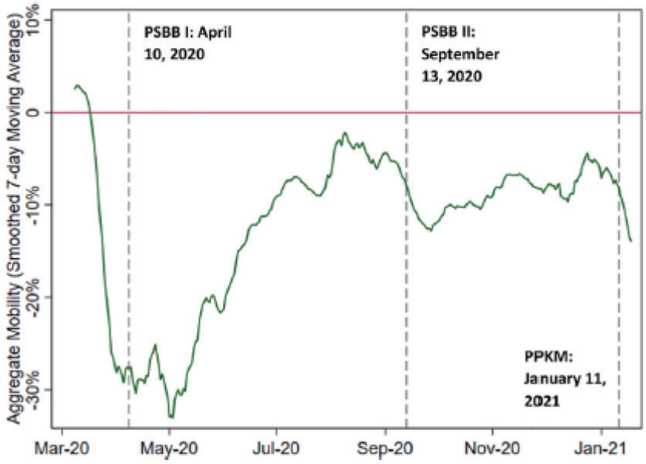


Fig. 1. Aggregate Change in National Mobility relative to February 2020 Baseline (smoothed 7-day moving average).

Source: Khoirunurrofik et al. 2021.

A significant mobility decline in April and May 2020 resulted in a 5.3 percent economic contraction in the second quarter of 2020. An increase in mobility after May 2020 was partly due to the relaxation by the central government of the restrictions by adopting the "new normal" in June 2020 to encourage economic recovery (Sparrow, Dartanto, and Hartwig, 2020). It is also important to note that not all economic activities can be performed online. Those whose livelihoods largely depend on physical presence had more incentive to engage in outside activities if they did not have sufficient resources to stay at home. Interestingly, a survey conducted by the Lingkaran Survey Indonesia (LSI) revealed that the frequency of doing outside activities does not differ significantly across income levels and education attainment (Table 8). With a recovery in mobility, while testing and tracing remained limited,[16] the rate of infections once again started to increase.

16 Limited testing and tracing can be inferred from the low budget absorption in the Health cluster in Table 6.

Table 8. Frequency of outside activities by level of income and education

Category	% of group from the whole sample	Very/Quite Often	Rarely	Never	Do Not Respond
Education					
Primary Education or less	14.9	85.5	11.5	2	0
Junior High School	19.2	82.3	16.1	1.6	0
Senior High School	46.4	80.6	17.5	1.9	0
College	19.5	88.7	8.7	2.1	0.5
Monthly Income (Indonesian Rupiah)					
1.5 Million or less	26.7	78.3	19.9	1.8	0
1.5 - 2.99 Million	26.9	82.5	15.6	1.9	0
3 - 4.49 Million	24.7	87.5	10.9	1.2	0.4
4.5 Million or greater	21.7	86.2	11.1	2.7	0

Source: LSI Unpublished Survey Result.[17]

3. The COVID-19 Pandemic and Fiscal Sustainability

3.1. Changes in government revenues and expenditures

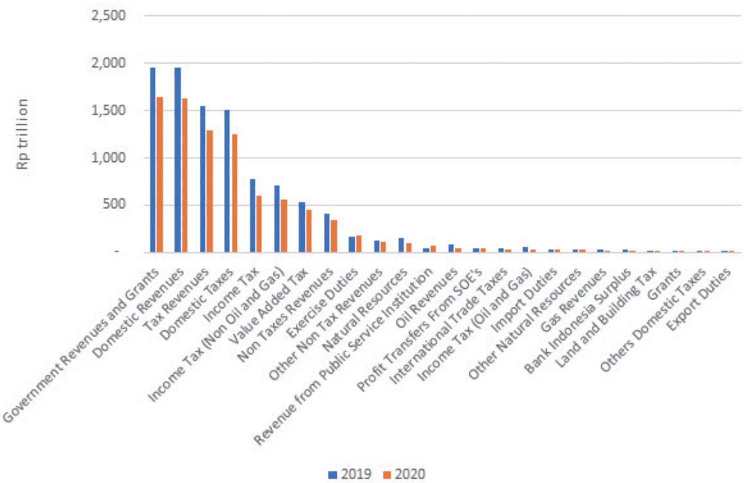
As an effect of the economic contraction, government revenue fell by 16.7 percent (from Rp 1,955 trillion in 2019 to Rp 1,629 trillion in 2020). Only three revenue sources registered positive growth in 2020: excise duties, export duties, and revenues from public service institutions. Revenue growth, combined with the reduction in total government revenues, caused the share of excise duties to increase from 8.8 to 10.8 percent. Excise revenue is still dominated by cigarette taxes, which contribute about 95 percent of total revenues from excise duties. Despite experiencing double-digit revenue growth, the share of export duties in total government revenue grew only slightly, from 0.2 to 0.3 percent, while the respective share of revenue from public service institutions increased from 2.5 to 4.3 percent.

On the expenditure side, some spending had to be cut to compensate for greater needs in other spending categories. Fuel subsidies and transfers to subnational governments are the two spending categories that saw the largest expenditure reductions in 2020. A sharp decline in global crude oil prices in 2020 caused the total amount of government spending on fuel subsidies to fall significantly, from Rp 137 trillion in 2019 to Rp 14 trillion in 2020. Unlike fuel subsidies, which depend heavily on factors that are beyond the Government's control (such as global oil prices and exchange rates), subnational transfer expenditures are under the direct

17 The table is for Jakarta. Other regions also show similar results.

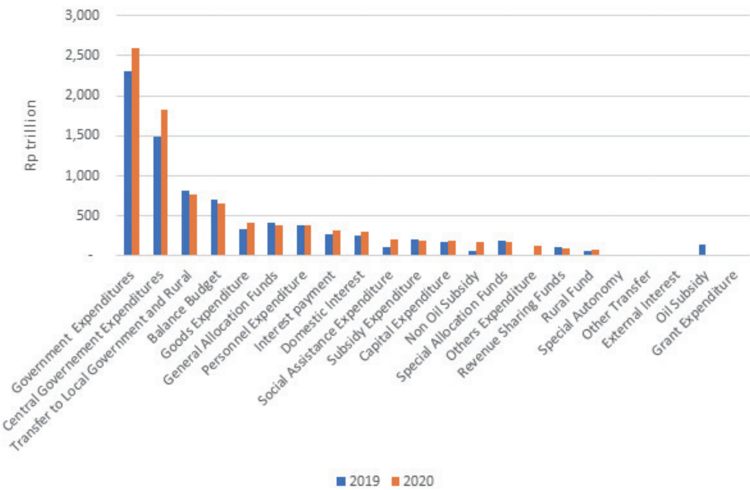
control of the central government. As shown in Table 5, the Government changed the budget allocation twice in 2020, once by reducing the subnational transfer from Rp 856.9 trillion to Rp 763.9 trillion. However, the actual spending in 2020 is even lower than the actual spending in 2019.

Figure 21. Government revenues by source, 2019–2020



Source: Authors' calculations from the Indonesia Financial Statistics, Bank Indonesia.

Figure 22. Government expenditures by category, 2019–2020



Source: Authors' calculations from the Indonesia Financial Statistics, Bank Indonesia.

Two notable efforts were made by the Government to improve fiscal sustainability on the revenue side. First, the so-called Omnibus Law (Law No. 11/2020) was enacted in 2020 to attract private investment. This departed from the argument that a continued budget deficit is harmful to the economy, such that the role of the government budget in boosting the economy should be reduced. Thus, the private sector should be the main driving force of economic growth in the post-pandemic era.[18] However, the effectiveness of the Omnibus Law in attracting private sector investment remains unclear in the short term.

The second effort was the enactment of the Law on Harmonization of Tax Regulations (Law No. 7/2021). Among the important changes in the law are: (i) the use of citizens' ID (Nomor Induk Kependudukan) as the tax ID; (ii) the introduction of a new income tax bracket (35 percent for with an annual income of more than Rp 5 billion), effective from January 2022; (iii) an increase in the VAT rate from 10 to 11 percent starting from April 1, 2022, and reaching 12 percent by 2025; and (iv) the implementation of a carbon tax, commencing with coal-fired power plants in April 2022.

The Government's efforts to improve fiscal sustainability on the expenditure side were less notable than on the revenue side. This is partly because expenditure policies during the pandemic largely depend on the progress and evolution of the virus outbreak. With the current level of virus spread, the Government allocated a total of Rp 455 trillion for the 2022 National Economic Recovery Program.[19] The number of clusters was reduced to three. The health cluster, the social protection cluster, and the economic cluster will receive Rp 122.5 trillion, Rp 154.7 trillion, and Rp 178.3 trillion, respectively. Such allocations are subject to progress in the health sector. A more prolonged outbreak will cause the budget required to control the health crisis to rise. On the other hand, as continued virus outbreaks harm the economy, the Government also needs to spend on social protection and economic incentive programs to prevent a greater economic contraction.

Once the pandemic comes to an end, it is logical to think that the Government will reduce spending on the health sector, as well as the National Economic Recovery Program. A fall in spending, if accompanied by an increase in revenues, will be beneficial for fiscal sustainability. However, as new COVID-19 variants continue to emerge and prolong the effects of the outbreak, it is difficult to provide an accurate assessment regarding the effect of current government policy on fiscal sustainability.

3.2. Immediate, mid-term, and possible long-term effects of the fiscal measures on the fiscal balance

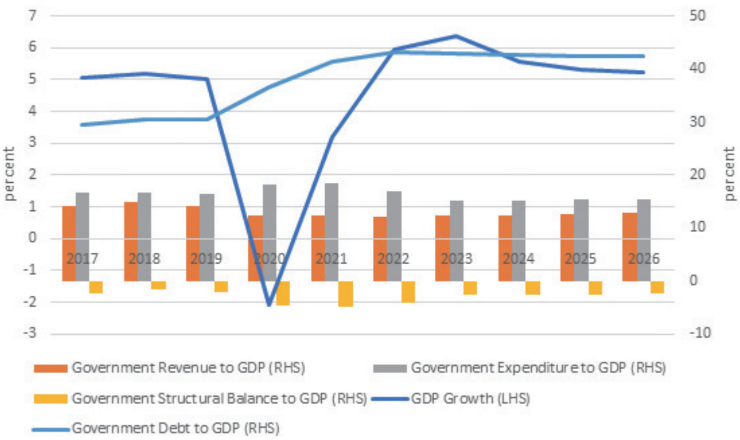
As a result of lower revenues and higher spending, unsurprisingly the budget deficit has increased. As shown in Table 3, the deficit in 2020 was Rp 948 trillion, equivalent to 6.1 percent of the GDP. The Government was able to reduce the deficit to Rp 784 trillion in 2021. With growth of 3.69 percent in 2021, the deficit-to-GDP ratio was reduced. The IMF projection suggests that government expenditure will remain higher than revenues until 2026 (Figure 23). However, the gap between expenditure and revenues will decrease. With sustained

18 Despite the law can be implemented, the constitutional supreme court ordered the government to amend the law in two years.

19 https://money.kompas.com/read/2022/01/19/143700426/naik-lagi-anggaran-pen-2022-tembus-rp-455-6-triliun?page=all#page2

positive economic growth starting in 2021, the budget deficit will decrease and reach 2.55 percent of GDP by 2023 and 2.4 percent of GDP by 2026. Reducing the budget deficit is crucial to maintaining the Government's reputation, as Perpu No. 1/2020[20] states that the budget deficit must be less than 3 percent of GDP from 2023 onwards.

Figure 23. Actual and forecast economic growth, expenditure, revenue, budget deficits and debt, 2017-2026



Source: IMF, World Economic Outlook.

3.3. Debt management policies after the COVID-19 pandemic

As shown in Figure 23, the debt-to-GDP ratio rose significantly from 30.5 percent in 2019 to 36.6 percent in 2020. The IMF estimates suggest that the debt-to-GDP ratio will rise to about 42 percent in 2021 and is unlikely to decrease significantly before 2026. Although the ratio is far below the 60 percent threshold set by the Law of State Finance, it is important to note the implications of higher debt levels on government interest payments. As shown in Figure 7, spending on interest payments is the third-largest government expenditure item and is on an upward trend. If there is no substantial change in policy, the leverage of the government budget on the economy will lessen as spending on interest payments takes an ever-larger share of spending, at the expense of investment in capital expenditure. This implies that the Government will be required to improve revenue collection and simultaneously improve spending efficiency to avoid additional debt in the future.

There is some debate over the effect of a higher debt-to-GDP ratio on fiscal sustainability in Indonesia. The Government argues that the ratio is still much lower than in other countries, even peer countries, such as Thailand, Malaysia, the Philippines, and Vietnam, where the tax-to-GDP ratios are 41, 50, 42, and 61 percent, respectively.[21] On the other hand, Indonesia's

20 See the discussion on Perpu 2020 in section 2.2
21 https://www.kemenkeu.go.id/menjawabutang

Supreme Audit Agency takes a different view, given that the tax revenue-to-debt ratio has reached 369 percent of government revenue, while the IMF recommendation is between 90 and 150 percent.[22] However, as the Government believes that the debt-to-GDP ratio remains at a sustainable level, there is no indication that the fiscal rule will change any time soon.

3.4. Domestic discussions/debate on the revised fiscal rules

3.4.1. Removal of the 3 percent deficit-to-GDP cap and the National Economic Recovery Program

The Government has made continuous efforts to convince citizens that increasing the budget deficit to finance the National Economic Recovery Program is a necessity. Nonetheless, some economists argue that the extent of the deficit (and thus new debt) can be reduced by cutting government spending by 30–50 percent.[23] Other economists view the Government as placing greater emphasis on protecting the economy than on handling the COVID-19 crisis.[24, 25] This is evident given that the budget for the health sector is significantly less than those for other sectors of the economy (Figure 17).

Another indicator that the Government places greater emphasis on the economy is its decision to ease mobility restrictions as the pathway to adopting the "new normal" in June 2020 to encourage economic recovery (Sparrow, Dartanto, and Hartwig, 2020). This was done despite a lack of effective testing and tracing. As a result, the number of daily cases registered an upward trend (Figure 11).

In 2021, the Government made some improvements. For instance, it allocated more funds to the health sector. The budget allocation for the vaccination program, testing, and tracing reached Rp 130 trillion for the 2021 fiscal year. With an increased testing rate and increased share of the vaccinated population, the positivity rate has fallen since July 2021 and has since reached the 5 percent threshold set by the World Health Organization (Figure 14).

3.4.2. Policy Effectiveness

The Government had hoped that its countercyclical policy would minimize the economic contraction. However, as shown in Tables 6 and 7, budget absorption remained low for most clusters in the early months of the National Economic Recovery Program. As explained earlier, supply-side policy dominates the program for SMEs, corporate finance, and business incentives. Some of these supply-side policies are in the form of tax expenditures. While the cost-reducing policy may help firms to remain afloat, this will only work if firms perceive that

22 https://money.kompas.com/read/2021/06/26/135047826/peringatan-bpk-kenaikan-utang-pemerintah-sudah-level-mengkhawatirkan
23 https://www.antaranews.com/berita/1702946/ekonom-indef-kritisi-kebijakan-utang-untuk-penanganan-covid-19
24 https://www.cnbcindonesia.com/news/20200831195512-4-183392/penanganan-covid-19-pemerintah-ri-dibanjiri-kritikan
25 https://www.tribunnews.com/bisnis/2020/06/01/faisal-basri-kritik-kebijakan-pen-terlalu-banyak-untuk-selamatkan-bumn

demand is sufficient to continue to make a profit. If the demand is still low because activities are limited, firms may choose to simply cease operating. Consequently, budget absorption is low because only firms that stay in business are eligible to utilize cost-reducing policies.

