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Indonesia's fiscal capacity and burden-sharing scheme: A new insight from handling COVID-19

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INDONESIA'S FISCAL CAPACITY AND BURDEN-SHARING SCHEME: A NEW INSIGHT FROM HANDLING COVID-19

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Abstract

The spread of COVID-19 has brought many economies into recession, and Indonesia is no exception. In response to the adverse impacts of the COVID-19 pandemic, a higher fiscal stimulus is needed to achieve economic recovery. However, as one of the world's most populous countries, Indonesia has struggled with limited financial resources, leading to a significant budget deficit. Although the government has addressed this issue through a burden-sharing scheme with the Central Bank, the public is still wary about Indonesia's macroeconomic stability and fiscal sustainability. This study will challenge the household budget analogy by arguing that fiscal deficit is not evidence of overspending. Also, it is argued that the burden-sharing scheme would not cause any negative macroeconomic consequences. Instead, a higher accumulation of external debt-denominated foreign currency is regarded as the primary source of potential macroeconomic instability. We explain that running a fiscal deficit will boost the economy, restore household consumption, and increase private revenue. In this context, the role of the central bank is crucial under the fiscal deficit regime because it absorbs all government bonds in the market as a part of the monetary operation. Hence, if the role of the central bank is not isolated in macroeconomic analysis, the government budget is different from the household or firm budget analogy. In other words, a fiscal deficit is a typical phenomenon not only during wartime or recession but also during peacetime or expansion. Thus, the option to issue new government securities and sell them directly to the central bank provides more economic security than external debt finance.

Keywords: fiscal deficit, burden-sharing scheme, household budget analogy, debt-monetization, fiscal sustainability, stock-flow consistent model

JEL Classification: E5, E62, E12

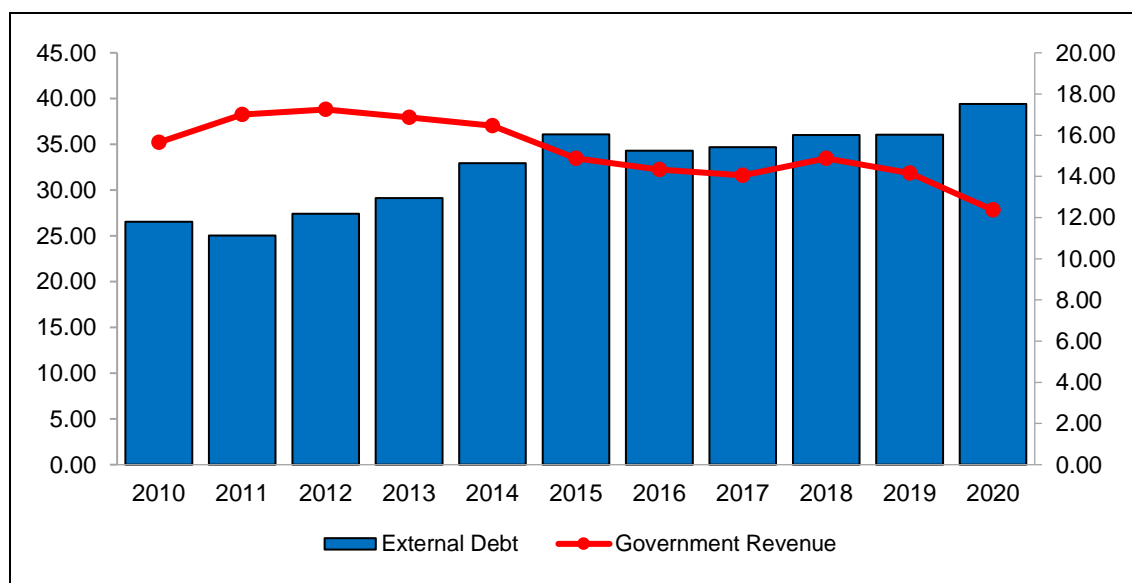
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1. INTRODUCTION

The spread of COVID-19 has brought many economies into recession, and Indonesia is no exception. During the COVID-19 crisis, countries' experience worldwide shows that restoring national economic performance requires appropriate public health measures and effective government spending. However, to do so, it demands a higher fiscal stimulus. In this context, as one of the most populous countries, Indonesia needs more resources to finance its public health policy and mitigate the negative impact of COVID-19 on the economy. In Indonesia, the government responded to the COVID-19 crisis by running the national economic recovery program (Program Pemulihan Ekonomi Nasional/PEN) since 2020. Under this program, the government allocated IDR695.2 trillion in 2020 and IDR744.75 trillion in 2021. Unfortunately, this raised a fiscal deficit from 2.2% to 6.34% of GDP in 2020 and 5.7% in 2021.

