Economics

ID: tax targets are too optimistic

DBS Group Research | 1 April 2015

- **The 2015 tax collection target is an optimistic 30% boost over 2014**
- **Even assuming improvements in collection efficiency, the target is a stretch**
- **A shortfall in tax revenue is likely; this could oblige expenditure cuts of up to 2% of GDP this year**

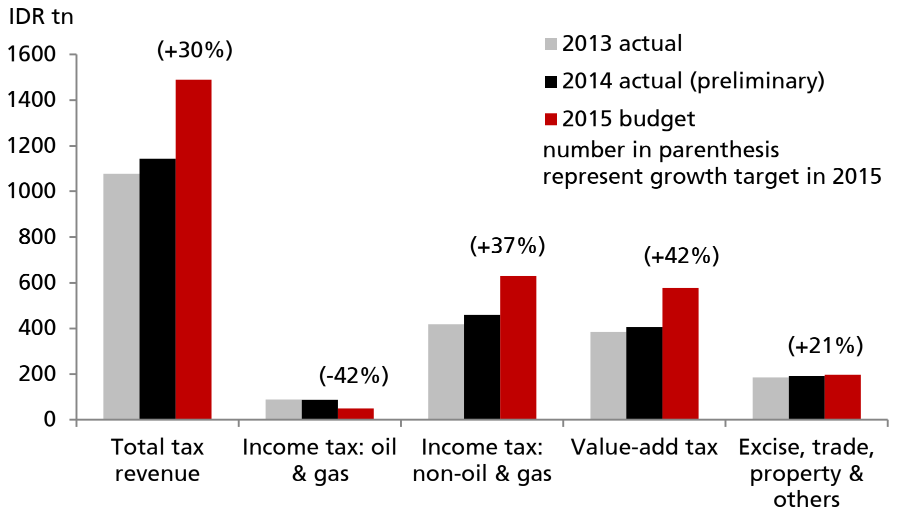
While the actual 2014 budget numbers are not officially out yet, preliminary figures shed light on the feasibility of the 2015 budget. The tax revenue target for 2015 is 30% greater than the preliminary 2014 figure and seems overly optimistic. A shortfall in revenue collection would have implication for expenditures; we reckon spending may have to be reduced by up to IDR 220tn (2% of GDP) as a result.

Target of 30% jump in revenues this year

The revised 2015 budget assumes total revenues of IDR 1,762tn, of which tax revenues amount to IDR 1,489tn (85% of the total). This tax revenue target represents a 30% jump over estimated 2014 collection (Chart 1).

The breakdown of the tax revenue target makes it even clearer that the government may be overly-optimistic. Income tax collection from the non-oil & gas sector and value-added tax revenues typically make up 75% of total tax revenues. Based on the 2014 preliminary numbers, income tax collection in the non-oil & gas sector is expected to increase by 37% while value-add tax revenues are expected to rise by 42%.

Chart 1: 2015 tax revenue target



Gundy Cahyadi • (65) 6682-8760 • gundycahyadi@dbs.com

These targets are very high from a historical perspective. Total tax revenue growth averaged 8% in 2013-14, about half the 15.6% average pace in 2008-12. The last time tax revenue growth surpassed 30% was in 2008. But that was when commodity prices were significantly higher than today. For example, prices of crude palm oil (CPO), which account for 15% of non-oil exports, were some 25% higher than what they are today.

30% growth in tax revenue collection for 2015 is overly optimistic

It is also worth noting that GDP growth is running at about 5% lately, compared to the 6.2% average in 2008-12. Raising corporate and income tax rates is unlikely now, given the further drag on growth that this would likely entail. While there have been discussions over new policy measures to increase tax revenues, there is yet to be any formal changes to the current tax laws.

The government's 30% tax revenue growth target is based partly on more efficient tax collection. The focus is to prevent under-reporting of taxable income among households and corporates. This is challenging but not an impossible task. Efficiency was improved when President Yudhoyono first took office in 2004. Tax revenues grew by an average of 20% per year in 2005-07, relatively high by historical standards.

Fiscal expenditure may be trimmed by as much as 2% of GDP

Some counterfactual arithmetic may help clarify the situation. Assume the government succeeds in matching the improvements made in 2005-07 and there is a 20% jump in tax collection from the non-oil & gas sector and in value-added tax revenues. Assume as well that the government meets its 2015 target for other tax and non-tax revenue. In this case, total revenue collection would still fall some IDR 170tn lower (1.5% of GDP) short of the current target (Table 1).

If the same calculations were made under the assumption of 8% tax revenue growth (which occurred in 2013-14), the total revenue shortfall would rise to IDR 280tn.

Assuming fiscal deficit stays at most 2.5% of GDP, lower tax revenues will prompt a material cut in fiscal expenditure

It would appear that the government has little choice but to cut expenditure targets for 2015. If it were to stick to planned 2015 expenditure, the fiscal deficit would jump to 3.5% and 4.4% of GDP, respectively, under the first and second scenarios above.

Some tinkering with the fiscal deficit target appears likely. The legal limit is currently 3% of GDP but the deficit has not surpassed 2.5% of GDP for more than ten years. Widening the deficit to 2.5% of GDP from the current 1.9% target would allow an additional IDR 60tn of red ink. Even after allowing for this, the government would still need to cut expenditure by IDR 110tn or IDR 220tn under the first and second scenario discussed above to keep the deficit below 2.5% of GDP.