One notable policy that could effectively increase demand is the selected tax relief for new car purchases. To boost demand for new cars, the Government partially or fully waived the (luxury) VAT imposed on new car purchases.[26] Initially, the policy was deemed ineffective in boosting demand.[27,28] Moreover, the policy was biased toward the high-income group. However, the Government argued that the policy was beneficial not only for the high-income group but also for other groups, as increased demand for new cars would increase demand for output/services in related sectors. The policy is claimed to have boosted sales of new car by 66.7 percent in 2021 and helped economic recovery.[29]

3.4.3. Burden Sharing

The burden-sharing scheme to finance the deficit (described in Section 2.2) has also drawn some criticism. For instance, it may create moral hazard that jeopardizes the credibility of both the Government and the central bank.[30] The IMF also warned the central bank regarding the adverse effect of prolonged burden-sharing [31] and urged an end to the burden-sharing scheme by 2022.[32] To convince the public, the Governor of BI made a clear statement to Parliament that burden-sharing would be terminated by the end of 2022.[33]

4. Next Steps in the Post-COVID-19 Period

4.1. The Government's roadmap for fiscal sustainability after the COVID-19 pandemic

The timing of the end of the pandemic remains uncertain due to continuing mutation and subsequent variants of the virus. The Omicron variant—which is far more transmissible—has spread rapidly across the globe, including to Indonesia. On January 24, 2022, the Omicron variant was responsible for 96.6 percent of the confirmed cases in Indonesia. The number of confirmed cases continues to increase, which may cause the Government to restrict mobility

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26 The eligibility criteria include both local contents and (engine) displacement size.
27 https://www.republika.co.id/berita/qom8dm328/mengejar-pertumbuhan-ekonomi-dengan-relaksasi-ppnbm
28 https://otomotif.bisnis.com/read/20210214/275/1356012/kebijakan-penurunan-ppnbm-mobil-baru-dinilai-tidak-efektif
29 https://otomotif.tempo.co/read/1549679/penjualan-mobil-2021-naik-667-persen-dekati-900-ribu-unit
30 https://news.detik.com/kolom/d-5190935/mempertimbangkan-dampak-perpanjangan-burden-sharing
31 https://katadata.co.id/agustiyanti/finansial/61dbb086d5e2a/imf-peringatkan-risiko-bank-sentral-borong-surat-utang-pemerintah
32 https://www.republika.co.id/berita/r6bjkr423/imf-minta-bank-indonesia-setop-bantu-pembiayaan-apbn-2022
33 https://www.finroll.com/financeroll/ekonomi-makro/moneter/terakhir-2022-bos-bi-tahun-depan-tidak-ada-lagi-burden-sharing/

and potentially harm the economy in the short run. On the other hand, a higher proportion of the vaccinated population is expected to reduce transmission and reduce the severity of those who fall ill. Indeed, the United States' Center for Disease Control (U.S. CDC) states that vaccines are effective in reducing the risk of hospitalization.[34] Below, given the uncertainties over the duration of the pandemic, we discuss our recommendations based on two scenarios: (i) that the pandemic ends within a year; and (ii) that the pandemic lasts longer than one more year and has a greater impact.

If the pandemic ends within a year:

1. The Government can reduce some spending on economic clusters, such as business incentives and financing, while spending on the health sector should remain, such that effective testing, tracing, and treatment can still be provided. Such spending is still required to prevent another surge in the virus. In addition, the Government still needs significant budget for social protection programs. As shown in Figure 16, the pandemic-led economic crisis has raised the poverty rate to slightly above 10 percent. The social protection budget is intended to help vulnerable groups fulfill their basic needs.

2. As shown in Figure 15, the number of salaried workers fell, while the number of unpaid/family workers increased. As the pandemic has affected many aspects of people's lives, activities in the post-pandemic period are likely to be somewhat different from those in the pre-pandemic period. As a result, some sectors may experience a change in their demand for labor. Given that millions of people have lost their jobs during the pandemic, it will be important to improve their capacity so that they can re-enter the workforce (or, even better, create employment through starting small businesses) in the post-pandemic period. Thus, the Government should consider allocating more budget to improving human capacity to adapt to the new working environment in the post-pandemic period.

3. Fiscal and monetary authorities should be aware of the potential for significantly higher inflation once the pandemic ends. An increase in aggregate demand—both in the domestic market and overseas—may cause demand-pull inflation. If this is not anticipated well in advance, it could result in macroeconomic instability and negatively affect the economy.

If the pandemic is prolonged:

1. The Government should focus on addressing the health sector through effective testing, tracing, and treatment, coupled with continued efforts to increase the vaccination rollout. As the current crisis originated as a health crisis, addressing the health sector will be necessary for economic recovery. Although focusing on health may harm the economy and cost the Government a significant share of the budget, it may be less costly to the economy (in the long run), as this health focus can shorten

34 https://www.cdc.gov/mmwr/volumes/71/wr/mm7104e3.htm

the duration of the pandemic. The sooner the pandemic is under control, the sooner the economy can start to grow once again.

2. To prevent a greater economic contraction, the Government should focus on a policy that effectively boosts demand. Workers, whose incomes have been negatively affected by the pandemic, still need to spend on basic needs. An adequate amount of cash transfer is not only beneficial in preventing a greater contraction of the economy but also in avoiding workers from resorting to risky economic activities outside that could potentially prolong the pandemic. Tax incentive policies have been mostly ineffective during the pandemic. Although tax incentives reduce producers' tax burdens, they will only work if producers still believe that demand will be sufficient in the longer term. If demand remains limited, the tax incentive will be underutilized and create an opportunity cost, as the budget could have been allocated elsewhere.

3. If the budget to strengthen the health sector and boost demand is significantly large, there is a risk that the 3 percent deficit-to-GDP ratio cap targeted for 2023 cannot be achieved. In such a case, an amendment to Perpu No. 1/2020 will be required.

4.2. Evaluation and policy recommendations

4.2.1. Evaluation

The Government's responses to the health crisis draw two important lessons. First, controlling the outbreak is a necessary condition for economic recovery. As long as the pandemic continues, people will reduce demand for products/services activities that require physical presence. A reduction in demand will have a negative impact on the demand for labor in the affected sectors, thus reducing incomes in those sectors. A reduction in labor income implies that demand for goods and services will also fall and affect other sectors. Such a downward spiral will continue as long as the risk of infection remains high. In short, the health sector should be given a higher priority in preventing a greater economic contraction.

The second lesson we can draw is that cost-reducing policies are mostly ineffective during the pandemic. This is because demand is still much less than under normal conditions if the outbreak continues. From a producer's perspective, although the Government provides tax incentives, there is no point in producing goods/services if demand is insufficient.

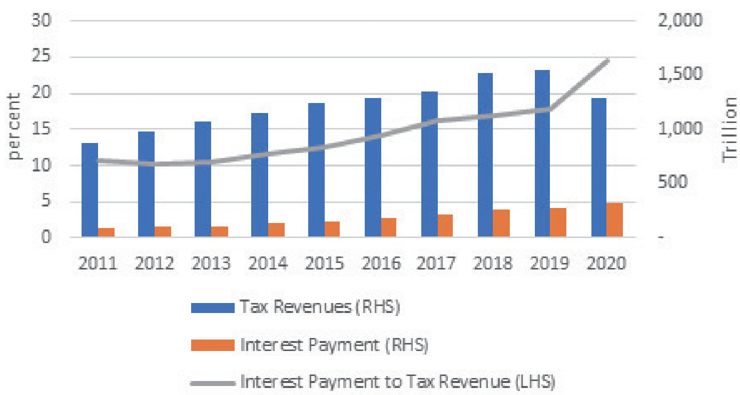
4.2.2. Policy Recommendations

Improving revenue is a necessary condition for reducing the budget deficit and preventing the Government from raising debt to a degree that it could jeopardize fiscal sustainability. In addition to some policy changes in the Law on Harmonization of Tax Regulations that can potentially increase tax revenues, the Government can also raise revenue further by simplifying the cigarette tax. As described in Section 3.1, the contribution of excise duties to government revenues reached 10 percent, and the cigarette tax contributes about 95 percent of these excise revenues. The excise revenue collection continued to grow despite the overall contraction of the economy.

The reason why the Government can generate more revenue from the cigarette tax is that the current tax system is overly complex (Prasetyo and Adrison, 2020). The tax rate depends on four aspects: (i) production volume; (ii) production techniques (i.e., machine-made vs hand-made); (iii) flavor (i.e., with clove vs without clove); and (iv) banderol price. The multi-tier system allows firms to avoid higher cigarette taxes.[35] Thus, simplifying the cigarette tax will not only increase the effectiveness of the cigarette tax by reducing consumption but also optimize government revenues (Chaloupka, Yurekli, and Fong, 2012).

Another option for the Government to consider is to review the debt-to-GDP ratio threshold for the fiscal rule. This is because the Government continues to claim that the debt-to-GDP ratio in Indonesia is far lower than in other countries, including advanced economies. It is important to note that, although Indonesia's public debt-to-GDP ratio is indeed lower than in many advanced economies, the capacity to generate revenue is also more limited, as indicated by Indonesia's low tax-to-GDP ratio. With a debt-to-GDP ratio of 36 percent in 2020, the ratio of interest payments to tax revenues reached 17.8 percent in 2019 and 24.4 percent in 2020 (Figure 24). If the perception that Indonesia's debt-to-GDP ratio is far below the threshold and this then gives the Government cause to let down its guard and increase debt, the ratio of interest payment to tax revenues could increase. If this occurs, fiscal sustainability will be endangered.

Figure 24. Tax revenues and interest payments, 2011–2020



Source: Authors' calculation from the Indonesia Financial Statistics, Bank Indonesia

35 The last tax simplification was made for 2022

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Country Case: The Republic of Korea

1. General Macroeconomic and Fiscal Conditions before the COVID-19 Pandemic
2. The Impact of the COVID-19 Pandemic and the Fiscal Response
3. The COVID-19 Pandemic and Fiscal Sustainability
4. Next Steps in the Post-COVID-19 Period

Country Case: The Republic of Korea[36]

1. General Macroeconomic and Fiscal Conditions before the COVID-19 Pandemic

1.1. Macroeconomic Conditions

The global financial crisis of 2008/09 presented a difficult challenge for the economy of the Republic of Korea (Rep. of Korea), given its high degree of integration with the global economy. Amid a significant contraction in the economies of most advanced countries, the Rep. of Korea's exports unavoidably suffered a sharp decline, together in turn with the Rep. of Korea's real economic growth rate (GDP). In 2008/09, the annual average GDP growth rate fell to about 1.8 percent. Nevertheless, the Korean economy rebounded with real GDP growth rates of 6.5 and 3.7 percent, respectively, in 2010 and 2011, and was evaluated to have overcome the crisis relatively smoothly in the short term. However, contrary to expectations, the real economic growth rate realized from 2012 until recently remained at an annual average of only about 3 percent.

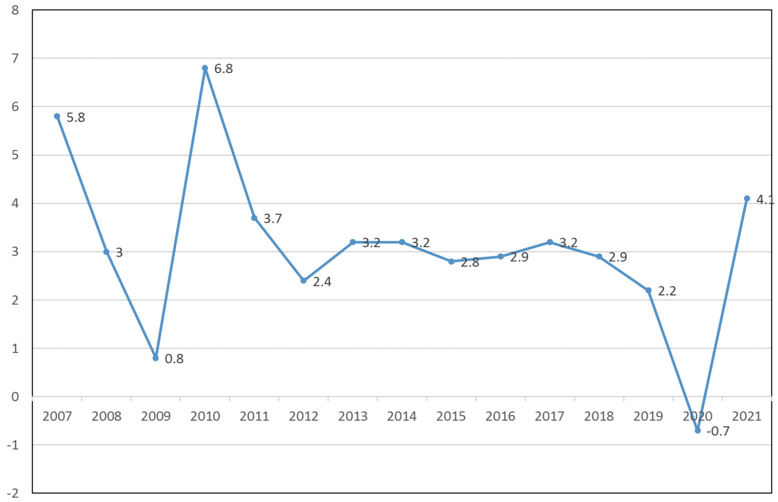
Before the COVID-19 crisis, the Korean economy was already exhibiting slow growth led by exports and investments, as domestic and foreign demand contracted. The Government maintained an accommodative fiscal stance in response to downward economic pressures, significantly contributing to economic growth. Domestic demand appeared sluggish in both consumption and investment, and stagnating exports due to weak overseas demand became a major constraint to economic growth. Considering the overall economic conditions at home and abroad, the economic slowdown is unlikely to accelerate in the near future, but a number of downside risks could restrict growth of the Korean economy.

At that time, in the short term, policy think tanks such as Korea Development Institute (KDI) (2019) suggested that the Government should take an expansionary stance, focusing on macroeconomic stability. They believed that the Rep. of Korea's economic growth could rally slightly if external economic conditions gradually improved in 2020, but the pace of recovery in the private sector would likely be limited. They also argued that an expansionary fiscal stance should be maintained to support the economic recovery, while monetary policies

36 Deockhyun Ryu, Chung-Ang University, dhryu@cau.ac.kr.

should be further eased to overcome low inflation.

Figure 25. Trend of GDP growth rate in the Rep of Korea (%)



Source: Bank of Korea, Economic Statistics System (ECOS).

The Korean economy entered the COVID-19 pandemic with sound macroeconomic fundamentals and high per-capita income, albeit sluggish growth. Public debt and borrowing costs were low and external vulnerabilities were well contained, with a net international creditor position, adequate reserves, and a flexible exchange rate. While GDP per capita exceeded US$30,000, growth had slowed to an annual average of 2.8 percent over the five years to 2019, reaching only 2.0 percent in 2019. The resulting economic slack kept inflation well below the Bank of Korea's (BOK) 2 percent target.

Table 9. Economic indicators in the Rep. of Korea before the COVID-19 pandemic

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
GDP growth rate (%)	3.7	2.4	3.2	3.2	2.8	2.9	3.2	2.9	2.2	-0.7	4.1
Consumption (%)	2.9	2.3	2.4	2.5	2.6	3	3.1	3.7	3.2	-2.2	4.2
Gross fixed investment (%)	1.3	-0.1	2.8	3.1	5.4	6.6	9.8	-2.2	-2.1	3.5	2.8
Current account balance (US$ billion)	16.6	48.8	77.3	83	105.1	97.9	75.2	77.5	59.7	75.9	88.3
CPI Inflation rate (%)	4	2.2	1.3	1.3	0.7	1	1.9	1.5	0.4	0.5	2.5
GDP deflator (%)	1.3	1.3	1	0.9	3.2	2	2.2	0.5	-0.8	1.6	2.5
Current Balance (% of GDP)	1.3	3.8	5.6	5.6	7.2	6.5	4.6	4.5	3.6	4.6	4.9

Source: Bank of Korea, ECOS.

1.2. Trend in fiscal aggregates before the COVID-19 crisis

The Rep. of Korea's total revenues increased from KRW 314 trillion in 2011 to KRW 476.4 trillion in 2019. After recording an increase of 8.1 percent in 2011, revenues maintained a high level of increase until 2013 (Figure 26). Since then, the negative growth rate (-0.9 percent) in 2014 slowly increased until 2016. Since 2017, the rate increased by 5 - 6 percent annually until the COVID-19 crisis. Meanwhile, total expenditure surpassed KRW 400 trillion in 2017, up from KRW 309 trillion in 2011, and recorded KRW 475.4 trillion in 2019. The expenditure growth rate did not reach the revenue growth rate until 2013 but, since then, with the exception of 2017, it has continuously exceeded the expenditure growth rate.

Figure 27 shows the trend of the Rep. of Korea's fiscal balance in terms of percentage of GDP. From 2011 to 2015, the fiscal balance surplus gradually weakened and then increased until 2018. Since 2019, the deficit began in earnest.