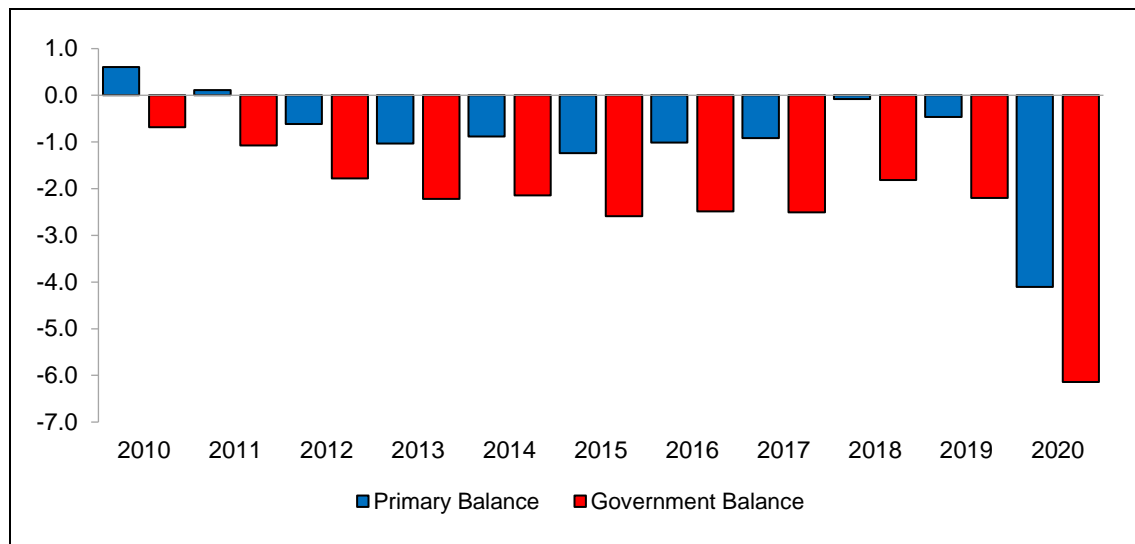
Figure 1: External Debt and Government Revenue 2010–2020
(% of GDP)



Source: Bank Indonesia (July 2021) and IMF World Economic Outlook (April 2021).

A larger fiscal deficit, however, led to increased government debt from 29.7% in 2019 to almost 40% of GDP in 2020. Also, the external debt ratio rose from 36.1% of GDP in 2019 to 39.4% in 2020. Although the external debt ratio is still below 50% of GDP, there is a belief that such debt may increase macroeconomic risk pressure because the external debt is mainly denominated by foreign currency. According to Bank Indonesia (BI), the share of external debt denominated foreign currency in 2020 is about 81% of total external debt. In addition, the debt service ratio has also been higher than 20% of GDP since 2015 or has exceeded the acceptable threshold for the debt service ratio. At the same time, Indonesia has experienced primary deficits since 2012, as shown in Figure 2. It can also be seen that the primary deficit jumps to about minus –4% of GDP. Taken together, these situations make the public worry about Indonesia's macroeconomic stability and fiscal sustainability.

Figure 2: Primary and Government Balance 2010–2020
(% of GDP)



Source: Ministry of Finance (2021) and BPS (2021).

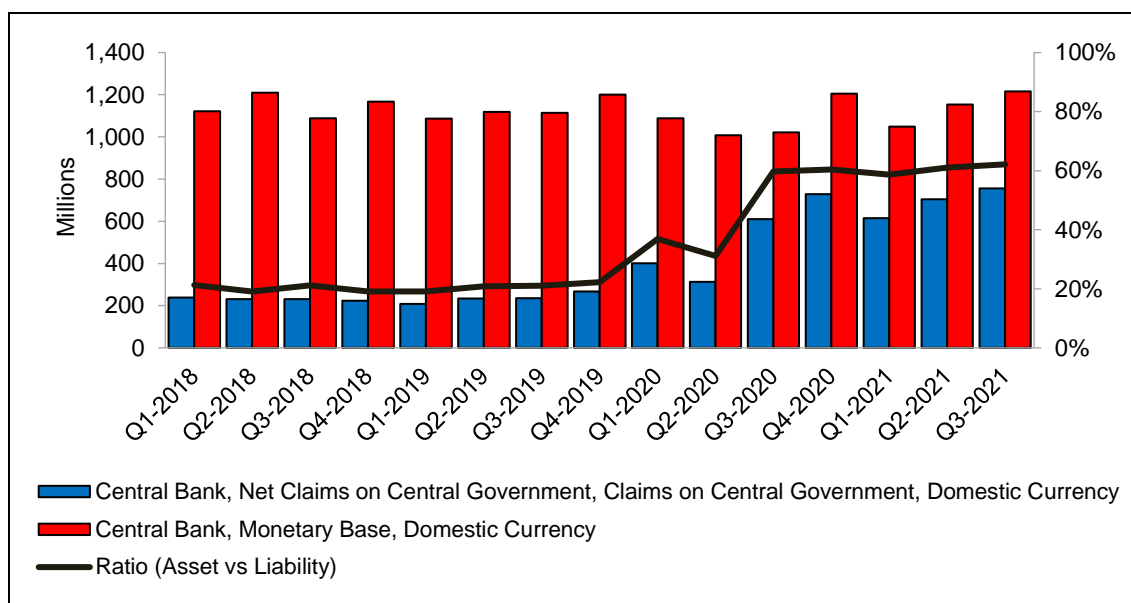
Conceptually, it is usually assumed that running a larger fiscal deficit could bring negative macroeconomic consequences. However, traditional worries-related fiscal deficits paid for by monetary operations, such as interest rate burden, inflationary pressure, and crowding-out effect, are challenged by some economists. Gordon (2014), for instance, argues that in the US, increasing public debt financed by central bank purchases of government bonds has no added burden on future taxpayers to pay interest on the debt and no acceleration of inflation. Likewise, Jones (2018) points out that a larger budget deficit has not been associated with a lower investment rate in the US economy. Moreover, Wray (2012, 2015) and Mitchell, Wray, and Watts (2019) argue that besides fiscal deficit matters in driving economic growth, it could also mean increasing the net financial wealth held by households, firms, and central banks. Finally, Kelton (2020) even asserts that fiscal deficit is normal and may not indicate overspending. Instead, inflation is the real evidence of overspending rather than the budget deficit.

