Inside Indonesia

Silencing the Skeptics

Indonesia's tax amnesty picks up speed

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- **Call it a late bloomer. After what was a worryingly slow start, it's as if Indonesia's tax amnesty program received an adrenaline shot a few weeks ago and has been on a heady upward rush since.**
- **At over IDR 3.3 quadrillion (~USD257bn), total assets declared is now 84% of the government's lofty target. Within that, onshore assets make up 69% of the total. Tax take amounts to USD6.4bn, half of the amount targeted thus far.**
- **The participation rate is unlikely to accelerate further from here, as higher penalty rates apply from tomorrow onward. Still, only the most diehard skeptics could claim that this program is no success. Indeed, to us, it marks the start of a silent paradigm shift that would change Indonesia's political economy dynamic for the better.**

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Yes We Can

It was something that we kept an eye on only occasionally. The frequency then intensified into daily, and by now, we have to try our utmost not to refresh the page every other minute. Here, we are referring to the online live tracker of tax amnesty participation, provided by the Finance Ministry.

The figure was chugging along unimpressively at first. The amnesty program was launched in late July but really became effective functionally only in early August. By late August, less than USD5bn of assets was declared, eking out but 1.4% of the government's USD308bn target. It prompted us to wonder if the government needed to tweak things more, including allowing for instalment payments of penalty rates, to make things more palatable for would-be participants. (See our Aug 24th report, "*Going for Gold*" for details).

As it turns out, our cold sweat was for nothing. The participation rate started to pick up pace in early weeks of September, and by the 16th of the month, nearly USD90bn was in. However, it was really over the past two weeks that the run-rate, well, ran up.

Source: Ministry of Finance, OCBC.

Why the sudden heady rush? In some ways, the same reason why young school kids find a sudden urge to finish their homework – and that is the motivational power of deadlines.

Even though the program is open until March 2017, the penalty tax rates are the lowest at 2-4% as long as the participants slot their applications in by September 30th, i.e. today. While they can still participate later on, the rates go up to 5-10% if they wait further.

Penalty tax rates under the Tax Amnesty program

Types of Previously Undeclared Assets		Period of Compliance		
		Q3 2016	*Q4 2016*	*Q1 2017*
Offshore assets that stay offshore		4%	6%	10%
Onshore assets and offshore assets that are repatriated		2%	3%	5%
Assets of companies earning gross income of less than IDR4.8bn (~USD360k) in the latest tax year	Stock of assets up to IDR10bn (~USD760k)	0.5%		
	Stock of assets above IDR10bn (~USD760k)	2%		

Source: Ministry of Finance, OCBC.

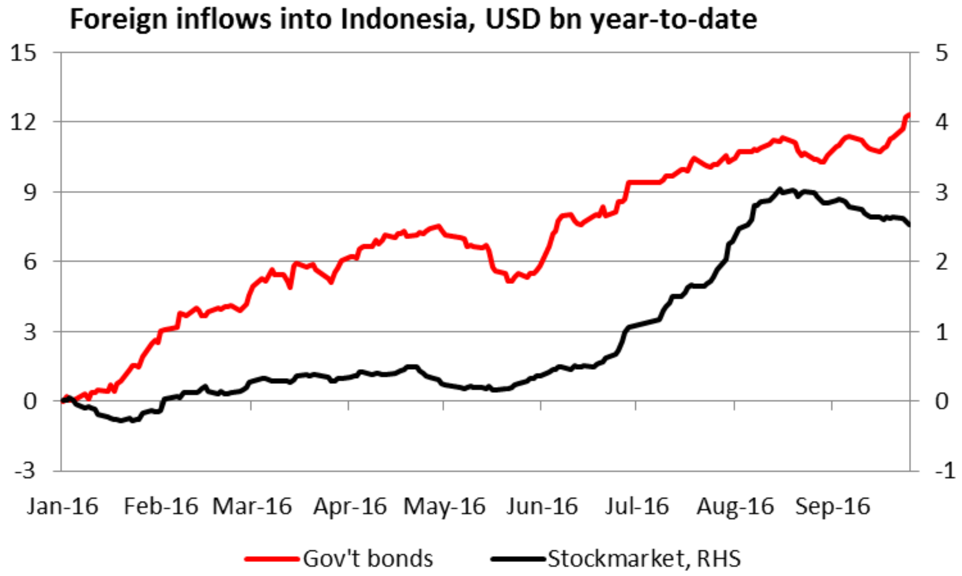
The magnitude of the uptick also alludes to the increasingly robust participation of the wealthier folks. Helped by active nudges by those in power – including over a dinner at the presidential palace last week that yielded a wealth of interesting group photos in the local media – the who's who of Indonesia's top business circle began to toe the line, declaring not only their verbal support but their hitherto neatly hidden assets, as well.