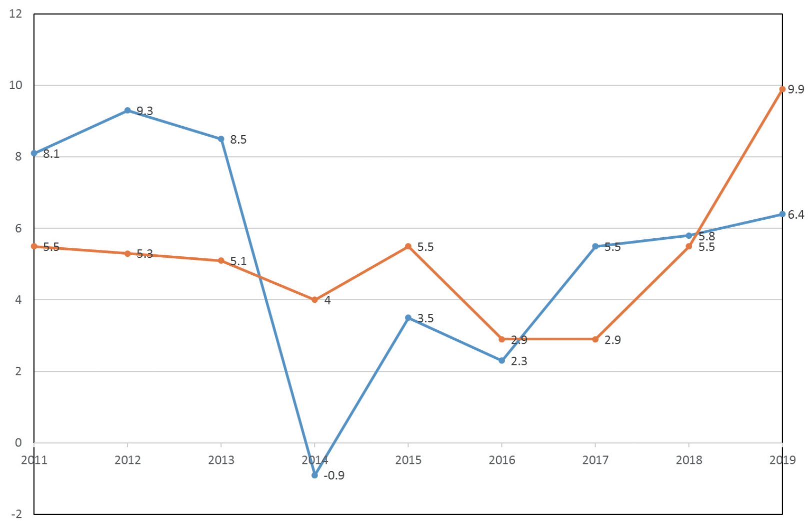
The public debt-to-GDP ratio was 30.3 percent in 2011, and this increased gradually to 37.6 percent by 2019. This is interpreted as the result of the conservative government's pursuit of sound public finances.

Table 10. Fiscal indicators before the COVID-19 crisis (KRW trillion, %)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total revenue	314.4	343.5	360.8	369.3	377.7	401	423.1	447.7	476.4
(% of change)	8.1	9.3	8.5	-0.9	3.5	2.3	5.5	5.8	6.4
Total expenditure	309.1	325.4	349	355.8	384.7	398.5	410.1	432.7	475.4
(% of change)	5.5	5.3	5.1	4	5.5	2.9	2.9	5.5	9.9
Fiscal Balance	18.6	18.5	14.2	8.5	-0.2	16.9	24	31.2	-12
(% of GDP)	1.3	1.3	0.9	0.5	0.0	1.0	1.3	1.6	-0.6
Government debt	420.5	443.1	489.8	533.2	591.5	626.9	660.2	680.5	723.2
(% of GDP)	30.3	30.8	32.6	34.1	35.7	36	36	35.9	37.6

Source: National Assembly Budget Office (NABO) STATS.

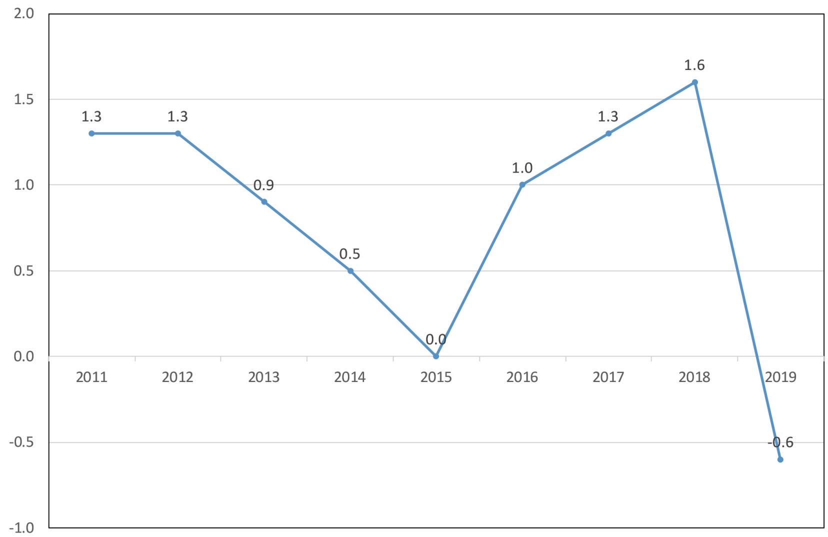
Figure 26. Trend of revenue and expenditure growth rates in the Rep. of Korea (%)



Note: The orange line denotes the growth rate of total expenditure and blue the growth of total revenue, respectively.

Source: National Assembly Budget Office (NABO) STATS.

Figure 27. Trend of fiscal balance (% of GDP)



Source: National Assembly Budget Office (NABO) STATS

1.3. Fiscal sustainability issues and fiscal rules during the COVID-19 crisis in the Rep. of Korea

The Rep. of Korea maintained its expansionary fiscal policy and organized its Seventh Supplementary Budget to cope with the aftermath of the COVID-19 pandemic. As a result, government debt increased rapidly and the fiscal deficit widened sharply. The Rep. of Korea passed a record budget of KRW 607.7 trillion in 2022, with two extra budgets in January and May, maintaining a more expansive fiscal policy stance.

The new Government's Ministry of Economy and Finance is expected to implement intensive spending restructuring and debt sustainability policies to maintain fiscal sustainability amid rising government debt. For example, the Government is expected to attempt to legislate fiscal rules to withdraw emergency measures adopted to cope with the pandemic and reduce discretionary spending by more than KRW 10 trillion, or strengthen fiscal soundness in the medium term.

In this situation, it may be problematic to evaluate the Rep. of Korea's fiscal sustainability only based on the level of the public debt-to-GDP ratio. It is desirable to first determine the size of fiscal expenditure reflecting expenditure requirements and then discuss whether the Government can control the debt this creates in the medium to longer term, i.e., in terms of fiscal sustainability. If the debt is within the range of repayment, the debt is sustainable, i.e., if interest repayments through revenue are possible and the debt ratio can be maintained at a certain level without paying interest by issuing further debt, then fiscal sustainability is established. The important issue is not the size of the debt itself, but whether revenue meets fiscal expenditure requirements in the long run. Let us look at the conditions to be considered to confirm this and what will happen if these standards are applied to the case of the Rep. of Korea.

First, it is necessary to consider the composition of government debt. There are two types of government debt: one is deficit debt to compensate for the general account deficit, and the other is financial debt that can be repaid without raising separate funds for debt repayments. Of the total government debt in 2019, deficit debt accounted for 57 percent and financial debt accounted for 43 percent. The public debt-to-GDP ratio in 2019 was 37.2 percent, but if only deficit debt is reflected then the government debt-to-GDP ratio would be only 21.2 percent.

The second issue is to look at is the maturity of government debt. Recently, the proportion of government debt with a remaining maturity of less than three years has gradually decreased, and long-term debt of more than 10 years has continued to rise. Accordingly, the average maturity of government bonds increased from 7.2 years in 2015 to 9.7 years in 2019. For example, government debt issued in 2019, which is scheduled to be distributed by 2020–68, consists of 7.3 percent of the remaining maturity of less than one year, 19.4 percent of less than one to three years, 18.9 percent of less than three to five years, 23.5 percent of 5–10 years, and 30.8 percent of more than 10 years. The 7.3 percent share of short-term debt with a remaining maturity of less than one year is far lower than the average (20.4 percent) of major developed countries.

Third, let us look at the trend of interest rates on government bonds. Recently, interest rates on government bonds have been on the decline internationally. For this reason, even if government debt increases significantly, the interest burden is not expected to be a major problem with a medium-term horizon of at least five years. According to the Fiscal Monitor published by the IMF in April 2020, interest rates on 10-year government bonds in major countries are now at their lowest level during the past 100 years and are converging to nearly 0 percent. The Rep. of Korea's interest expense on government debt in 2019 was also KRW 18 trillion, down KRW 700 billion from the previous year. The size of government debt is increasing every year, but interest costs was showing a stabilizing trend due to low interest rates.

Fourth, it is worth noting that, in the Rep. of Korea, the economic growth rate (g) was higher than the interest rate (r) for a considerable period of time, and the value of the interest rate minus growth rate (r-g) showed a negative (-) relationship. It is the macroeconomic conditions so that the burden of government debt can be reduced as long as the nominal economic growth rate exceeds the interest rate. However, with the exception of 2020, the year of the start of the COVID-19 crisis, this relationship is expected to continue for the time being.

Finally, the share of foreign-owned bonds in total Korean government bonds has been maintained in the 10 percent range since the 2010s. This is considerably lower than the average of 25.7 percent in developed countries. Therefore, the risk of rapid net capital inflows is not high, and the impact is limited even if it were to occur. In addition, it should be noted that the Rep. of Korea is a net foreign creditor country and had a huge current account surplus of US$90 billion in 2021.

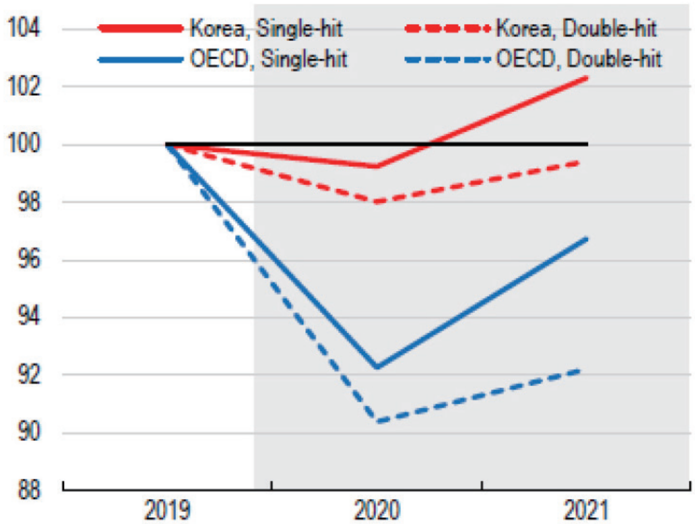
In conclusion, the public debt-to-GDP ratio of a specific figure is not an immutable truth. Moreover, it is inaccurate to talk of a temporary rise in the ratio due to inevitable fiscal expansion to overcome the current COVID-19 crisis, as if it were a shortcut to the country's financial collapse. Of course, fiscal consolidation is needed at some point in time to reduce the fiscal deficit but, before that, the economy must first recover and have a strong economic structure.

2. The Impact of the COVID-19 Pandemic and the Fiscal Response

2.1. Economic and Social Impacts of the COVID-19 Pandemic

The Rep. of Korea, one of the first countries to be hit by the COVID-19 pandemic, has suffered major financial loss, similar to other countries. However, a prompt and effective policy response allowed the Government to successfully contain the spread of the virus and escape the worst of the economic fallout. Together with the Government’s measures to protect the affected industries and households, the damage suffered by the domestic economy has been less severe than in other major economies. The Government expected the GDP growth rate for 2020 to be at -1.1 percent, down from the initial projection of +2.9 percent. Entering the recovery phase, however, the Rep. of Korea now sees the GDP growth rate at 2.8 percent in 2021. In terms of the impact of the COVID-19 pandemic across sectors, tourism, retail trade, and construction were identified as the three most affected sectors, respectively, in order of the magnitude of their losses and the need for government support to aid recovery.

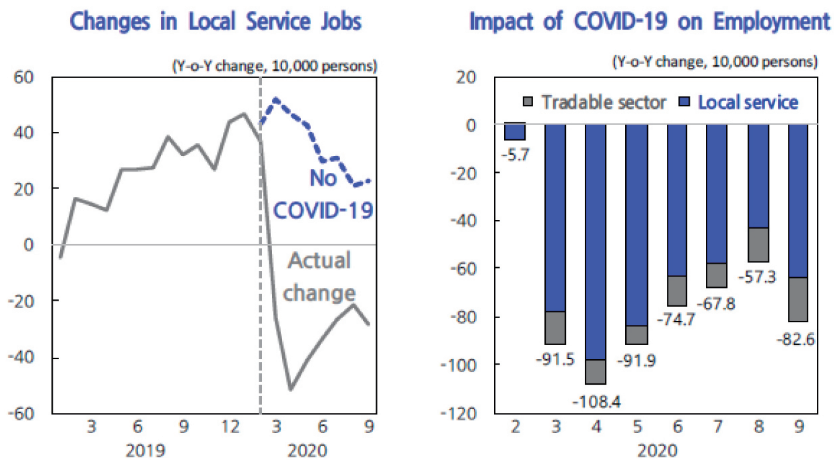
Figure 28. The decline of GDP in the Rep. of Korea and the OECD



Source: OECD, 2020.

According to the KDI (2020), the number of jobs lost as a result of the pandemic is estimated to be 1.08 million jobs in April and 83,000 in August in 2020, respectively, and most of which were local services sector jobs. Despite a recovery trend after April 2020, local services sector jobs have taken another downturn since the resurgence in September 2020 (Figure 29, left panel). The pace of recovery before the resurgence was relatively slow. While the majority of jobs lost to the pandemic were in the local services sector, the tradable sector also suffered some losses (Figure 29, right panel). Although the decline of jobs in the tradable sector has been growing since May, the worsening conditions in September have been the cause of serious concern.

Figure 29. Impact of the COVID19 pandemic on jobs and employment in the Rep. of Korea



Note: 1) The dotted vertical line denotes the outbreak of the COVID-19 pandemic in February

2) The effect of the decrease in the number of employed is the difference between the actual change and the estimated change in a non-COVID-19 scenario.

3) The trade industry includes both manufacturing and knowledge-based industries.

Source: KDI, 2020.

2.2. Fiscal Responses

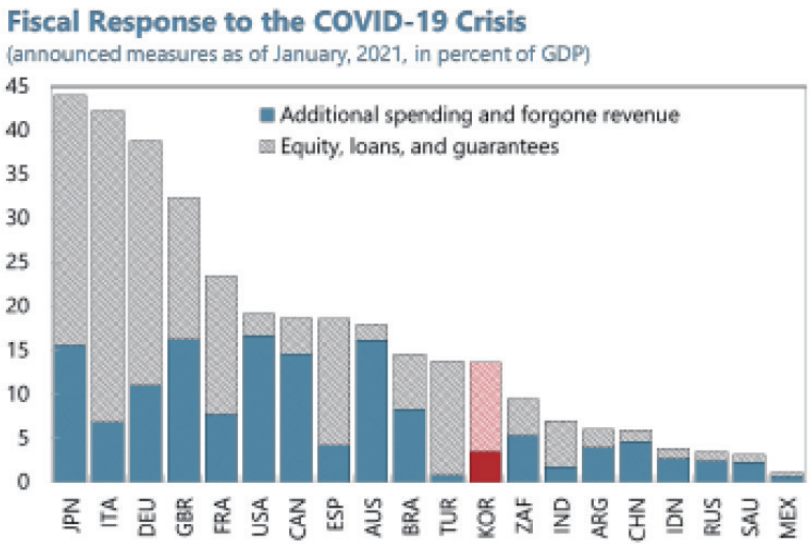
2.2.1. Economic Outlook for the Korean Economy in 2021–2022

The Korean economy's GDP growth rate was -0.9 percent in 2020, the first year of the COVID-19 crisis. Despite this contraction, the Korean economy rebounded with 4.0 percent growth in 2021, one of only two countries among advanced economies whose economies returned to pre-COVID-19 growth rates before the end of the COVID-19 crisis. The country's GDP growth rate is expected to be in the range of 2.8–3.4 percent in 2022 by many organizations, including KDI, the BOK, the OECD, and the IMF.

However, uncertainties are growing regarding the outlook for the Korean economy. The key question is whether the COVID-19 crisis will be gradually resolved after the latest Omicron mutation. One crucial unknown at this point in time is whether more dangerous variants of the COVID-19 virus will emerge going forward. There is little doubt that the elimination of the pandemic by the end of 2022 is at the heart of the optimistic economic outlook for 2022. Asset prices have soared due to massive liquidity and fiscal expansion supplied in the process of overcoming the COVID-19 crisis, and signs of inflation are also adding to uncertainties in the economic environment. Meanwhile, a full-fledged rise in interest rates by the U.S. Federal Reserve will have a negative impact on economic flows and asset markets. In addition, rising international oil and raw material prices due to the Russia-Ukraine war will have a highly negative impact on the Korean economy, which relies heavily on foreign trade.

The authorities have used the available policy space to cushion the economic effects of the pandemic, deploying a wide array of fiscal, monetary, and financial measures. Fiscal policy was eased, adding to an already expansionary stance of the original 2020 budget. Much of the discretionary support to households, workers, and SMEs was targeted to those most affected, through both expansions of existing programs and new measures. The overall fiscal balance for 2020 is estimated at -4.1 percent of GDP, with an estimated fiscal impulse of 2.6 percent of GDP.

Figure 30. Fiscal response to the COVID-19 crisis



Source: IMF, 2021a.