The public and policymakers in Indonesia, unfortunately, still worry about the negative consequences of rising government debt-denominated domestic currency, particularly Indonesia's fiscal capacity and sustainability. For this reason, this study discusses whether the burden-sharing scheme by increasing government debt brings about macroeconomic risks. We argue that running a budget deficit through the monetary operation under a burden-sharing scheme is not borrowing in the traditional sense because government debt is bought by the central bank. This implies that there is no requirement for current and future taxpayers to pay interest payments in the future. We explain our argument using the household budget analogy in which fiscal deficit is not evidence of overspending, allaying potential concerns about negative macroeconomic consequences. Instead, a higher accumulation of external debt-denominated foreign currency is the primary source of macroeconomic instability.

2. UNDERSTANDING THE BURDEN-SHARING SCHEME

As briefly described in the previous section, the government of Indonesia has run a burden-sharing scheme to finance economic recovery during the COVID-19 pandemic. Under this scheme, the Ministry of Finance issues government securities (Surat Berharga Negara/SBN) to BI with a reverse repo rate reference rate. The government then pays interest/yield to BI according to the SBN maturity. On the same day, BI will return the interest/yield to the government through the finance ministry as BI's contribution according to the burden-sharing scheme. Put simply, this scheme printed money and then distributed it to the Ministry of Finance to support its fiscal spending. The central bank's involvement in the burden-sharing scheme can be seen in its balance sheet. As shown in Figure 3, the ratio between assets and liability of the central bank is relatively low, but it has significantly increased since 2020 because of the burden-sharing scheme.

Figure 3: Net Claims on Central Government (Assets) and Monetary Base (Liability) of the Central Bank of Indonesia (IDR)



Source: International Financial Statistics, IMF (2022).

There are three burden-sharing mechanisms conducted by the government and Bank Indonesia to respond to the COVID-19 crisis (Ministry of Finance 2020). First, the burden will be entirely borne by BI through the purchase of SBN under the private placement scheme. This SBN proceeds to finance public goods, such as health, social safety net, and sectoral spending. The government offers a coupon rate equal to the BI reverse repo rate, but BI will fully return the interest to the government. Second, the government will bear the burden of selling SBN to the market through a market mechanism. Under this mechanism, BI will be the standby buyer or act as the last resort. In addition, BI contributes to the market rate difference by using the three-month BI reverse repo rate minus 1.0%. Unlike the first mechanism, the SBN proceeds in the second mechanism are used to finance nonpublic goods, such as provisions to micro-, small, and medium enterprises (MSMEs) and non-MSME cooperatives. Third, the instrument is similar to the second mechanism, but the government will bear the total

burden at the market rate. The proceeds from this mechanism are used to finance other nonpublic goods.

In the monetary economics literature, a burden-sharing scheme is a simple form of debt monetization, also known as “seignorage.” In such a scheme, the seignorage recipient—the government—receives new money created by the central bank (Cukierman 2021). In practice, the central bank’s fiscal response is to buy government bonds directly. In this regard, the government is offered money by the central bank, and its account will be credited an equivalent amount in the central bank balance sheet. This transaction increases government debt on the one hand and expands the central bank balance sheet on the other. However, this transaction is temporary because the central bank will write off the government debt and shrink its balance sheet after monetizing the additional debt (Bajaj and Datt 2020).

Debt monetization is mainly used by a country suffering from fiscal deficits. In this case, monetary policy may not work under such a constraint. There are three variants of deficit (or debt) monetization (Bajaj and Datt 2020): *direct monetization*; *indirect monetization*; and *direct monetization with debt write-off*. In the first variant, the central bank buys government securities directly from the government in the primary market. In indirect monetization, government securities are purchased by the central bank in the secondary market through open market operations. The last variant is direct monetization, but the central bank will write off government securities from the asset side of its balance sheet. From this clear explanation, technically, debt monetization is similar to quantitative easing (QE). However, the main difference between them is that the central bank is allowed to buy only seasoned bonds under QE, whereas under debt monetization, the central bank is allowed to buy new government securities as a direct source of financing (Cukierman 2021).

The use of debt monetization to address fiscal deficits, however, raises a debate, while at the same time being considered taboo because such a scheme may undermine the central bank’s independence (Sargent 1999; Bodea and Higashijima 2017; Cukierman 2021). The opponents of debt monetization argue that if the central bank finances government deficit, it will cause fiscal dominance of monetary policy, making the central bank’s independence compromisable, opening the door to uncontrollable future government spending and increasing inflation (Dhal 2015; Bajaj and Datt 2020). In other words, fiscal discipline is a crucial issue in the context of financing state expenditure. On the other hand, it is undeniable that fiscal policy is one of the main factors affecting the macroeconomic environment in which a central bank operates (Allard et al. 2013). In this regard, the central bank’s involvement in the government bond market is allowed as long as it does not significantly impact the balance sheet or conflict with central bank independence. Moreover, both the government and central bank interact and share fiscal and monetary policy responsibilities, requiring mutual understanding and cooperation (Allard et al. 2013). Thus, it is contended that debt monetization under the pandemic will not, in fact, cause inflation and problems related to public expenditure if well regulated (Bresser-Pereira 2020).

3. CATEGORIZING FISCAL DEFICITS UNDER THE BURDEN-SHARING SCHEME

The burden-sharing scheme is the conduct of debt monetization, which is one of the alternative fiscal-monetary stimulus plans. The central bank buys the additional government debt through its treasury to increase its money supply by directly financing fiscal expansion in the stimulus package. This action increases the official treasury

debt. Although debt monetization has been considered taboo, it offers a pragmatic way out (Bajaj and Datt 2020) to respond to the unfavorable economic situation under the budget deficit. However, it has been assumed that the government's burden-sharing scheme will raise the debt ratio. In this regard, an increased debt ratio will generate negative economic implications and risks in the future, as argued by those who oppose the enactment of a significant fiscal stimulus in a severe crisis (Seidman 2018).