Such enthusiasm has trickled down too, with long lines of common folks forming at tax offices around the country. The logical thinking must have been that, if the supposedly politically connected big shots are throwing in the towel and joining the amnesty program, then perhaps it is wise to follow the current rather than be left vulnerable to waves of audits and punitive probes later on.

In aggregate, all these have added up to an impressive lot. At the time of writing – it's still ticking up – the total assets declared amount to IDR 3344 tn (~USD 257bn). The majority (69%) of it comes from onshore assets, followed by offshore assets that are opting to stay offshore (27%), and just 4% of offshore assets repatriating.

Among these figures, the fact that repatriation rate of the offshore assets is low will no doubt be snatched upon by skeptics out there to argue that the program has not been a success. We beg to differ, however. To begin with, there is the suspicion that some of the offshore assets might have been repatriated before the onset of the program, to avoid the three-year lock-up period. Given that the capital flow checks and controls would have been porous enough for the money to flow out to begin with – and thus as prone to undetected reshoring – that is not an inconceivable possibility. Moreover, we should not forget that, having been declared in black-and-white terms now, the still-offshore assets could eventually go back in formal ways depending on the risk-reward calculations of the owners. Ultimately, as we have said before, given the dire state of global returns, the appeal of investments in Indonesia would be standing out more and more in relative terms.

Viewed from another angle, the absence of a sudden rush of assets coming home might be a blessing in disguise for Indonesia's macroeconomic stability after all. For one, it removes the challenges of facing a concentrated currency appreciation risk for an economy that is still trying to build up its manufacturing export base. Already, the central bank has repeated its stance that it does not want to see Rupiah strengthening too much. This is important given that foreign portfolio inflows have been remained strong, especially those heading into the sovereign bonds market. Indeed, the fact that USDIDR has been hovering around the 13,000 level speaks to stickiness of it that is likely to stay.



Source: Bloomberg, OCBC.

Overall, how would the recent uptick in tax amnesty participation affect the economy? In the near term, here are some of the things we are likely to see.

First of all, somewhat ironically, economic growth might take a breather. This is because the act of paying for the penalty tax rates – while arguably quite low – is going to drain liquidity from the population at large in the near term. Eventually, the money that the government has collected would of course flow back to the economy and it's a matter of left pocket vs. right pocket from the perspective of overall national accounts. Still, it takes time. After the initial dip, however, the fact that a lot of the asset owners have come clean would give them not just a sense of relief, but also the openness to make big ticket item purchases that they held back from doing when they feared getting the wrong kind of attention from tax authorities.

On the monetary policy front, the net effect will be a higher likelihood of another rate cut when Bank Indonesia meets next in October. This would mark the sixth time it is cutting rate. Already, it has been actively providing liquidity to the banking system in order to relieve the crunch as Indonesians withdraw cash to pay for the penalties. It is likely to up the ante by cutting policy rate to 4.75% next to help things further. It helps too that the concern that the tax amnesty would be a failure has been evidently erased with the latest uptick.

The real game-changing element of this program is over the longer term, however. We have touched on the idea of how the amnesty initiative would be a boon to Indonesia's narrow tax base and less-than-developed financial sector before and will not dwell in lengths here. (For details, see our Feb 2nd report, "*Home Sweet Home*", for instance).

What is worth thinking about too, and much less discussed thus far, is the notion that the tax amnesty would shift how the average Indonesian views the government-to-citizenry relationship.

In most advanced countries, citizens are used to paying taxes on their incomes and accept it as part of life – unless, of course, if you happen to be one particularly tax-savvy property magnate cheekily running for top office to boot. They do, however, in return, expect accountability from the government in terms of how the money is spent. In various forms including through the ballot boxes and policy pressure groups, the citizens then engage in policy discussions and help to shape the priorities of the government, including on the fiscal front. This taxation-and-representation nexus is part and parcel of the maturing process of a democracy.

In Indonesia, that dynamic has been sorely missing thus far. While the democratic system has taken root and has indeed overseen a peaceful transition of power for over a decade now, it is not yet as enlivened by policy-oriented discussions as it could be. Though it is slowly changing, national and local elections appear to be still driven by personalities rather than policies. Now that more people will learn to pay taxes, for the first time perhaps, things should change for the better as Indonesians learn to demand a say in how their money is spent by the government. What it would then do is to ultimately form the basis for a more engaged citizenry, which would in turn force the politicians to battle one another not just in terms of popularity but also policy platform.

Such development would naturally take time, but one day, political scientists would look back at the tax amnesty program as a contributing factor to the development of a more robust democracy in Indonesia. That is also perhaps something positive to think about for Indonesians who have to now get used to the idea of paying taxes by the book.

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