2.2.2. The Rep. of Korea's Fiscal Response to the COVID-19 Pandemic

To cope with the COVID-19-induced economic crisis, the Korean Government has implemented a wide range of measures to mitigate the pandemic's impact on the most affected households, small and medium enterprises (SMEs) and specific industries. In 2020, four supplementary budgets totaling KRW 66.7 trillion, which correspond to 3.3 percent of GDP, were passed by the National Assembly. As a result, total revenues decreased by KRW 11.1 trillion compared with the original budget (from KRW 481.8 trillion to KRW 470.7 trillion). The total expenditure growth rate greatly increased by 18.1 percent compared with the original budget. The fiscal balance deficit widened by 4.4 percent of GDP, and government debt (D1 standard) was 43.9 percent of GDP in 2020 compared with 39.8 percent in 2019—a huge increase of 4.1 percentage points.

Table 11. Budget measures to cope with the COVID-19 crisis (KRW trillion, %)

	FY 2020					FY 2021 Budget
	Budget	Supplementary Budget				
		1st	2nd	3rd	4th	
Total revenue (% of change)	481.8 (1.2)	481.6 (1.2)	482.2 (1.3)	470.7 (-1.1)	470.7 (-1.1)	483.0 (0.3)
Total expenditure (% of change)	512.3 (9.1)	523.1 (11.4)	531.1 (13.1)	546.9 (16.5)	554.7 (18.1)	555.8 (8.5)
Fiscal Balance (% of GDP)	-30.5 (-1.5)	-41.5 (-2.1)	-48.9 (-2.5)	-76.2 (-3.9)	-84.0 (-4.4)	-72.8 (-3.6)
Government debt (% of GDP)	805.2 (39.8)	815.5 (41.2)	819.0 (41.4)	839.4 (43.5)	846.9 (43.9)	945.0 (46.7)

Source: Ministry of Economy and Finance (2021).

Let us briefly now turn to look at what measures have been taken in each of the four supplementary budgets. On January 20, 2020, the first COVID-19 patient was diagnosed in the Rep. of Korea. By mid-February, 2020, the COVID-19 virus began to spread through local areas, such as Deagu and Gyeongsangbuk-do. Due to continued community transmission at the end of February 2020, an additional budget of KRW 11.7 trillion (US$10 billion) was approved in March as the First Supplementary Budget for FY2020. The First Supplementary Budget aimed to overcome the COVID-19 crisis in the early stages of the outbreak. It focused on four areas of investment: (i) disease prevention efforts; (ii) SMEs and small traders; (iv) employment and welfare; and (iv) the local economy. The Second Supplementary Budget was designed to implement the Emergency Relief Payment worth KRW 12.2 trillion, which was passed by the National Assembly on April 30, 2020.

By June 2020, as the COVID-19 virus showed no signs of abating, the Government decided to take stronger measures and submitted a Third Supplementary Budget. To this end, the Government proposed the Third Supplementary Budget amounting to KRW 35.3 trillion (US$30 billion), with the goal of supporting employment, financing the Korean New Deal (the Rep. of Korea's new national development strategy) and helping to ensure financial stability.

With the number of daily confirmed COVID-19 cases exceeded three digits for more than one month by mid-August 2020, the Government decided to implement measures limiting the operation of businesses with a high risk of spreading infectious diseases, such as karaoke bars, buffet restaurants, and internet cafes. Given that these measures adversely affected the services sector, many SMEs suffered severe declines in sales, in turn leading to significant job losses. The Government implemented a further supplementary budget, the Fourth Supplementary Budget, worth KRW 7.8 trillion (about US$6.6 billion) to support those who had lost their sources of income due to the restrictions on business operating hours. While the Second Supplementary Budget emergency relief payment was distributed to the entire nation, the Fourth Supplementary Budget consisted of customized support measures centered on small business owners, individuals with job insecurity, families with children, and low-income families.

Table 12. Supplementary budgets for FY2020

	Date	Amount	Details (KRW trillion)
1st supplementary budget	March 17	11.7	• Disease prevention and control 2.1 • Support for small merchants 4.1 • Income support for low-income families 1.8 • Child-raising support 1.2 local economy recovery 1.2
2nd supplementary budget	April 30	12.2	• Emergency relief payments 12.2
3rd supplementary budget	July 3	35.1	• Emergency loans for struggling small merchants, SMEs, and large enterprises 5.0 • Strengthening employment security and social safety net 10.0 • Domestic economy, exports, and local economy 3.2 • Korean New Deal investments 4.8 • Expanding the Rep. of Korea's COVID-19 response model 2.4
4th supplementary budget	Sept. 22	7.8	• Support for small merchants and SMEs 3.9 • Emergency employment security 1.5 • Income support for low-income families 0.4 • Child-raising support 1.4 • Employment support 0.8 • Purchase of vaccines, etc. 0.2

Source: Ministry of Economy and Finance, 2021.

2.2.3. Budget for FY2022 and fiscal aggregates

The 2022 budget remains expansionary, although the stance appears moderate compared with previous years. The budget deficit is expected to be slightly reduced while still elevated, but this is a risk worth taking to support economic recovery and maintain the engines of growth. Since the election of the new Government in 2022, there has been a continuation in the vaccination rollout program and an easing of quarantine rules. The fiscal policy for 2022 should focus more on selective support for the affected segments of the population and on economic structural transformation, as opposed to further economic stimulus programs.

A brief look at the changes in the budget variables and total fiscal volumes in 2021 and 2022 is as follows. Total revenues are projected to be KRW 609.1 trillion in 2022, an increase of 26.2 percent compared with the 2021 supplementary budget, backed by steady recovery and excess tax revenue. The Government plans to finance a KRW 59.4 trillion worth of the Second Supplementary Budget of 2022 without any government bond issuance. The expenditure plan is designed to make use of KRW 8.1 trillion in available financial resources, including budget surpluses and public fund reserves, KRW 7.0 trillion financed through expenditure restructuring, and KRW 44.3 trillion from excess tax revenues. Total expenditure is KRW 679.5 trillion, an increase of 21.8 percent compared with the 2021 original budget and a KRW 55.2 trillion increase from the First Supplementary Budget of 2022. The consolidated fiscal balance deficit will be 3.3 percent to GDP, the same as the First Supplementary Budget. Government debt will be 49.7 percent to GDP, which is 0.4 of a percentage point lower than the First Supplementary Budget in 2022.

Table 13. FY2021 and FY2022 budget proposals (KRW trillion, %)

	2021 Budget		2022 Budget			
	Original	Supplementary	Original	1st Suppl.	2nd Suppl.	Change
Total Revenue	482.6	514.6	553.6	553.6	609.1	55.5
(% of change)	-0.2	-6.8	-14.7	-14.7	-26.2	
Total Expenditure	558	604.9	607.7	624.3	679.5	55.2
(% of change)	-8.9	-18.1	-8.9	-11.9	-21.8	
Consolidated Fiscal Balance	-75.4	-90.3	-54.1	-70.8	-70.4	0.3
(% to GDP)	(-3.7)	(-4.4)	(-2.5)	(-3.3)	(-3.3)	(-)
Government Debt	956	965.3	1,064.40	1,075.70	1,068.80	-7
(% to GDP)	-47.3	-47.3	-50	-50.1	-49.7	(-0.41)

Source: Ministry of Finance and Economy, 2022.

3. The COVID-19 Pandemic and Fiscal Sustainability

3.1. Challenges Ahead

Even before the start of the COVID-19 crisis, the Rep. of Korea had been facing major economic problems caused by an aging population due to the low birth rate. Korean society is undergoing fundamental changes in its demographic and can be characterized by a prolonged low birth rate, a deepening aging of the population due to an increase in life expectancy and, as a result, a systemic shift toward a long-term trend of declining population. There are several issues that arise in relation to this long-term trend. Among them, the advent of an aging and ultra-aged society can be seen in related problems, such as a weakening of economic growth potential and a surge in fiscal spending due to an expansion of welfare.

The Government announced its long-term fiscal outlook in December 2020 as it had to make efforts to restructure, streamline, and increase tax resources, as well as social insurance in preparation for the growing financial burden caused by the low birth rate and the overall aging of the population. In addition, the 4th Basic Plan for Low Fertility and Elderly Society (2021–2025) was announced based on the achievements and limitations of three basic plans to address the low birth rate and the aging of society over the past 15 years.

The change in the population demographic due to the low birth rate and greater life expectancy is bringing unprecedented changes to Korean society. Unless this trend changes significantly, an era of prolonged population decline can be expected, and the potential for economic growth seen in the record high growth rates of the past will likely evaporate. There is also a possibility that the country's fiscal soundness, which has been a strong prop whenever previous economic crises have occurred, could collapse.

The Rep. of Korea's success in minimizing lower infection rates and economic damage relative to other developed countries with effective quarantine policies is the basis for its economic recovery post-pandemic. The economy is recovering rapidly through 4.0 percent growth in 2021 and a current account surplus of more than US$90 billion. The Rep. of Korea and the United States are the only developed countries that have recovered to their pre-pandemic economic growth levels before the end of the COVID-19 crisis.

However, with the emergence of new variants of the coronavirus, such as the Delta variant and most recently the Omicron variant, the end of the COVID-19 pandemic remains uncertain. Therefore, financial support for the development of vaccines and treatments remains essential. Whenever a new strain of the coronavirus appears, the Rep. of Korea has implemented 3T policies, namely testing, tracing, and treating. This greatly undermines the business base of self-employed small business owners, and means that significant targeted financial support will be inevitable for the time being. Recovery from the COVID-19 crisis should be undertaken simultaneously with the continued vaccination rollout, quarantine, and policies to support financially distressed self-employed small business owners.

3.2. Korean fiscal rules (K-Fiscal Rules) and their implications

Fiscal rules refer to policy measures that guarantee fiscal soundness by setting specific numerical goals for total fiscal indicators, such as the fiscal balance, government expenditure, and the public debt-to-GDP ratio. Fiscal rules can be embodied in a wide variety of forms depending on the scope of the target government (supranational union, central government, local governments, social security pension fund, debt, fiscal balance, expenditure, income, etc.), and legalization (the Constitution, law, rules, political commitments, etc.). There are views that the introduction of these rules will automatically keep the Rep. of Korea's finances sound and eliminate unnecessary fiscal expenditures.

The Government announced new fiscal rules on October 5, 2021, which will take effect from 2025 after a transition period of three years. A summary of these national fiscal rules is as follows.

The proposal includes the formula of (public debt-to-GDP ratio of 60 percent) x (consolidated fiscal balance/-3 percent) ≤ 1.0, which means that public debt cannot exceed 60 percent to GDP and the consolidated fiscal balance deficit cannot exceed 3 percent to GDP, but at the same time the two indicators are complementary, giving some room for flexibility.

The three components of the formula are as follows. First, the public debt-to-GDP ratio limit of 60 percent is set after taking into account the current debt ratio, mid- to long-term fiscal conditions, and growing welfare spending, as well as the consequences of increased spending this year due to COVID-19 relief, including the debt outlook for 2024 of nearing 60 percent. Second, the 3 percent budget deficit limit in the consolidated fiscal balance is set after taking into consideration this year's deficit of over 4 percent due to four supplementary budgets, as well as fiscal balance outlooks for 2021 and 2022. Third, the formula makes it mandatory for the Government to work on improving fiscal soundness when it fails to meet the formula, such as by improving spending efficiency, increasing revenues and reducing budget deficits.

The fiscal rules contain guidelines regarding the transition period and exceptions (escape clauses). From the Ministry of Economy and Finance (2020), there will be a transition period of three years before the fiscal rules are introduced in the 2025 fiscal year, which will reflect 2024 fiscal conditions. There are also two escape clauses: (i) when unforeseeable challenges, such as the COVID-19 pandemic, strike the economy, the rules will not apply for the year in question, and the ratios are to be recovered gradually over the following four years; and (ii) when economic slowdown requires expanded fiscal spending to stimulate growth, support employment and promote production, the 3 percent consolidated fiscal balance deficit rule will be eased by 1 percentage point to a 4 percent deficit.

While there are concerns regarding the recent rapid increase in Korean government debt beyond past levels, it is inevitable that government debt will increase as the need for debt financing increases, due to weakening of the growth base, an aging population, and increasing welfare expenditure requirements. In addition, policy responses due to the COVID-19 crisis have also contributed to the fiscal deficit and the increase in government debt.

In reality, while fiscal rules are easy to establish, they are far more difficult to comply with. In addition, it is easy to comply with the pre-set limits during a time of economic boom, but far more difficult during a recession. Public finances should be operated in a surplus during a boom and a deficit during a recession, i.e., in a counter-cyclical manner. However, once fiscal rules have been set, it may become difficult to implement policies in a flexible way, which could lead to undesirable pro-cyclical characteristics.

When economic shocks such as the 2008/09 global financial crisis or the COVID-19 crisis occur, a large fiscal deficit inevitably results. In such situations, despite the desirability of fiscal expansion policies by further increasing the fiscal deficit, the existence of fiscal rules is likely to lead governments to adopting austerity policies that delay economic recovery and lower the level of public services. Such an example can be seen in the European Union's adoption of austerity policies in Greece and Italy, which fell into an economic crisis in 2011. This was later evaluated as the wrong policy and one that further deepened the crisis. This is an example demonstrating that rigid fiscal rules are not always useful. In addition, fiscal rules are often avoided using methods such as creative accounting or 'window dressing' that transfer and apply the deadline for compliance with the rules. A typical example is the act of converting government fiscal expenditures into those of public enterprises so that they are not included in government spending.

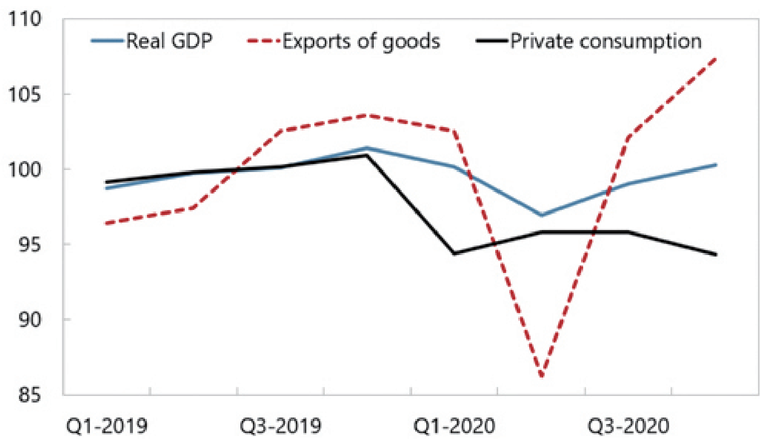
Fiscal rules have been introduced in various countries because there is a risk that fiscal soundness could deteriorate significantly, or deteriorate in the short term, due to a specific policy goal, such as an international union (such as European monetary union). Such a situation is unlikely to occur in the case of the Rep. of Korea. Therefore, it may be inappropriate to discuss in the same policy measures in countries that have previously introduced fiscal rules. In addition, there are many institutional matters that the National Assembly and the Government must agree upon and discuss in order to introduce fiscal rules. For example, the choice of rules (debt, expenditure, etc.), the application of intensity and exception regulations, the establishment of central-local government scope, and the establishment of a politically independent guarantee organization. It is also important to consider that the objective basis for the 60 percent cap on public debt proposed by the Ministry of Economy and Finance has not yet been articulated.

In conclusion, it can be seen that the introduction of explicit fiscal rules, such as an upper limit on public debt in the Rep. of Korea, is not necessarily effective or valid. The purpose of introducing fiscal rules is to prepare institutional and legal measures necessary to protect fiscal soundness, which can be viewed as premature in the case of the Rep. of Korea from the perspective of current institutional maturity and fiscal sustainability. As recommended by international organizations such as the IMF and the OECD, it may be more appropriate to introduce effective measures to ease the pace of debt growth in the short term and operate them as "implicit fiscal rules."

4. Next Steps in the Post-COVID-19 Period

The recovery in economic activity has been uneven across sectors of the Korean economy. Manufacturing and exports have rebounded strongly after falling due to the COVID-19-related collapse in trading partner imports. Tech exports are outperforming, reflecting pandemic-induced increases in online activities. This has supported buoyant business investment. In contrast, activity in the services sector has been sluggish, weighed down by still depressed consumption.