Although debt monetization receives criticism, such a scheme is expected to impact the economy positively as it can broaden the fiscal space in the medium and long term. Theoretically, debt monetization could trigger a high rise in inflation and even severe stagflation (Rezki et al. 2020). Nevertheless, it might not be fully applicable under certain conditions, such as weak private consumption, because, in theory, debt monetization, in real terms, is similar to QE, meaning that the burden-sharing scheme is a typical monetary policy. Since the central bank will also bear the burden, and under the general concept of macroeconomics related to the national income identity, the transactions between the central bank and the government are "internal," as depicted in the stock-flow consistent (SFC) model (see Table 1). In this regard, monetization does not affect the consolidated balance sheet of the government and the central bank (Bajaj and Datt 2020).

In Table 1, columns 6–8 deal with the transactions between the government sector and its central bank. The central bank column is merged initially with the government in the basic concept, but then it is split from the government to obtain a more realistic picture of the money creation process. Column 7 is the current account of the central bank. As seen, the central banks hold government bills in the form of banknotes, that is, cash, carrying no interest payment. As a result, the central bank makes a profit, F_{cb} , which is assumed is entirely returned to the government ($+F_{cb}$), as shown in Column 6 as a new entry. In this regard, the central bank, in fact, returns all of its profits to the government, implying that the government's gross interest disbursements on its debt are equal to $r_{b(-1)} \cdot B_{(-1)}$, and its net disbursements are only $r_{b(-1)} \cdot [B_{(-1)} - B_{cb(-1)}]$. A debt write-off implies writing down government securities on the asset side and a deduction in released equity on the liability side of the central bank balance sheet (Bajaj and Datt 2020). From this, the government can lower its public debt and limit future interest payments on outstanding debt. In other words, the government's fiscal deficit and public debt level go to a lower level, resulting in the need for additional consolidation through higher taxation or expenditure reduction (Bajaj and Datt 2020).

Column 6 is the budget constraint of the government. It shows that if the government cannot finance its expenditure from taxes (or the central bank dividend), it must issue bills. In the case of the burden-sharing scheme, the government opts to finance the fiscal deficit by issuing new government debts, mainly to the central bank via the private placement and market mechanism if BI acts as the last resort, followed by households and banks through a market mechanism. Finally, Column 8 illustrates the relationship between the addition of a bond portfolio owned by the central bank and the amount of high-powered money, $+\Delta H$. This relationship explains inflation as proposed by Milton Friedman, in which, in recent years, government deficits have been associated with high-powered money increases. Thus, monetizing government debt in the form of a burden-sharing scheme causes concern about inflation, but such a scheme is a domestic transaction that is possibly less risky.

Furthermore, the central bank promises to return the interest to the government under the burden-sharing scheme. In this case, the interest paid to the government shows up as additional income for the central bank, and insofar as the surpluses gained by the central bank are fully transferable back to the government, other things being equal, this is equivalent to the government financing its deficit at zero cost (Bajaj and Datt

2020). However, the burden-sharing scheme refers to the BI reverse repo rate, so the scheme does not give the government a free lunch if the stimulus channeled by banks fails to be augmented in the lending market. Regardless, the fiscal stimulus provides lending opportunities for the banking sector. Also, the reverse repo rate is a monetary policy parameter determined by BI, so when the rate drops in the future, it will flatten the yield curve and lower bank prime lending rates, resulting in economic recovery. Thus, households and firms may start to borrow, and the economy can recover.

Table 1: Transactions Flow Matrix

	Households (1)	Production Firms		Banks		Government (6)	Central Bank		Σ
		Current (2)	Capital (3)	Current (4)	Capital (5)		Current (7)	Capital (8)	
Consumption	$-C$	$+C$							0
Investment	$-I_h$	$+I$	$-I_f$						0
Govt. exp.		$+G$				$-G$			0
Wages	$+WB$	$-WB$							0
Profits, firms	$+FD_f$	$-F_f$	$+FU_f$						0
Profits, banks	$+FD_b$			$-F_b$	$+FU_b$				0
Profit, central Bk							$+F_{cb}$	$-F_{cb}$	0
Loan interests	$-r_{l(-1)} \cdot L_{h(-1)}$	$-r_{l(-1)} \cdot L_{f(-1)}$		$+r_{l(-1)} \cdot L_{(-1)}$					0
Deposit interests	$+r_{m(-1)} \cdot M_{h(-1)}$			$-r_{m(-1)} \cdot M_{(-1)}$					0
Bill interests	$+r_{b(-1)} \cdot B_{h(-1)}$			$+r_{b(-1)} \cdot B_{b(-1)}$		$-r_{b(-1)} \cdot B_{(-1)}$	$+r_{b(-1)} \cdot B_{cb(-1)}$		0
Taxes – transfers	$-T_h$	$-T_f$		$-T_b$		$+T$			0
Change in loans	$+\Delta L_h$		$+\Delta L_f$		$-\Delta L$				0
Change in cash	$-\Delta H_h$				$-\Delta H_b$			$+\Delta H$	0
Change, deposits	$-\Delta M_h$				$+\Delta M$				0
Change in bills	$-\Delta B_h$				$-\Delta B_b$	$+\Delta B$		$-\Delta B_{cb}$	0
Change, equities	$-(\Delta \theta_f \cdot p_{ef} + \Delta \theta_b \cdot p_{eb})$		$+\Delta \theta_f \cdot p_{ef}$		$+\Delta \theta_b \cdot p_{eb}$				0
Σ	0	0	0	0	0	0	0	0	0

Source: Wynne and Lavoie (2007).