Table 1: Possible adjustment in fiscal expenditure

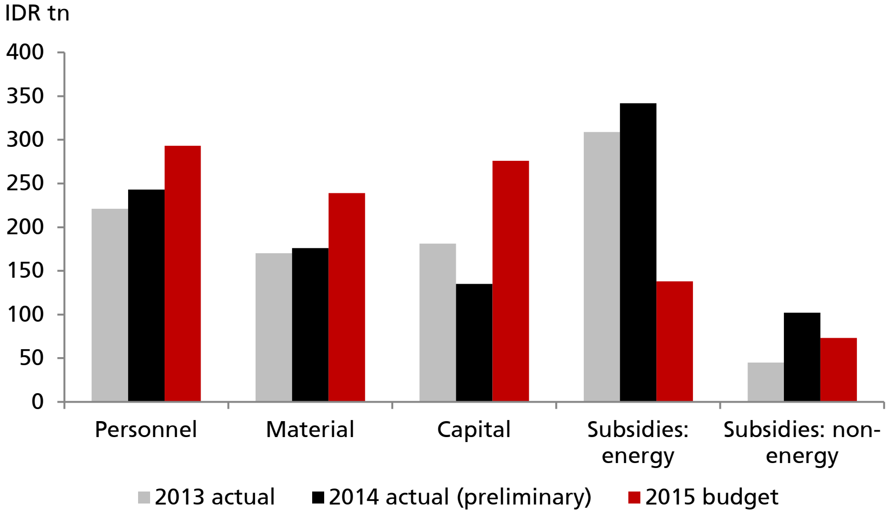
	2015 budget	Scenario 1	Scenario 2
Total expenditure	1,984	1,984	1,984
Total revenue	1,762	1,590	1,487
- (A) income tax: non-oil & gas	630	552	497
- (B) value-added tax	577	486	437
Fiscal deficit (% of GDP)	1.9	3.5	4.4
Adjustment in expenditure (assumes 2.5% fiscal deficit)	N.A.	-110	-215
Adjustment in expenditure (assumes 3.0% fiscal deficit)	N.A.	-53	-157

All figures in IDR tn

Scenario 1 assumes 20% increase for (A) and (B)

Scenario 2 assumes 8% increase for (A) and (B)

Chart 2: Central government expenditure target



With subsidy spending unlikely to be trimmed further, cuts would need to come mostly from personnel, material and / or capital expenditure. Of these, the budgeted increase in capital expenditure is the highest (Chart 2), and thus, the one most at risk. Plainly, cutting investment would represent yet another drag on GDP growth both in the near-term and medium-term. Stay tuned.

Sources:

Data are sourced from Ministry of Finance and CEIC while forecasts are from DBS Group Research.

Recent Research

CNH: The growing influence of yuan settlement in forex reserves	31 Mar 15
CN: Fiscal reforms to accelerate	27 Mar 15
IN: Assessing RBI priorities	24 Mar 15
KR: Wither export competitiveness	19 Mar 15
CNH: A freer China	17 Mar 15
Qtrly: Economics-Markets-Strategy 2Q15	12 Mar 15
IN budget: Growth trumps fiscal goals	2 Mar 15
ID: No shift in BI's tight policy bias	27 Feb 15
SG budget: Shaping Singapore's future	24 Feb 15
India budget: a balancing act	17 Feb 15
US: substantial deflation here, now	16 Feb 15
SG: Jubilee budget 2015	10 Feb 15
USD Rates: Market vs Fed	10 Feb 15
CN: The need for a better unemployment gauge	4 Feb 15
IN: Facing ECB QE and a strong dollar	30 Jan 15
Asia: Are currencies too strong?	28 Jan 15
ID: Delivery is key	28 Jan 15
SG: Old problem, new approaches	27 Jan 15
KR: Explaining low inflation	21 Jan 15
Global crude: low for long?	19 Jan 15
IN: Falling oil prices – good or bad?	19 Jan 15
IN: RBI cuts rates, more to come	15 Jan 15
CN: Restarting SOE reforms	13 Jan 15
JP: mixed impact of low oil prices	12 Jan 15
UST yields: Downward distortions	12 Jan 15
Asia: vulnerability dashboard	19 Dec 14
Qtrly: Economics-Markets-Strategy 1Q15	10 Dec 14
CNH: To break fresh ground in 2015	17 Nov 14
CNH: Conversion cap finally lifted	12 Nov 14
JP: The impact of QQE2	7 Nov 14
CN: Significant easing remains unlikely	5 Nov 14
Asia export race: Who's winning?	30 Oct 14
ID: Watching external debt	30 Oct 14
MY: Assessing the GST impact	29 Oct 14
IN: Reviving manufacturing	28 Oct 14
HK-ASEAN trade prospects	24 Oct 14
JP: Policy intentions lack clarity	24 Oct 14
HK: Initial impact of Occupy Central	16 Oct 14
SG: Growth struggles continue	14 Oct 14
IN: Inflation and shifting policy dynamics	10 Oct 14
KR: Weakness exaggerated	9 Oct 14
EZ: Rates are firmly anchored	9 Oct 14
SG: Restructuring pain	8 Oct 14
CN: Price deregulation in motion	25 Sep14
TH: Stronger consumption is key	24 Sep 14
US: The water rate addendum	23 Sep 14