Figure 31. Uneven economic recovery in the Rep. of Korea



Source: IMF, 2021b.

This “K-shaped” recovery is reflected in diverging outcomes at the firm and worker levels. Performance among large, tech export-oriented firms has been strong, while the services sector, in which SMEs are more prevalent, has lagged. Employment declined by 1 million jobs

(-3.7 percent) in March–April 2020 and, after a brief upturn, has returned to this trough despite the recovery in headline economic activity. Most job losses have been experienced by "non-regular" workers, while employment of "regular" workers on open-ended contracts has held up. The COVID-19 shock's effects were also largest for lower wage sectors and lower-income earners, falling more heavily on female and young workers. This has also likely exacerbated inequality, though some of the near-term impact was offset by temporary transfers.

To overcome the impacts of the COVID-19 crisis, given that the effectiveness of monetary policy has significantly weakened since the global financial crisis, there is little option but to use the following expansionary fiscal policies.

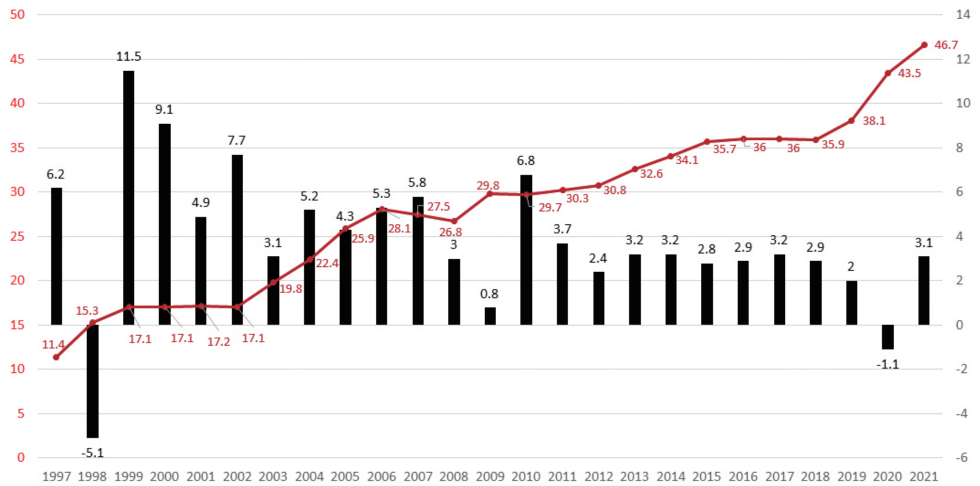
First, most developed countries are trying to stimulate their economies through large-scale fiscal expenditure in response to negative economic growth of more than 5–6 percent in 2020. Expansionary fiscal expenditure is essential during this economic crisis. To overcome the foreign exchange crisis, the Rep. of Korea also raised the deficit ratio of the managed fiscal balance to 4.7 percent of GDP in 1998, driving a V-shaped growth recovery of 11.3 percent in 1999, and expanded fiscal expenditure from 0.8 percent in 2008 to 6.8 percent in 2009. Despite the COVID-19 crisis, expansionary fiscal policies for economic recovery appear inevitable.

Second, fiscal policy should invest in restoring the engines of growth in the economy. As existing global value chains (GVCs) are being disrupted by the restrictions on free movement due to the COVID-19 pandemic, there is a possibility that new economic innovation and technical characterization of the so-called 4th industrial revolution will intensify going forward. It will therefore be necessary to expand investment to lay the foundations for future growth, such as corporate support, innovative infrastructure construction, and data science-related support.

Third, since unemployment and income inequality are likely to worsen after the crisis, it is also necessary to expand fiscal expenditures to further expand social safety nets, such as supporting employment and welfare.

This fiscal expansion inevitably increases the Government's fiscal burden. The decline in revenues and soaring expenditures due to falling growth are expected to lead to an increase in the public debt-to-GDP ratio. In overseas cases, the public debt ratios of Spain, Japan, the United States, Italy, and France are expected to rise by more than 20 to 30 percentage points from 2019 to the end of 2021 due to the COVID-19 crisis response. In the Rep. of Korea, government debt is also expected to increase according to the 2022 budget and the 2021–2025 National Fiscal Management Plan. The expansionary fiscal policy inevitably raises the government debt ratio and expands the fiscal deficit but, as a result, if the economic recovery accelerates, the possibility of a recovery in fiscal soundness increases.

Figure 32. Economic prosperity and public debt-to-GDP ratio in the Rep. of Korea



Note: Bar means real GDP growth rate, red line means debt-to-GDP ratio, respectively.
Source: Authors' calculation based on Bank of Korea's ECOS.

In other words, fiscal soundness is not an end in itself, but a dependent variable that can vary depending on the economic situation. In the wake of the 2008 and 2011 economic crises, the main factor that determined the process of restoring fiscal soundness in major European countries was the rise in growth due to economic recovery. The Rep. of Korea's public debt-to-GDP ratio is showing a somewhat steeper trend compared with the past, but this should stabilize rapidly once the growth rate recovers after a crisis—as it has done in the past. It can be seen from the 2008 global financial crisis and the 2011 fiscal crisis in Europe that revenue expansion, expenditure reduction, and the introduction of fiscal rules are only possible when preceded by high growth rates. Let us now summarize the action plan for fiscal sustainability.

First, the perspective of government debt management has shifted from securing fiscal soundness to sustainable finance. Fiscal sustainability-oriented government debt management refers to managing government debt by adding indicators that reflect "sustainable finance". These alternative indicators include the public debt-to-GDP ratio, excluding financial liabilities with corresponding assets, and the interest payments-to-GDP ratio (flow-to-flow). It is also necessary to determine fiscal sustainability considering the maturity structure of government bonds and their share of foreign ownership.

Second, fiscal reform is needed for efficient fiscal expenditure. When drawing up a budget plan and preparing a national fiscal management plan, it is necessary to actualize expenditure restructuring and reduce tax exemptions and promote it more strongly. For example, in the case of expenditure restructuring, fiscal expenditure is reviewed at zero base and, in the case of fiscal subsidies or other public projects, if similar overlapping projects are found, it is consolidated with ministries and business units without exception. In addition, it is essential to reflect the results of various performance evaluations in the subsequent year's budget without exception.

Third, for fiscal expenditure in the non-welfare sector, it is necessary to set a temporary expenditure limit for a certain period of time to secure fiscal space for expenditure on welfare spending. For example, it may be necessary to secure financial resources for the welfare sector by temporarily limiting the rate of increase in expenditure in non-welfare sectors, such as the economic sectors.

Finally, in establishing a welfare system through an increased tax burden, it will be necessary to legislate to present an annual financing plan. In other words, when estimating welfare-related fiscal needs, the scale of financing through debt issuance and the scale of financing through social insurance and taxes should be presented in the medium term. In addition, for permanent welfare finance requirements, in principle, there is a requirement for a major means of expanding revenue, including through the introduction of a specific purpose tax.

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Country Case: Vietnam

1. General Macroeconomic and Fiscal Conditions before the COVID-19 Pandemic2. The Impact of the COVID-19 Pandemic and the Fiscal Response

2. The Impact of the COVID-19 Pandemic and the Fiscal Response

3. The COVID-19 Pandemic and Fiscal Sustainability

4. Conclusion and Next Steps in the Post-COVID-19 Period

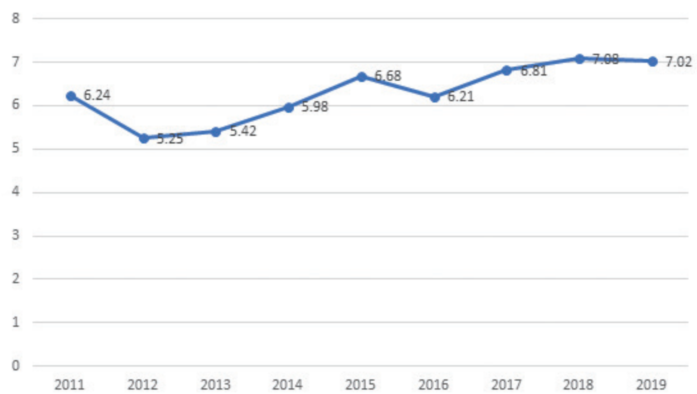
Country Case: Vietnam[37]

1. General Macroeconomic and Fiscal Conditions before the COVID-19 Pandemic

1.1. Macroeconomic Conditions

Prior to the COVID-10 pandemic, Vietnam was one of the economies with highest growth rates in the world. The average annual GDP growth rate in the period 2011–2019 reached 6.3 percent.[38] GDP per capita in 2019 reached US$3,416 (GDP per capita, PPP constant 2017, in 2019 reached US$10,134). Macroeconomic stability was maintained and inflation was benign and kept under control at a low level. The average annual Consumer Price Index (CPI) decreased from 4.7 percent in 2016 to 3.5 percent in 2018, and then to 2.8 percent in 2019. Major indicators of the economy have been significantly improved.

Figure 33. GDP growth of Vietnam before the COVID-19 pandemic, 2011–2019 (%)



Source: General Statistic Office of Vietnam.

37 Le Quang Thuan, National Institute for Finance, lequangthuan1@mof.gov.vn.

38 The Economist magazine in August 2020 ranked Vietnam in the top 16 most successful emerging economies in the world. According to World Bank data, with an average economic growth of 6.8 percent a year in the 2016–2019 period, Vietnam is in the top 10 fastest growing countries.

Economic growth is based on the increasing contribution of total factor productivity (TFP). In Vietnam, labor productivity has improved steadily and significantly over the years. The economic structure has shifted toward increasing the share of the processing and manufacturing industries sector and decreasing the share of the agriculture sector in the overall economy.

Table 14. Economic indicators, 2016–2019

	2016	2017	2018	2019
GDP growth rate (%)	6.21	6.81	7.08	7.02
GDP per capita (US$)	2,693	2,929	3,182	3,416
Inflation rate (%)	2.7	3.5	3.5	2.8
Exchange rate (US$/VND)	22,159	22,700	23,288	23,171
Current Balance (% of GDP)	0.2	-0.6	1.9	3.8

Source: General Statistic Office of Vietnam, IMF database, Asian Development Bank (ADB).

1.2. Trend in fiscal balance and public debt prior to the COVID-19 pandemic[39]

During the period from 2011 to 2019, considerable progress was made in putting public finance on a sounder footing, while the share of domestic revenue was increased and budget expenditure was rationalized with an increase in capital expenditure and a decrease in recurrent expenditure. The budget deficit decreased from an average of 5.4 percent of GDP in the period 2011–2015 to an average 3.5 percent of GDP in the period 2016–2019.

Table 15. Budget deficit and public debt indicators, 2016–2019

	2016	2017	2018	2019
Budget deficit (percent of GDP)	3.58	2.74	2.8	2.67
Public debt (percent of GDP)	63.7	61.4	58.3	55.0
Foreign debt (percent of GDP)	44.8	49.0	46.0	47.1
Government debt (percent of GDP)	52.7	51.7	49.9	48

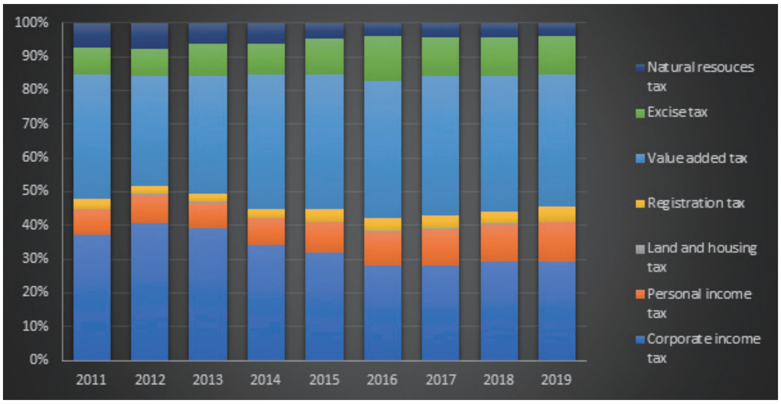
Source: Ministry of Finance of Vietnam.

39 According to Vietnam's Law on Public Debt Management, public debt includes: (i) government debt; (ii) government guaranteed debt; and (iii) and local government debt. Government debt is a debt arising from domestic and foreign loans. This debt is signed or issued in the name of the State or in the name of the Government of Vietnam. Government-guaranteed debt is a debt borrowed by an enterprise or a policy bank of the State and guaranteed by the Government. Local government debt is a debt borrowed by the People's Committee of the province.

The size of national budget revenue mobilization in the 2011–2020 period was 3.8 times higher than that in the 2001–2010 period, during which domestic revenue increased about 5.1 times, revenue from crude oil increased about 1.3 times, and balanced revenue from import and export activities increased about 2.9 times.

The average ratio of budget revenue mobilization in the period 2011–2020 was about 24.5 percent of GDP. In the period 2011–2015, it reached 23.6 percent of GDP, and in the period 2016–2020 it reached about 25.2 percent GDP. Compared with the period 2001–2010, the ratio of budget revenue mobilization tended to decrease, mainly due to a sharp decrease in revenues from crude oil and import-export activities. In the period 2011–2020, total revenues from crude oil and import-export activities were only 6.3 percent of GDP, on average, a decrease of 4.6 percentage points compared with 10.9 percent of GDP in the period 2001–2010. The ratio of budget revenue mobilization from taxes and fees in the period 2011–2015 reached about 20.7 percent of GDP. In the 2016–2020 period, it reached about 21 percent of GDP.

Figure 34. Tax revenue structure (% of GDP)



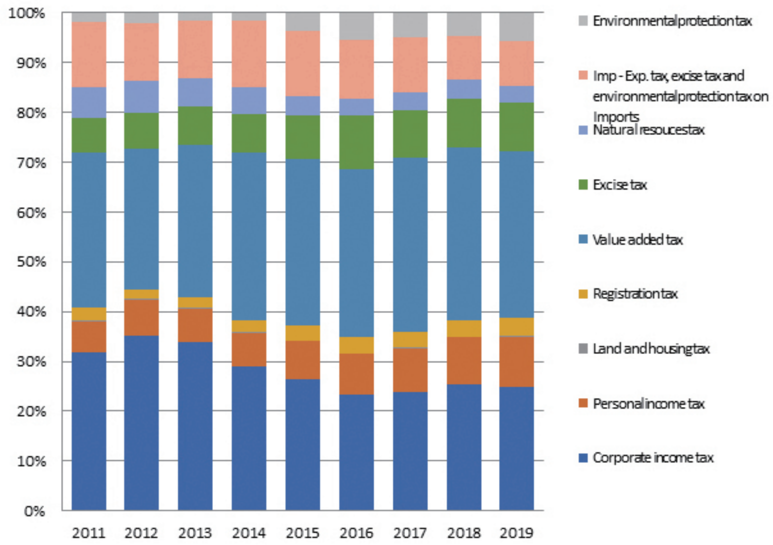
Source: Ministry of Finance of Vietnam.

The budget revenue structure has improved, with an increase in the domestic revenue ratio in total state budget revenue. In the 2011–2020 period, the proportion of domestic revenue reached 76.7 percent compared with 57.6 percent in the 2001–2010 period. The proportion of land use revenue in the total state budget revenue in the 2011–2015 period was 6.1 percent and in the period 2016–2020 was 10.1 percent. The budget revenue structure changed positively with a gradual increase in the share of domestic revenue to offset the decrease in export and import taxes due to international commitments in various free trade agreements (FTAs) and oil price fluctuations on the global market. The average share of crude oil revenue and balanced revenue from import-export activities in the period 2016–2020 decreased to 17.5 percent of the total state budget revenue (in the period 2006–2010 it was 38.3 percent and 20 percent in the period 2011–2015).