Since the supply and demand disruptions caused by the COVID-19 crisis remain challenging for the government, fiscal packages to maintain the economy and health system are critical. Compared to other fiscal-monetary policies, the government's debt monetization (the burden-sharing scheme) can induce additional government expenditures (Cukierman 2021). Moreover, in the long term, such a scheme is beneficial in terms of the government's borrowing as it can lower the yield curve and extend the range of maturities, resulting in a flat yield curve, easing the access of corporations and households to credit (Cukierman 2021). On the other hand, if the government finances its budget deficit by raising tax revenue, things would be more difficult under the COVID-19 crisis and possibly jeopardize the economy.

As seen in the literature, the government may not need to finance the fiscal response through higher taxes in the future by monetizing debt (Bajaj and Datt 2020). This is essential for the government considering the COVID-19 crisis, which differs from previous crises. The COVID-19 pandemic has affected the economy, so if the government raises taxes to increase revenue and then uses it to finance economic recovery, households and firms will bear the burden considerably. Moreover, in the looming recession due to COVID-19 policies, such as avoiding face-to-face contact, households tend to hang on to their money rather than consuming goods, and firms are unable to provide sufficient demand and generate income to support the economy. Therefore, the option to issue new government securities and sell them directly to the central bank as part of fiscal policy, especially during the COVID-19 pandemic, provides economic security (Kelton 2020; Watkins 2021).

4. FISCAL DEFICIT FROM THE PERSPECTIVE OF HOUSEHOLD BUDGET ANALOGY AND ITS RELATION TO MACROECONOMIC STABILITY

Understanding the household budget analogy is essential to determining whether a budget deficit is bad or good for the economy. For this reason, this section explains the different budget constraints faced by households, firms, and the government. At a glance, fiscal capacity does not always refer to tax revenue because the central bank could also support the fiscal policy by buying government bonds. There are at least two main reasons to support this argument. First, the government can always finance its spending regardless of the tax ratio. For example, suppose the government decides to run a fiscal deficit in 2020 by borrowing money from domestic resources. In this case, the inadequate revenues in 2020 can be covered by increasing tax revenue in 2021, 2022, etc. Second, the government budget deficit can always be paid by issuing government bonds or treasury bills, despite having a lower tax ratio. Central bank power as a currency issuer guarantees that the government budget is not revenue or financially constrained (Mosler 2010; Wray 2015; Mitchell, Wray, and Watts 2019; Kelton 2020).

On the other hand, households' and firms' spending is limited by income. So then, if they want to spend more and, to some extent, over and above their income or run a budget deficit, they should make some loans to the bank or other financial institutions. Hence, the household and firm budget is financially constrained, meaning it is almost impossible for households and firms to run a budget deficit. If they force themselves to run budget deficits, they will face severe problems such as default or insolvency. Meanwhile, if the government decides to run a budget deficit, it does not mean that it is overspending because the government budget is not limited by tax revenue. However, running a budget deficit by issuing government bonds can also mean increasing the private sector and the central bank's financial assets. In this context, if the government bonds' yield is attractive, private sectors will buy government bonds or treasury bills, increasing households, firms, and the central bank's financial assets.

Furthermore, running a budget deficit for households and firms will reduce their propensity to consume and invest, negatively affecting macroeconomic performance. The government budget analogy, however, is different from the household budget or firm budget analogy. Such a difference brings about distinct macroeconomic consequences. If households and firms individually run a budget deficit, they may be at risk. The probability of default is larger because they do not have the same fiscal and monetary power as the government. Meanwhile, running a fiscal deficit from the government's point of view will inject the economy, restore household consumption, and increase tax revenue. In this context, the role of the central bank is crucial under the fiscal deficit regime because it absorbs all government bonds in the market as a part of the monetary operation. Hence, if the role of the central bank is not isolated in macroeconomic analysis, the government budget is nonidentical from the household or firm budget analogy.

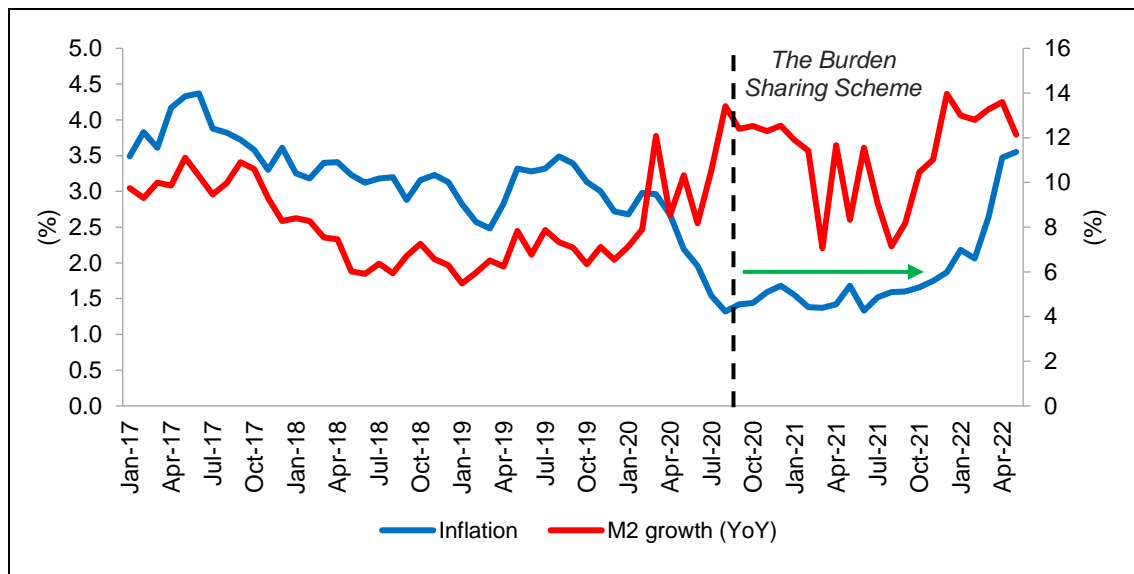
5. THE BURDEN-SHARING SCHEME, DEBT SUSTAINABILITY AND MACROECONOMIC FACTORS

Before the economic crisis, Indonesia had a good record in terms of fiscal prudence in which the government successfully avoided financing its deficits through money creation or debt issuance (Nasution 2003). However, the severe financial crisis that hit the Indonesian economy in 1997 left a significant amount of debt, which put fiscal sustainability at risk, requiring a set of strategies for the budget, such as reducing the deficit and total debt to GDP (Nasution 2003). In this case, the government intended to optimize domestic tax and nontax revenues, implement budget austerity, and reduce reliance on external financing (Nasution 2003).

Unlike the 1997/98 crisis, the COVID-19 crisis requires the government to respond differently, with regard to the fiscal position. In response, the government is providing a stimulus package constrained by the budget deficit through the burden-sharing scheme with the central bank. The government, however, has to ensure that its fiscal policy can encourage economic recovery without significantly impacting monetary objectives. In other words, the government needs to consider the three issues affecting base money in its fiscal policy addressing the COVID-19 crisis. First, the option to maximize the revenues from the tax would not be appropriate under declining economic activities due to the social distancing policy. Second, reducing the government's expenditure to achieve budget efficiency is critical to reallocating the budget to prioritized sectors. Last, how the government finances its deficit should not undermine fiscal sustainability.

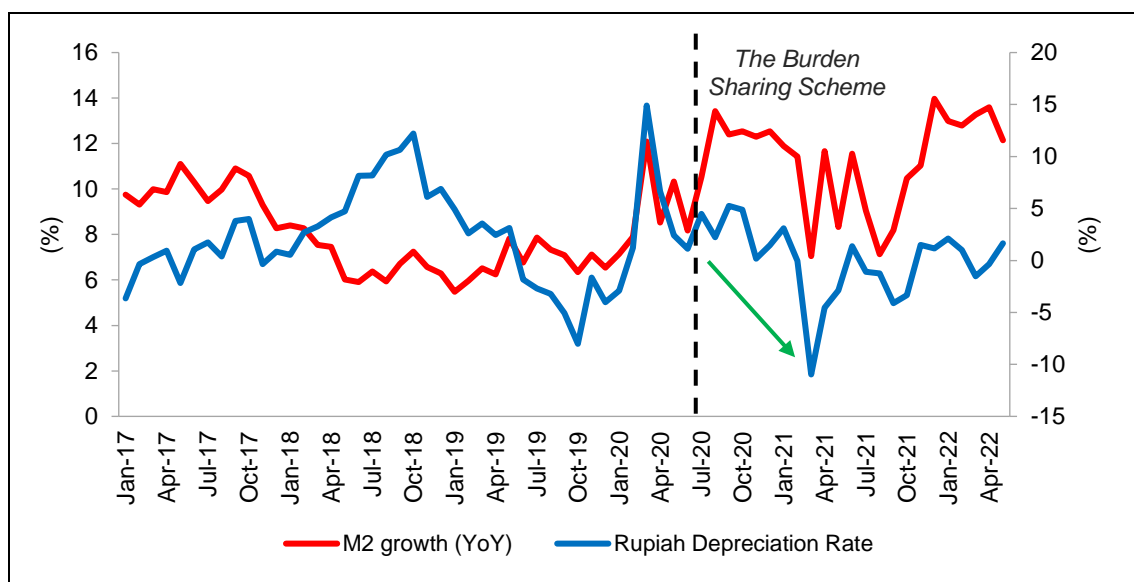
Indonesia is experienced in implementing fiscal deficit, so running a budgetary deficit has been more frequently implemented than a fiscal surplus. Indonesia's fiscal deficit before the COVID-19 pandemic was consistently below 3% because the regulation allowed the government to have a larger fiscal deficit—but no larger than 3%. However, in response to the COVID-19 pandemic, the government was permitted to have a fiscal deficit that was larger than 3% of GDP. World Bank data indicate that the public debt in Indonesia increased from 36.6% of GDP in 2019 to 41.4% in 2020 and 43.4% in 2021. However, this does not mean that government debt is manageable or controllable. One of the primary reasons is the composition of government debt regarding the currency of the denomination. Government debt denominated in foreign currency is about 30% of total government debt in 2021, which increases the vulnerability of debt sustainability to external factors related to exchange rate effects.

Running a fiscal deficit and relaxing the regulation to extend the deficit threshold show that the government supported the recovery program to address the COVID-19 crisis. In relation to this, the burden-sharing scheme seems more potent than raising external debt without worrying about its macroeconomic consequences. One of the main reasons for this is that there is no need to worry about Ricardian equivalence under such a scheme because there is no debt, future tax, or interest rate increase. Therefore, this option is more likely to drive demand significantly more than external debt-financed fiscal stimulus. Another reason is that the size of Indonesia's government debt is relatively low compared to other countries. Indonesia's government debt ratio was about 42.8% of GDP in 2021, according to the IMF. This number is much lower than the global average. From this perspective, a burden-sharing scheme can be of relevance for financing COVID-19-related factors beyond 2022.