The domestic revenue structure has also undergone an improvement. Revenues from economic sectors accounted for nearly 60 percent of domestic revenue, with the main contributions from the non-state business sector and the foreign direct investment sector. Revenue from the non-state business sector increased from 17.9 percent in the 2011–2015 period to about 18.2 percent in the 2016–2020 period, while the share of revenues from the state business sector decreased from 25.1 percent to about 13.8 percent in the same period. This change is in line with the orientation of reorganization, equitization of state-owned enterprises, and the increased attraction of domestic and foreign resources toward development investment.

Regarding the tax revenue structure, the proportion of corporate income tax (CIT) in total tax revenue decreased from 31.2 percent in the 2011–2015 period to 23.7 percent in the 2016–2020 period, in line with the CIT rate reduction schedules, from 25 percent in 2009 to 22 percent in 2014, and then to 20 percent from 2016. The proportion of value-added tax (VAT) revenue in total tax revenue increased from 31.3 percent in the 2011–2015 period to 33.2 percent in the 2016–2020 period. The proportion of personal income tax (PIT) increased from 6.8 percent in the 2011–2015 period to about 9.3 percent in the 2016–2020 period, while excise tax (special consumption tax, or SCT) increased from 7.7 percent in the 2011–2015 period to about 9.6 percent in the 2016–2020 period, while environmental protection tax increased from 2.2 percent in the 2011–2015 period to 5.2 percent in the 2011–2015 period.

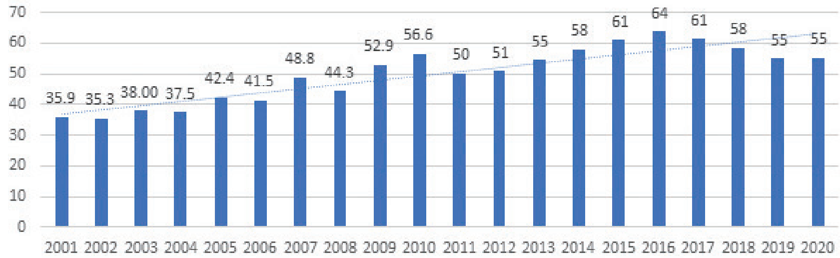
Figure 35. Tax revenue structure (% of total tax revenue)



Source: Ministry of Finance of Vietnam.

The public debt (including: government debt, government guaranted debt and local government debt) in the period of 2011–2020 remained below the threshold approved by the National Assembly. The public debt-to-GDP ratio decreased sharply, from 63.7 percent of GDP at the end of 2016 to 55.2 percent of GDP at the end of 2020, while the government debt balance was about 49.1 percent of GDP.

Figure 36. Vietnam public debt-to-GDP ratio before the COVID-19 pandemic, 2001–2020 (%)



Source: Ministry of Finance of Vietnam.

1.3. Fiscal sustainability tools implemented by the Government

Although the Government's fiscal position was strengthened by consistently high economic growth while inflation remained benign, and the trade balance was continuously in surplus in the period 2011–2019, the public finances of Vietnam still faced various external and internal risks. Understanding these risks, as well as the importance of ensuring fiscal sustainability for macroeconomic stability and development, the Government focused on the reform of institutional and legal frameworks to enhance the effectiveness and efficiency of public financial resource management.

The Government's view is that it is acceptable to allow a high budget deficit in the short term to free up more investment funds for development, but the outstanding balance of the public and national debt should always be maintained within safe limits in the medium to longer term.

The tax policy and legal system for budget revenue have been reformed to protect state budget revenue and to support Vietnam's socio-economic development and international economic integration.

Tax reform in this period focused on reducing the corporate income tax rate to encourage investment and to promote business activities and broadening the tax base. This was accompanied by increases in the rates of excise tax, natural resources tax and environmental protection tax to encourage green production and consumption behavior toward sustainable development.

On the management of expenditure, the Government focused on improving the allocation efficiency and use of public financial resources, continuing to restructure budget expenditures. This was supported by strengthening discipline, transparency and accountability in public financial management.

The Law on the State Budget was modified and many new regulations added (effective from January 1, 2017) to enhance the efficiency and effectiveness of the use and management of state budget resources.

With the strengthening of the legal framework for PFM, the efficiency of using public resources has improved. Budget capital in combination with crowding in sources of private capital has contributed strongly to infrastructure development, poverty reduction, and an increase in the level of social equity. Public investment capital has been prioritized to focus more on national targeted programs and important national projects that have inter-regional connectivity and spillover effects.

Supervision, risk management, and national debt safety have been significantly strengthened and rendered more effective. Public debt has also been restructured such that is has become safer and is set on a more sustainable basis.

The Law on Public Debt Management has created a legal framework for improving the effectiveness of public debt management by ensuring the decisive role of the National Assembly. Meanwhile, Provincial People's Councils have been given powers in the management of local government debt (which is a part of public debt) that had not been mentioned in previous regulations of the Law. The Law on Public Debt Management has also reaffirmed the important role of the Government in public debt management, including mobilization, allocation and repayment, and specified the authority and responsibility of the relevant agencies in public debt management.

The reform of the legal framework on public debt management has contributed to improving the effectiveness and efficiency of loan management and use, thereby ensuring national financial security. Debt safety indicators are strictly controlled within the safety threshold approved by the National Assembly.

The above-mentioned tools of institutional and legal frameworks are effective for controlling the fiscal risks that Vietnam may face in the medium and long term, including: risks related to local government debt; risks related to off-budget funds; costs from reforming the state-owned enterprises; and the impacts of population aging or natural disasters, climate change, etc. Therefore, these tools make an important contribution to ensuring national finance security.

1.4. Fiscal rules

According to the provisions of the State Budget Law (Art. 7), loans to offset the budget deficit can be used only for capital expenditure, not for recurrent expenditure. The central budget deficit is offset from the following sources: (i) borrowing domestically from the issuance of government bonds or public bonds and other domestic loans; and (ii) foreign borrowing from loans of governments and international organizations, and issuing government bonds on the international market. Regarding local government budget deficit, only provincial budgets can be in deficit and debt can only be used to invest in projects under the medium-term public investment plan decided by the Provincial People's Council. Local budget deficits are offset by domestic borrowings from the issuance of local government bonds, on-lending from the central government and other domestic loans. Local budget deficits are aggregated into national budget deficit and decided by the National Assembly. The Government specifies conditions for allowing local budget deficits to ensure compliance with local debt repayment capacity and the total national budget deficit. The loan rights of local budgets are categorized into three groups of local governments: (i) for two largest cities of Hanoi and Ho Chi Minh City, the loan right does not exceed 60 percent of the local budget revenues (including revenues 100 percent local budget and shared revenues between central and local budgets); (ii) for provinces with local budget revenues (including revenues 100 percent local budget and shared revenues between central and local budgets) that are greater than the local budget's recurrent expenditure, the loan right must not exceed 30 percent of the provincial revenue; and (iii) for provinces with local budget revenues (including revenues 100 percent local budget and shared revenues between central and local budgets) that are less than or equal to recurrent expenditures of the local budget, the loan right must not exceed 20 percent of the provincial revenues.

According to the provisions of the Law on Public Debt Management, the National Assembly decides the ceiling and warning threshold on public debt. Public debt safety indicators include: (i) public debt-to-GDP ratio; (ii) government debt-to-GDP ratio; (iii) the Government's direct debt repayment obligation (excluding on-lending) to total annual national budget revenue; (iv) the country’s foreign debt-to-GDP ratio; and (v) the country's foreign debt repayment obligation to total exports and imports turnover of goods and services. The Law on Public Debt Management also stipulates a five-year public debt repayment and borrowing plan, and a five-year public debt management program and annual public debt repayment and borrowing plan. The five-year public debt repayment and borrowing plan includes: (i) safety indicators for public debt; (ii) total loan amount and debt repayment of central and local government budgets, and loan limits for on-lending and government guarantee limits; and (iii) public debt management solutions. The annual public debt repayment and borrowing plan includes: (i) the Government's annual plan on borrowing and debt repayment; (ii) the annual plan on borrowing and paying debts of local governments; and (iii) loan limits for on-lending and the annual government guarantee limit.

The five-year national fiscal plan, and the borrowing and public debt repayment plan for the period 2016–2020[40] stipulate that the national budget deficit ratio for the period 2016–2020 must not exceed 3.9 percent of GDP, of which the central budget deficit must not exceed 3.7 percent of GDP and local government budget deficits must not exceed 0.2 percent of GDP, so that by 2020 the national budget deficit would not exceed 3.5 percent of GDP. Accordingly, Resolution No. 25/2016/QH14 of the National Assembly stipulates that ensuring public debt safety, with the goal of: (i) annual public debt must not exceed 65 percent of GDP, government debt must not exceed 54 percent of GDP, the country's foreign debt must not exceed 50 percent of GDP; (ii) the country's foreign debt repayment obligations are less than 25 percent of total export turnover of goods and services; and (iii) the Government's direct debt repayment obligations (excluding on-lending) must not exceed 25 percent of total annual national budget revenue.

40 The Resolution No. 25/2016/QH14 of the National Assembly dated 9 November 2016.

2. The Impact of the COVID-19 Pandemic and the Fiscal Response

2.1. Economic and Social Impacts of the COVID-19 Pandemic

Vietnam recorded its first two cases of COVID-19 infection[41] on January 23, 2020, in Ho Chi Minh City. Up to now, there have been four waves of outbreak in Vietnam.[42] The fourth wave, which started on April 27, 2021, with a new and dangerous Delta variant, has spread through industrial zones, large cities, and major economic hubs (Hanoi, Ho Chi Minh City, Danang, etc.). By December 31, 2021, Vietnam had recorded about 1.7 million cases of infection and about 32,400 fatalities.[43]

As an open economy with broad sectors in terms of its economy, trade, tourism, etc., integrated with many other economies, Vietnam suffered very severe impacts from the COVID-19 pandemic. To limit the spread of the disease, Vietnam had to implement social distancing measures. This negatively affected people's lives and economic activities. The most directly affected sectors are tourism, commerce, and transportation, especially aviation due to the implementation of social distancing measures and people's anxiety, causing significant declines in consumption. Similar to other countries, the complicated development of the pandemic has had a profound impact on the economy, both on the supply side and on the demand side.

On the supply side, the prevention and control measures used by many countries are social distancing, stopping production, business, tourism, etc., all of which reduce the labor supply, especially in areas requiring direct labor participation in the production process. The disruption of production activities in GVCs has also affected the supply chains from one industry to another, and from one sector to another.

On the demand side, together with people's anxiety regarding activities involving social contact, lock-downs and social-distancing measures have made demand for direct shopping in stores, shopping malls, and entertainment venues, etc. dramatically contract. While online shopping has developed to a degree in compensation, this has not filled the gap created by the decline in demand compared with the pre-pandemic situation. In addition, incomes of the majority of Vietnamese decreased sharply, especially those working in the tourism and aviation transport industries. The unpredictable development of the COVID-19 pandemic has caused a sharp drop in consumer demand. Many of Vietnam's major trading partners and other major economies have also been greatly affected by the pandemic, creating sharp declines in import demand, including goods imported from Vietnam.

According to the data of the General Statistics Office of Vietnam, in 2020, there was 46,600

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41 Chinese nationality citizens.

42 The first wave of outbreak from January 23, 2020 to July 25, 2020, with 415 cases were recorded; the second wave of outbreak from July 25, 2020, to January 27, 2021, with 1,336 cases were recorded; the third wave of outbreak from January 27, 2021, to April 26, 2021, with 1,300 cases were recorded and the fourth wave of outbreak from April 27, 2021 to now.

43 Source: https://covid19.gov.vn/

enterprises that had suspended business, an increase of 62.2 percent; nearly 37,700 enterprises that had stopped business altogether and were waiting for bankruptcy procedures, a decrease of 13.8 percent; and nearly 17,500 enterprises had completed bankruptcy procedures, an increase of 3.7 percent. On average, nearly 8,500 businesses withdrew from the market every month in this period. In 2021, the number of enterprises suspending business was nearly 55,000, an increase of 18 percent compared with the previous year, while 48,100 enterprises had ceased business entirely and were awaiting bankruptcy proceedings, an increase of 27.8 percent, and 16,700 enterprises had completed bankruptcy proceedings, a decrease of 4.1 percent. On average in 2021, nearly 10,000 businesses withdrew from the market every month.

Vietnam's labor market was severely affected by the pandemic. Prior to the COVID-19 pandemic, nearly 88 percent of the population participated in the labor force (aged 25–59). Of this workforce, the highest proportion was 14.3 percent of the age group 25–29 and 14.2 percent in the age group 30–34. The lowest shares (less than 10 percent) in the labor force were the age group of 15–19 years old and 20–24 years old, together with the over 60 age group.

When the COVID-19 pandemic arrived in Vietnam, it directly affected employment across all sectors and all provinces, especially when the Government implemented social-distancing measures. In 2020, the unemployment ratio of working age workers was only 2.48 percent. The labor force participation ratio in 2021 is estimated at 67.7 percent, a decrease of 1.9 percentage points from the previous year, while the average population of Vietnam in 2021 was 98.51 million people.

Table 16. Unemployment ratio in Vietnam, 2016–2021

	2016	2017	2018	2019	2020	2021
Unemployment ratio (% of labor force)	2.29	2.22	2.19	2.17	2.48	3.22

Source: General Statistics Office of Vietnam.

2.2. Fiscal Responses to the Impact of the COVID-19 Pandemic

After the first outbreak of the disease was recorded in Vietnam, the Government identified two main tasks: (i) the protection of the population's health by aggressive contact tracing, targeted testing and the isolation of suspected cases to limit the spread of infection; and (ii) support for economic growth and to ensure social welfare (using flexible and expansionary fiscal and financial policies to support businesses and low-income families).

Major fiscal measures[44] undertaken by the Government included: (i) additional health spending; (ii) tax exemptions and deferrals; and (iii) cash transfers. Other measures included:

(1) Additional health spending, represented by an increase in budget expenditure for disease prevention; the procurement of drugs, chemicals, equipment for the prevention and control of COVID-19; and financial support for health-care facilities, for civil servants who participate in disease prevention and control. For the purchase of vaccines and medication to treat the COVID-19 virus, the Government issued regulations on funding sources. In addition to the state budget, the Government also established a COVID-19 Vaccine Fund to mobilize funding and support from organizations and individuals.

(2) Tax exemptions, reductions and deferrals to reduce the difficulties faced by businesses and low-income families in the context of the pandemic, including VAT, CIT, PIT, excise tax, import tax, agricultural land use tax, license fees, etc.

- Tax exemptions include: Exemptions from import tax on medical supplies and equipment for the prevention of infection from the COVID-19 virus; supplies and input materials of enterprises in the leather, footwear, textiles, agriculture, forestry and fishery processing, mechanics, supporting sectors, and the automobile industry; exemptions from license fees for households, individuals, groups of individuals participating in the first year of production and business activities; SMEs moving from household businesses; and continued exemptions from agricultural land use tax through to 2025.

- Tax reductions in 2020 and 2021 include: Temporary 30 percent reduction in CIT for businesses with total taxable revenue in 2020 not exceeding VND 200 billion; temporary 30 percent reductions in environmental protection tax on jet fuel; temporary 50 percent reduction in the registration fee for domestically manufactured or assembled cars; reductions in import tax for many groups of products for businesses in agriculture, mechanical engineering, supporting industries, and automobile industries; and reductions of 15 percent in land rent charge for businesses, organizations and individuals affected by the COVID-19 pandemic.

- Tax deferrals of VAT, CIT, PIT and land rent charge for businesses: excise tax deferrals on domestically manufactured or assembled cars to stimulate the domestic production and consumption of cars.

(3) Cash transfers: The Government issued policies and implemented cash transfers for people in financial difficulties, as a result of the pandemic causing job losses and

44 Beside fiscal measures, Vietnam adopted also monetary and financial measures, such as: The State Bank of Vietnam cut its repo and refinancing rates by 150 and 200 bps in total between March and October 2020; Credit institutions rolled out a 300 trillion credit support package in March on a voluntary basis to provide new loans to borrowers at lower interest rates by 0.5–2.5 percent compared with pre-Covid-19 interest rates; Credit institutions adopted loan restructuring; freezing loan classification; reduced transaction fees; zero interest loans for affected firms; Vietnam Social Policy Bank provided zero interest-rate loans for affected firms that maintain employees on payroll. Short-term funding ratio requirement.