Figure 4: Inflation and Money Supply (M2) Rate

Source: Indonesian Economic and Financial Statistics (2022).

There is a concern that the burden-sharing scheme (or debt monetization) may cause a high inflation rate or stagflation. If we look at the COVID-19 pandemic timeline, the first case was found in March 2020, and the government then implemented several measures to minimize the spread. In Q3-2020, the government began to implement the burden-sharing scheme to stimulate the economy. However, the policies restricting human mobility and precautionary motives for saving in response to uncertain future conditions led to a weak demand for consumption. This concern can be reflected by relatively low inflation, as shown in Figure 5 although the money supply grew due to the burden-sharing scheme. In 2021, inflation started to increase in response to the demand for consumption recovery.

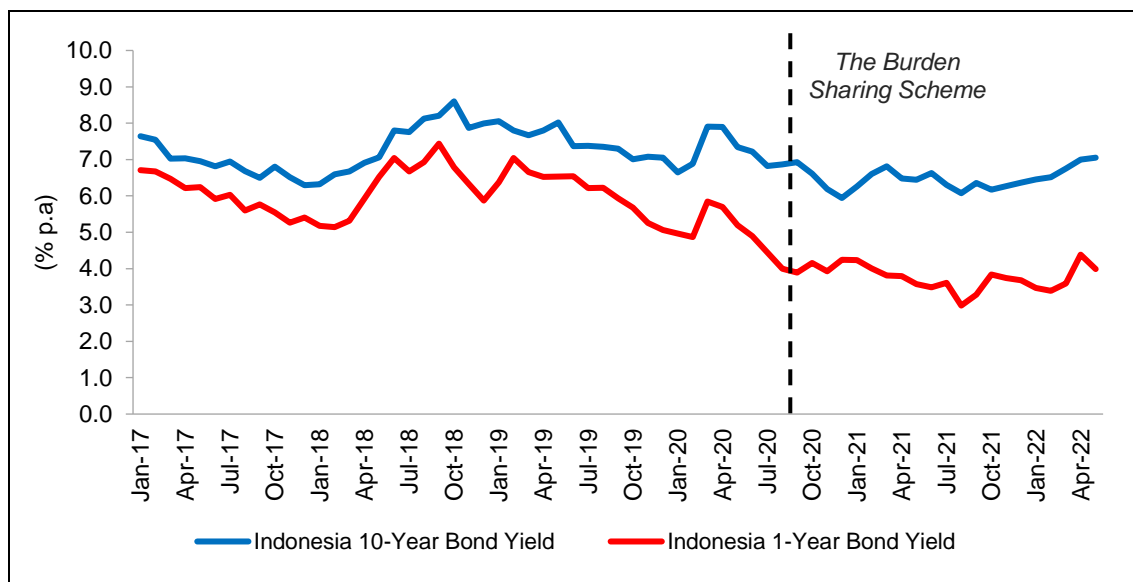
Figure 5: Money Supply (M2) and Rupiah Depreciation (USD) Rate

Source: Indonesian Economic and Financial Statistics (2022).

In terms of the exchange rate, an increased money supply caused market adjustments. In this case, there was an expectation of reducing the yield of owning Indonesia's assets so that interest rates tended to decline (Figure 5). Theoretically, such a condition adversely affects Rupiah, making it depreciate against the USD. However, this effect might occur in the short term until foreign investors' expectations become stable.

Furthermore, the burden-sharing scheme also affects the government bond market. Figure 6 shows the government bond yield slightly decreased for both 10-Year Government Bond and 1-Year Government Bond. It seems that investors still have positive expectations toward Indonesia's economy. A stable credit rating supports this condition, keeping the bond market positive. If we look at the structure of the investor profile, the share of foreign holders dropped, but the percentage of government bonds owned by domestic investors, on the other hand, increased after 2019. This condition, however, shows financial institutions, particularly commercial banks, tend to allocate their funds to government bonds instead of fostering the economy through lending. Such a problematic concern is understandable under an uncertain economic situation due to the COVID-19 pandemic that is not yet over.

Figure 6: Government Bond Yield

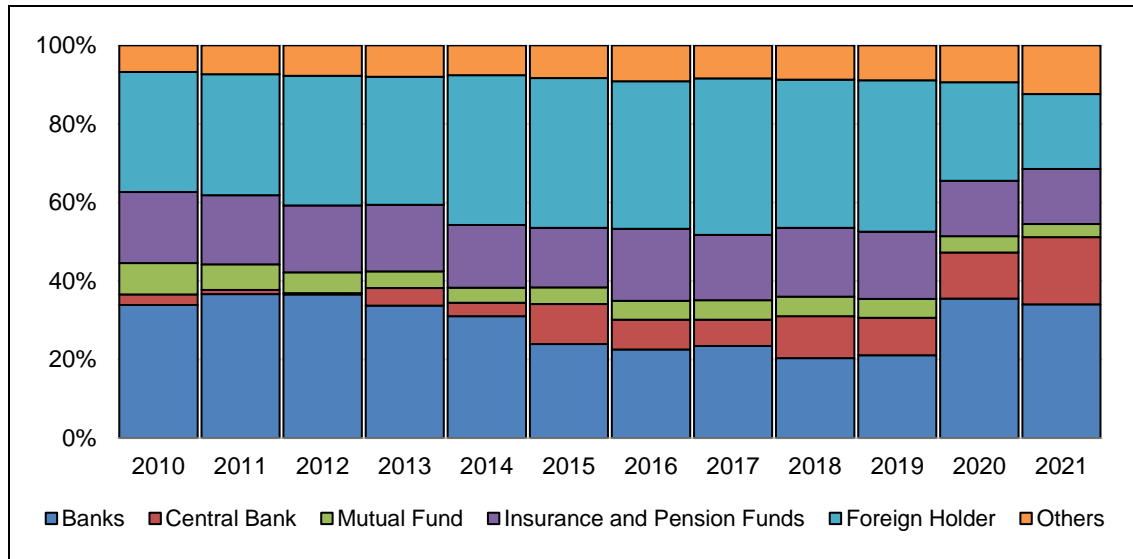


Source: Investing.com.

The burden-sharing may not be as damaging as perceived, although it is important to safeguard the anchoring of inflation expectations by taking government bond duration into account, not only to rebalance the portfolio but also to signaling the market. In addition, several conditions should be considered to implement debt monetization, such as: (i) the country is under a low or moderate level of inflation; (ii) the fiscal deficit is relatively small; and (iii) the central bank needs to ensure that its position and role is independent of the government's fiscal need. Since the government can meet these conditions, the burden-sharing scheme in which the central bank purchases government bonds is expected to be effective and able to recover the economy. Figure 8 shows that GDP growth started to revive in 2021, meaning that the economy was about to recover, although the COVID-19 pandemic has not been over yet.

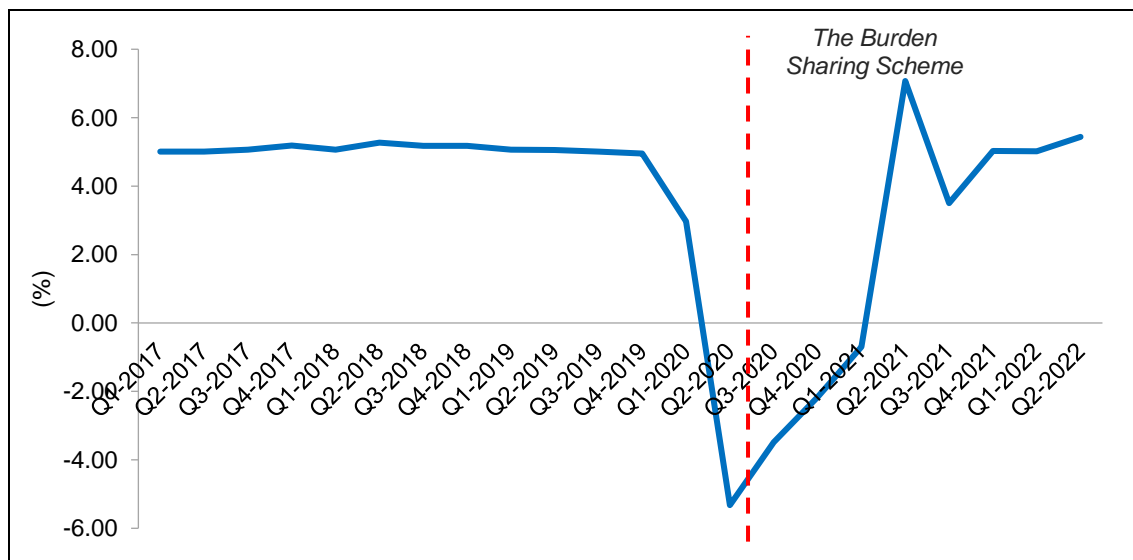
The burden-sharing scheme has been an important factor in helping to support economic growth.

Figure 7: Investor Profile – Indonesia’s Government Bonds



Source: AsianBondsOnline – ADB (2022).

Figure 8: GDP Growth



Source: Indonesian Economic and Financial Statistics (2022).

6. CONCLUSION

Before the COVID-19 pandemic, Indonesia also faced budgetary and trade deficits. However, COVID-19 handling demands a more significant fiscal stimulus. Unlike advanced economies, fiscal policy in Indonesia is constrained by a higher foreign external debt and lower tax ratio. The Ministry of Finance and the central bank then agreed to finance COVID-19 handling through a burden-sharing scheme to address

this problem. The burden-sharing scheme is simply printing money conducted through the monetary operation. As a result, this scheme increased the fiscal deficit from 2.2% to 6.% of GDP in 2020 and 5.7% in 2021. At the same time, government debt increased from 29.7% in 2019 to almost 40% of GDP in 2020, and the external debt ratio from 36.1% of GDP in 2019 to 39.4% in 2020. In the middle of raising primary balance, this situation brings with it some macroeconomic consequences, making the public and policymakers worry about Indonesia's macroeconomic stability and fiscal sustainability.

This paper shows that running a fiscal deficit does not necessarily indicate that government capacity diminishes to meet its spending. The lesson learned from the burden-sharing scheme is the government of Indonesia can finance its spending independently from tax payments by issuing government bonds denominated in local currency. This means that budget constraint faced by the government and households is different, so that government spending is not financially constrained. Furthermore, a burden-sharing scheme is not borrowing in the traditional sense, given that government debt is bought by the central bank. This implies that there is no requirement for current and future taxpayers to pay interest payments in the future, allaying concerns about fiscal sustainability. We also note that a higher accumulation of external debt-denominated foreign currency is a key source of potential macroeconomic instability in the future.

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