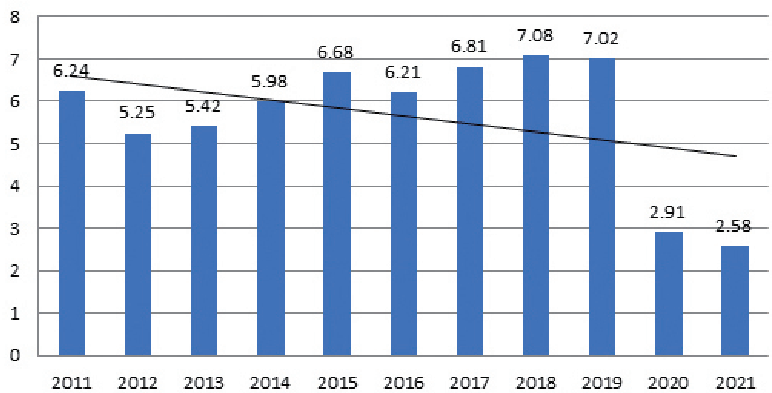
income reductions, by using central and subnational government budgets, and the Unemployment Insurance Fund.

(4) Other measures: deferrals of contributions to the social security fund for affected employers and employees; electricity price cuts for low-income households and firms in certain sectors; and improving telecommunication services to enable work from home, and free-of-charge telecommunication services for hospitals and central quarantine facilities. In May 2021, the Government established a Fund for Vaccines against COVID-19 to receive, manage and use funding sources for purchasing and self-researching and producing vaccines for all Vietnamese citizens.

Thanks to these prompt and effective policy responses, in 2020 Vietnam still managed to achieve a GDP growth rate of 2.91 percent (although this is the lowest growth rate in the past 10 years). Inflation was kept under control at a low level, with the average CPI in 2020 increasing by just 3.23 percent compared with 2019, reaching the target set by the National Assembly of less than 4 percent. Exports increased by 6.5 percent and imports increased by 3.6 percent. In growth rates of sectors, the agriculture sector (including forestry and fisheries) increased by 2.68 percent, the industry and construction sector increased by 3.98 percent, and the services sector increased by 2.34 percent.

In 2021, Vietnam continued to be affected by the pandemic, especially the fourth wave of outbreak from April 27, 2021. Therefore, GDP growth in 2021 was only 2.58 percent (a target of 6 percent notwithstanding). Direct losses due to the pandemic in the two years from 2020 to 2021 are estimated at US$37 billion.

Figure 37. Vietnam's GDP 2011–2021 (%)



Source: Vietnam General Statistics Office (GSO)

In terms of sectoral contributions to the economy as a whole: (i) the agriculture, forestry and fisheries sector increased by 2.9 percent, contributing 13.97 percent to total GDP; (ii) industry and construction increased by 4.05 percent, contributing 63.80 percent; and (iii) the services sector increased by 1.22 percent, contributing 22.23 percent.

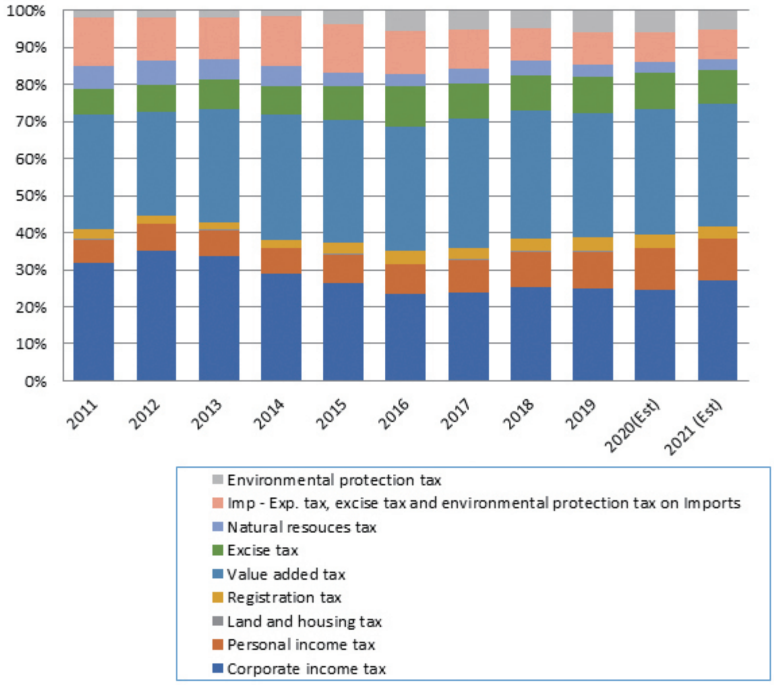
Export and import activities slowed in the third quarter of 2021, but recovered in the fourth quarter, and achieved a relatively strong growth rate over the whole year. In 2021, the total export and import turnover reached US$668.5 billion, an increase of 22.6 percent over the previous year, of which exports increased 19 percent; imports increased by 26.5 percent; and the trade balance for goods is estimated to be in surplus by US$4 billion. In the fourth quarter of 2021, exports were estimated at US$95.6 billion, an increase of 19.4 percent over the same period of 2020, while imports were estimated at US$89.07 billion, an increase of 16 percent.

Although social investment capital growth was low in 2021, this was nonetheless positive in the context of the COVID-19 pandemic. It is estimated that in 2021, the realized investment capital at current prices reached VND 2,891.9 trillion, an increase of 3.2 percent over the previous year. The main contribution to social investment capital growth comes from the non-state sector. Although foreign direct investment (FDI) decreased by 1.2 percent in terms of disbursed capital, registered capital was still positive (newly granted US$15.25 billion, up 4.1 percent. In addition, adjusted registered capital reached US$9.01 billion, up 40.5 percent), showing the continued confidence of foreign investors.

Macroeconomic stability has been successfully maintained. For 2021, inflation was kept within its target range, averaging 1.84 percent, the lowest increase since 2016, while average core inflation in 2021 increased by 0.81 percent compared with the average in 2020. The deposit interest rate level was kept stable, creating favourable conditions for the lending interest rate to decrease by nearly 1 percentage point in 2021.

In the context of the impact of the pandemic on economic activities, especially on import and export activities, the most affected tax revenues are corporate income tax (CIT), export tax and the import-export tax, excise tax and the environmental protection tax on imports.

Figure 38. Tax revenue structure 2011–2021 (% of total tax revenue)



Source: Ministry of Finance of Vietnam.

However, in general, the macroeconomy has remained stable and the major economic indicators are positive (Table 17).

Table 17. Economic indicators 2016–2021

	2016	2017	2018	2019	2020	2021
GDP growth rate (%)	6.21	6.81	7.08	7.02	2.91	2.58
GDP per capita (US$)	2,693	2,929	3,182	3,416	3,500	3,759
Inflation rate (%)	2.7	3.5	3.5	2.8	3.2	1.84
Exchange rate (US$/VND)	22,159	22,700	23,288	23,171	23,070	22,846
Current Balance (% of GDP)	0.2	-0.6	1.9%	3.8%	2.2%	-1.0%

Source: General Statistic Office of Vietnam, IMF database, ADB.

The budget deficit in 2020 and 2021 increased due to the need to increase budget spending on pandemic prevention and social security, in the face of budget revenue declines. However, the public debt in 2020 and 2021 was maintained at a stable and safe level.

Table 18. Budget deficit and public debt indicators, 2016–2021

	2016	2017	2018	2019	2020 (Est)	2021 (Est.)
Budget deficit (% of GDP)	3.58	2.74	2.8	2.67	3.99	4.00
Public debt (% of GDP)	63.7	61.4	58.3	55.0	55.2	43.7
Foreign debt (% of GDP)	44.8	49.0	46.0	47.1	47.2	39.0
Government debt (% of GDP)	52.7	51.7	49.9	48	49.1	39.5

Source: Ministry of Finance of Vietnam.

3. The COVID-19 Pandemic and Fiscal Sustainability

3.1. Changes in GDP government revenue and expenditure

In the context of the pandemic, Vietnam's fiscal sustainability faces challenges both in terms of budget revenue and expenditure. Budget revenues declined as a result of: (i) the slowdown in economic growth, and the disruptions to production and business, particularly in the tourism, retail trade and aviation transportation industries; (ii) external economic activities facing many difficulties due to the weak global consumption and supply; and (iii) global crude oil prices falling sharply and remaining at low levels in 2020. Meanwhile, the central and local government budgets increased spending on health-care tasks, ensuring environmental sanitation, and the prevention and control of the COVID-19 pandemic, together with spending to ensure social security and support for low-income families and small businesses.

Therefore, in 2020, total budget revenue reached only 98 percent of the target, equivalent to 24 percent of GDP, of which tax revenues were 19.1 percent of GDP. Such revenue results are nonetheless positive in the context of economic growth of only 2.91 percent (much lower than the target of 6.8 percent), and the implementation of many policies on tax exemptions, reductions or deferrals. Domestic revenue reached 100 percent of the target, mainly from land revenue (revenues from the transfer of land use rights by the State to organizations and individuals). However, significant revenues from business activities failed to meet the target, and revenue from crude oil reached 98.3 percent of the target, because the annual global average crude oil price fell to only US$45.7 a barrel in 2020, a decrease of 14.3 percent compared with the estimated price (US$60 a barrel). Balanced revenue from import and export activities reached 85.6 percent of the target. In 2021, due to the continuing impact by the pandemic, especially from the end of April onward, economic activities continued to face difficulties, with economic growth likely to be lower than the target of 6 percent, leading domestic revenue to decrease to an estimated 95 percent of the annual revenue plan.

Regarding budget expenditure, in 2020, budget expenditure was about 28.4 percent of GDP; the share of capital expenditure in the total budget expenditure was estimated at 30.8 percent, a sharp increase compared with 25 percent in 2019 and higher than the target of 25–26 percent; and the share of recurrent expenditure was about 63.1 percent, higher than the

59.8 percent share in 2019. In 2021, capital expenditure is estimated at 56.6 percent of total budget expenditure and recurrent expenditure is estimated at 81.5 percent of total budget expenditure.

3.2. Immediate, mid-term, and possible long-term effects of fiscal measures on the fiscal balance

To ensure fiscal sustainability in the context of increased budget spending on health and social security while budget revenues have declined due to the economic slowdown, Vietnam has adjusted budget expenditure tasks, cutting recurrent expenses on those tasks that are not urgent. Accordingly, 70 percent of conference costs and travel expenses and 10 percent of other recurrent expenses of ministries and central agencies have now been cut.

The results of the implementation of budget revenue and expenditure policies have ensured that the state budget remains in balance. The budget deficit in 2020 and in 2021 was 3.99 and 4.00 percent of GDP, respectively.

3.3. Debt management policies after the COVID-19 pandemic

The management, borrowing and repayment of public debt and government debt in 2020 and the 2016–2020 period have achieved many positive results, closely following the objectives and tasks of public debt management in accordance with resolutions of the National Assembly on socio-economic development and fiscal plans. Debt safety indicators are strictly controlled, within the limit of the public debt threshold allowed by the National Assembly, and gradually decreased over the years in the period 2016–2020. Public debt in 2020 was 55.2 percent of GDP and in 2021 is about 43.7 percent of GDP.

The Government has both mobilized new borrowings, and actively restructured the government bond debt portfolio, ensuring coherence between government bond issuances with the progress of principal debt repayments and disbursements of public investment capital.

Over the years, the repayment of government loans has been strictly implemented, including the Government's direct debt obligations and the on-lending debt obligations.

Standard & Poor’s Global Ratings has revised its outlook on Vietnam from ‘stable’ to ‘positive’, while maintaining the country’s ‘BB’ long-term and ‘B’ short-term sovereign credit ratings.[45] The credit rating agency believes that Vietnam will continue to remain well placed for a solid recovery over the next couple of years, and that the country’s public debt will continue to maintain its efficiency and flexibility.

A comprehensive view on fiscal sustainability can conclude that Vietnam’s debt structure has improved, with the public debt balance decreasing from a high level of 63.7 percent

45 https://www.businesstimes.com.sg/asean-business/sp-global-ratings-revises-vietnams-outlook-to-positive

of GDP in 2016 to about 55.2 percent of GDP at the end of 2020; the growth rate of public debt decreased from an average of 18 percent per year in the period 2011–2015 to about 6.8 percent a year in the period 2016–2020; and the share of domestic debt increased from 40 percent in 2011 to more than 65 percent of the total outstanding government debt at the end of 2019.

Table 19. Fiscal indicators, 2016–2021

	2016	2017	2018	2019	2020	2021
General Government Overall Balance (% of GDP)	-3.2	-2.0	-1.0	-3.3	-3.9	-4.7
General Government Primary Balance (% of GDP)	-1.6	-0.4	-0.5	-1.9	-2.6	-3.4
General Government Revenue (% of GDP)	19.1	19.6	19.5	19.6	18.5	15.6
General Government Expenditure (% of GDP)	22.2	21.5	20.6	23.0	22.4	20.4
General Government Gross Debt (% of GDP)	47.6	46.3	43.7	43.6	46.3	47.9

Source: IMF (Oct.2021), Fiscal Monitor: Strengthening the Credibility of Public Finances.

However, fiscal sustainability in Vietnam still faces multiple challenges. First, budget revenue is not sustainable, while the room to increase budget revenue is limited. In 2020, central budget revenue reached only about 90 percent of the target, with budget revenues in almost all subnational governments facing many difficulties, while balanced revenue from import and export activities also faced challenges due to tariff cuts in compliance with recently signed FTAs. Vietnam has also to face the issue of transfer pricing and tax evasion, causing huge losses of budget revenue, especially in the FDI sector and tax arrears. The longer the pandemic lasts, the greater the negative impact on economic growth, and the lower budget revenue will fall.

Table 20. Fiscal indicators forecasts, 2022–2026

	2022	2023	2024	2025	2026
General Government Overall Balance (% of GDP)	-4.7	-4.5	-4.2	-3.9	-3.6
General Government Primary Balance (% of GDP)	-3.6	-3.3	-3.0	-2.6	-2.3
General Government Revenue (% of GDP)	15.8	16.0	16.2	16.5	16.8
General Government Expenditure (% of GDP)	20.5	20.5	20.5	20.4	20.4
General Government Gross Debt (% of GDP)	47.8	47.8	47.0	46.1	45.3

Source: IMF (Oct.2021), Fiscal Monitor: Strengthening the Credibility of Public Finances.

Second, the pressure on budget expenditure remains a major concern. The budget still has to increase spending on health activities to ensure environmental sanitation and activities to support pandemic control efforts, as well as the challenge of managing state budget expenditure to improve spending efficiency. Meanwhile, social security policies are also creating pressure on the budget. Vietnam will need to continue to use fiscal and monetary measures to recover and develop its economy, creating a driving force for sustainable development, and will therefore be forced to increase the state budget deficit and public debt.

In addition, Vietnam also faces challenges in PFM to improve the efficiency of public resources, especially spending on social security and public investment. Regarding spending on social security, with the pandemic still ongoing, and complicated by with the appearance of new variants, the scope of budget spending will increase while resources are still limited, requiring the promulgation of support policies to take into account the fit between needs and budget capabilities.

Vietnam identifies public investment as one of the important drivers of economic growth, especially public investment to develop the infrastructure system. However, disbursing public investment, especially Overseas Development Assistance (ODA), is a major challenge. In 2020, disbursement of public investment capital (as of January 31, 2021) only reached 60.74 percent of the target. In addition to the pandemic and natural disasters, the main reasons are due to difficulties in project preparation, site clearance, and problematic legal regulations.

Third, the Government's direct debt repayment obligation compared with budget revenue has increased rapidly and is likely to exceed the threshold of 25 percent in the coming years due to the principal repayment schedule, with high concentration in some years. This issue, on the one hand, will affect budget resources for budget expenditure, while on the other hand carries potential risks for national fiscal sustainability and also has negative implications for the country's national credit rating.

National Assembly Resolution No. 23/2021/QH15 dated July 28, 2021, on the national fiscal plan and borrowing and public debt repayment plan for 2021–2025 have identified the goals of mobilizing, allocating, managing and using overall resources effectively for socio-economic development, macroeconomic stability and growth, and resolving social security issues in this period. Accordingly, they set an annual public debt ceiling of 60 percent of GDP; the warning threshold is 55 percent of GDP; the annual government debt ceiling is 50 percent of GDP; the warning threshold is 45 percent of GDP; the country's annual foreign debt ceiling is 50 percent of GDP; and the warning threshold is 45 percent of GDP. Thus, compared with the National Fiscal Plan for the 2016–2020 period, the annual public debt ceiling is reduced from 65 to 60 percent of GDP, while the government debt ceiling is reduced from 54 to 50 percent of GDP.

Table 21. Fiscal sustainability indicator targets, 2021–2025

	Targets for 2021–2025
Budget revenue as % GDP	≥ 16%/year
Tax revenue as % GDP	about 13-14%/year
Domestic revenue as % total budget revenue	about 85-86% (2025)
Capital expenditure as % total budget expenditure	about 28-29%/year
Recurrent expenditure as % total budget expenditure	about 60-63%/year
Budget deficit as % GDP	about 3.7%/ year
Public debt	≤ 60% (annually)

Source: Ministry of Finance of Vietnam.

Along with the implementation of policy measures to control the pandemic, the Government is also currently implementing a program of economic recovery and sustainable development. The National Assembly approved Resolution No. 43/2022/QH15 dated January 11, 2022, valid from January 11, 2022, to December 31, 2023, on fiscal and monetary policy to support this program. The objective of the program that will be implemented in 2022–2023 is to restore and promote economic activities, and growth drivers for achieving an average growth target of 6.5–7.0 percent a year in the 2021–2025 period, maintaining macroeconomic stability. Resolution No. 43/2022/QH15 includes the following:

(1) Tax measures

Continue to implement tax exemptions, tax reductions and tax deferrals, including tax exemptions, tax reductions of VAT and CIT. For VAT: a reduction of 2 percent in the VAT rate in 2022, applicable to groups of goods and services currently applying the VAT rate of 10 percent (remaining 8 percent), except for some following groups of goods and services: telecommunications, information technology, financial activities, banking, securities, insurance, real estate trading, metals, prefabricated metal products, mining products (not including coal mining), coke, refined petroleum, chemical products, goods and services subject to excise tax. For CIT: enterprises are allowed to account their expenses to support COVID-19 prevention and control activities in Vietnam as deductible expenses when they determine taxable income for the 2022 tax year.

(2) Public expenditure

Increase capital investment in 2022 and 2023 on: (i) health care (investment in new construction, renovation, upgrading and modernization of the health-care facilities), preventive health care, regional centers of disease control (CDC), human resources development, domestic production of vaccines and drugs to treat COVID-19; (ii) social welfare, employment (interest rate support for borrowers under preferential lending policies); (iii) support enterprises, cooperatives, business households in important industries and sectors, enterprises, cooperatives and business households that are able to recover their business; loans to renovate old apartments, build social houses, houses for workers to buy, rent and hire-purchase; and (iv) develop infrastructure for road traffic, IT, digital transformation, and in response to climate change and disaster consequences.

(3) Other fiscal policies

Housing rent support for employees; increase the government guarantee limit for domestically issued bonds for the Bank for Social Policies to provide loans to support job creation.

According to Resolution No. 43/2022/QH15, monetary policy should be managed flexibly to contribute toward maintaining macroeconomic stability, controlling inflation, ensuring the safety of the credit institution system, and supporting the recovery and development of the economy. Credit institutions continue to reduce operating costs to cut lending interest rates by 0.5 to - 1 percentage point in 2022 and 2023, especially for priority sectors.

To free up resources to implement fiscal policies, the Resolution permits the budget deficit to be increased in fiscal years 2022 and 2023 by an average of 1 to 1.2 percent of GDP a year.

Overall, the Government will enhance the implementation of institutional reforms, improve the business and investment environment, cut costs for businesses, and create new engines of economic growth; restructure the economy in coordination with renovating the growth model, improving productivity, quality, efficiency and competitiveness; increase the mobilization, allocation and effective use of resources; build a modern infrastructure system; promote sustainable imports and exports; and improve the quality of human resources to create a more dynamic economy.

4. Conclusion and Next Steps in the Post-COVID-19 Period

4.1. The Government's roadmap regarding fiscal sustainability after the COVID-19 pandemic

From early 2021 until now, the pandemic is continuing to impact many countries including Vietnam, and it is not possible to predict when it will end. Meanwhile, the huge economic stimulus and support packages in many countries are mitigating the damage caused by the pandemic to the world economy, but these policies will inevitably increase the public debt burden in many countries and potentially cause debt crises in the future. Global inflation may increase sharply due to the impact of expansionary fiscal and monetary policies that many countries have implemented in the 2020 and 2021 to control the pandemic and economic recovery support with huge increases in the money supply. However, once the economic outlook improves, consumption demand is likely to increase sharply, while supply may not be able to meet the renewed demand after such a prolonged period of interruption, which is likely to lead to a sharp increase in commodity prices.

With the Government's efforts to implement strong measures to control the pandemic, and provide fiscal policies to support an economic recovery, the macroeconomic indicators of Vietnam are forecast to be positive over the medium term.

Table 22. Economic indicators forecast, 2021–2026

	2021	2022	2023	2024	2025	2026
GDP growth rate (%)	2.58	6.6	6.8	7.0	7.1	6.9
GDP per capita (US$)	3,743	4,187	4,605	5,081	5,601	6,148
Inflation rate (%)	2.0	2.3	3.2	4.0	4.0	4.0
Current account balance (% of GDP)	1.8	3.2	2.6	2.0	1.2	0.6

Source: IMF database.

4.2. Evaluation and policy recommendations

Although Vietnam's economic growth and fiscal sustainability prospects are forecast to be positive over the medium term, the risk of a prolonged pandemic may discourage investors, erode the financial capacity of people and businesses, and shift investment flows to other safer countries. If Vietnam fails to control the pandemic well, economic growth may become out of step with global economic growth. On the other hand, the risks of public debt and rising inflation in the world could threaten Vietnam's macro stability.

Therefore, we recommend the following measures:

First, given that this economic crisis stems from a health crisis, not an economic-financial crisis, the synchronous implementation and the effectiveness of the overall strategy on COVID-19 prevention and control remains a decisive and key factor. Therefore, the Government should continue to implement strong measures for pandemic prevention and control, ensuring that adequate financial resources are available.

Second, the Government should prioritize maintaining macroeconomic stability, controlling inflation, stabilizing the money market, ensuring the safety of the banking system, and ensuring the major indicators of the economy. Fiscal policy should be closely coordinated with monetary policy to control inflation, and stabilize and reduce interest rates and capital costs. Restructuring of the economy should be accelerated in a practical and effective manner, by developing e-commerce, the digital economy, and new business models based on IT and digital technology applications.

Third, the economic recovery and sustainable development program must ensure the goal of fiscal sustainability in the medium and longer term. This means that Vietnam should accept an increase in the budget deficit and public debt in 2022 and 2023, but it must reduce budget deficit and public debt in 2024 and 2025 to ensure that the levels of budget deficit and public debt are controlled within the threshold approved by the National Assembly.

Fourth, Vietnam should continue to promote institutional and legal framework reforms, the simplification of administrative procedures to improve the investment and business environment and to facilitate economic activities, and continue to attract large FDI investors to Vietnam. The development of businesses is a cornerstone of budget revenues and fiscal sustainability.

Fifth, to ensure fiscal sustainability in the medium and longer term, Vietnam needs to ensure sustainability in exploiting natural resources and land on the basis of market mechanisms. Because natural resources and land are limited, their exploitation and use should be taken into account in the long-term and inter-generational vision. Meanwhile, the Government should have policies to mobilize other resources from the private and FDI sectors for infrastructure development and green economic development projects to ease the burden on the budget.

At the same time, Vietnam should restructure the budget, including revenues and expenditures. For revenue restructuring, Vietnam needs to ensure a reasonable balance between indirect and direct taxes, ensuring harmony between the structure of revenues from income taxes, consumption taxes and taxes on property. As such it will be necessary to: (i) review and broaden the tax base and adjust the rates of excise tax to guide consumption in accordance with the purpose of environmental and people's health protection; (ii) broaden the tax base and to adjust tax rates of environmental protection tax to ensure that it is as an effective tool in limiting the production and use of goods that cause environmental pollution; (iii) review and eliminate tax incentives that are no longer well suited to the domestic situation and international integration to ensure tax neutrality; and (iv) implement measures to prevent and combat transfer pricing and tax base erosion in accordance with international best practice. For expenditure restructuring, Vietnam will need to: (i) reduce recurrent expenditures, restructure public investment spending, and improve the efficiency and effectiveness of allocation and disbursement of public investment; (ii) improve the leading role of budget resources to promote other resources for development; and (iii) focus on spending on human resource development to ensure social welfare and inclusive development, such that no one is left behind.

Sixth, it will also be necessary to (i) perfect the state treasury management mechanism in line with management practices in developed countries; (ii) improve the management mechanism and control of budget expenditure commitments in line with international best practice; and (iii) strengthen decentralization and improve the fiscal transparency and accountability of spending units.

Seventh, the Government should consider: (i) reforming the institutions and policies on public debt management; (ii) promoting the implementation of modern debt management tools, ensuring the safety and sustainability of the national finance system; and (iii) ensuring the linkage between budget and public debt management with treasury management to improve the management efficiency of the public financial resources. This includes strictly managing the budget deficit and improving the efficiency of loans in line with the principle that loan capital is only used for development investment spending.

Eighth, the Government should consider: (i) strengthening the effectiveness of public financial supervision, inspection and control institutions; (ii) fighting corruption and waste; (iii) promoting public financial transparency and accountability; and (iv) strengthening the audit, inspection and examination institutions of in PFM.

Ninth, the Government should strengthen the supervisory role of the elected bodies (the National Assembly and the People's Council at all levels) in PFM. At the same time, the Government should apply the relevant sanctions for violations of PFM and corruption or the misuse of the budget in accordance with the law.

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Concluding Remarks

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This paper analyzes fiscal management both before and during the COVID-19 pandemic in three countries, with their prospects going forward together with policy suggestions. All three case-study countries had sound economic conditions and relatively low public debt-to-GDP ratios prior to the pandemic. They have also succeeded in handling the shocks from the COVID-19 crisis with only relatively minor contractions of real GDP. Though the initial shock was unprecedent, and many countries suffered major contractions in real GDP in 2020, the three case-study countries all recorded positive economic growth rates in 2021. Obviously, their fiscal policies played an important role in protecting lives and keeping their economies from safe from even deeper recessions. But significant increases in public debt have followed, with public debt-to-GDP ratio rising by about 10 percentage points from 2019 to 2021 in Indonesia and the Rep. of Korea, while Vietnam has experienced a relatively moderate increase in its public debt-to-GDP ratio of only about 5 percentage points, although in terms of absolute size this is higher than the increase in the ratio in Indonesia and about the same as that of the Rep. of Korea.

Indonesia has an explicit fiscal rule which states that the budget deficit should be kept under 3 percent of GDP and public debt should remain under 60 percent of GDP. Vietnam has a somewhat looser fiscal rule that changes with each five-year national fiscal plan, and during the period of 2016–2020, the Government stipulated that the budget deficit should not exceed 3.9 percent of GDP and public debt should not exceed 65 percent of GDP. The Rep. of Korea does not have any explicit fiscal rule at present, but the Ministry of Economy and Finance has proposed a fiscal rule that is similar to that of Indonesia during the pandemic period. In all three countries, it appears challenging to follow the fiscal rules at least in terms of the budget deficit-to-GDP ratio, which is 3 to 4 percent. Even if the three countries do follow their own fiscal rules, they cannot guarantee long-term fiscal stability without securing stable sources of tax revenue.

The COVID-19 pandemic remains a huge challenge for financial management. In view of the current situation, more fiscal effort will be needed to save lives and support people and sectors of the economy that are vulnerable to shocks. An increase in fiscal deficits and debt seems to be inevitable for the time being. Of course, these three countries have relatively low national debt compared with many other countries. However, it should be noted that the size of the government and national debt tends to increase with the development of the economy. The pandemic could further reinforce this trend. The current low level of national debt could be only a temporary situation. The high speed of increasing public debt during the pandemic period clearly shows that maintaining low public debt is challenging in the world full of uncertainties and risks.

Despite this concern, or paradoxically because of it, the pandemic could be an opportunity to improve fiscal management in these countries. The current crisis could provide momentum for these countries to make greater effort to improve their tax administration and expand their tax base. Indonesia and Vietnam have been trying to expand their tax bases by reducing the underground economy and absorbing it into the official sector, despite the difficulties of achieving this goal. The chapters on Vietnam and Indonesia clearly show that the current crisis adds a sense of urgency to this effort. Expanding the tax base takes a high priority in the fiscal management in these countries. In the Rep. of Korea, which has a relatively advanced tax administration system, there is debate regarding future fiscal stability. The new Government took office in May 2022 and has a fiscal policy stance in which some tax cuts are necessary to vitalize the economy, while introducing a fiscal rule. But many experts argue that introducing explicit fiscal rules is not an urgent issue when the economy still needs expansionary fiscal policy. Others emphasize the necessity of tax increases and propose various ways of increasing tax revenue to meet the demand for social welfare caused largely by the aging of the population and an unstable labor market.

On the spending side, these countries face serious challenges of aging populations and the need for economic restructuring. The Rep. of Korea is already an aging society with the share of the population aged 65 and older at 16.5 percent in 2021. Although the size of aging population is smaller in Indonesia and Vietnam, the speed of aging is rapid, and their shares of the elderly will reach the current Korean level in only about 20 years. Sound fiscal management is required to build a welfare system for these aging populations within such a short time span. Appropriate public investment is also required in social infrastructure, and the education and health sectors. To secure fiscal sustainability, both Indonesia and Vietnam should return to and maintain solid economic growth experienced prior to the pandemic, while preparing to adjust to the changing global economic environment in the post-COVID-19 period. They will need to adapt their economic structures to respond with flexibility to rapid technological change, the so-called 4th industrial revolution. The structure and content of fiscal expenditure will need to change accordingly.

All these challenges place considerable burdens on fiscal management. We expect that the COVID-19 pandemic will provide the impetus for reform in both fiscal revenues and expenditures in PEMNA member countries, and that these case studies can offer a source of policy recommendations for other countries.

Research Team Bio

Research Lead

Jin-Yeong Kim is a professor of economics at Konkuk University in Seoul. He received the his PhD in economics from the University of Rochester in 1999. Before joining Konkuk University's faculty in 2002, he worked at the Korea Institute of Public Finance. He has advised and worked closely with many government organizations such as the Ministry of Economy and Finance, Ministry of Education, and Ministry of Employment and Labor.

Research Team Members

Vid Adrison got his PhD in Economics from Georgia State University, USA in 2007. He is currently the Head of the Economics Department, Faculty of Economics and Business at the Universitas Indonesia. He has published scholarly articles on fiscal decentralization, public finance, cigarette taxation, industrial economics, and labor economics.

Deockhyun Ryu is currently a professor of economics at Chung-Ang University. He graduated from Seoul National University's economics department in 1992 and received his PhD in economics from Rice University in Houston in 2004. His research fields include international finance, economic growth, macro public finance, and financial time series analysis. Before joining Chung-Ang University in 2007, he worked from 2004 to 2007 at the Korea Institute of Public Finance, a government think tank specializing in tax and fiscal policy.

Le Quang Thuan got his MSc degree on Public Management and Economics from the Universite Libre de Bruxelles in Belgium in 2003 and his PhD degree on Public Law – Public Finance from the Universite Paris 1 Pantheon-Sorbonne in France in 2008. He is senior researcher and currently working as a division chief at the National Institute for Finance of the Ministry of Finance of Vietnam.

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