Fiscal Policy to Support Climate Change Action

Jakarta, 22 August 2013

Indonesia's strive to achieve high, green growth

- Economic growth 7% per year framed in
  - the 4-track development strategy (pro-growth, pro-job, pro-poor, pro-environment)
  - 26-41% voluntary emissions reduction targets by 2020 against BAU

- Growth acceleration and expansion focused in 6 economic regions
  - Through large-scale national and international investment
  - A wide range of economic activities: food estate, palm oil plantation, mining (incl.coal), manufacturing, tourism, etc.
  - Big potential for poverty eradication but if not done properly will produce huge greenhouse gases emissions

Why Should Indonesia Get Greener?

- Development Benefits: Energy security, competitiveness
- Fiscal Benefits: Reducing waste, free up funds
- Quality of Life Benefits: Cleaner air, reduced congestion
- Poverty & Equity: Reducing environmental burden on the poor
- Reduced Economic Burden: Policy distortions & inefficiency
- Opportunity Cost: biodiversity or ecosystem services

Can Indonesia afford the degradation, distortions and development deficit of not getting greener?

Principles for Green Fiscal Policy

Investing for Future

- Linking in with development objectives

- Distributional issues addressed

- International financing in exchange for doing fair share

- Get prices right: Competitiveness, reduced waste

Reducing Distortions

- Perverse incentives and distorting policies minimized

- Non-price market failures alleviated

- Externalities (non-carbon) internalized

Fiscal Policy Supporting "Pro-4" Agenda

The Government Mission for the year 2012:
Acceleration and Expansion of the Qualified Economic Growth, Inclusive and Fairness to Improve People's Welfare

4 Pillars of Development

| Pro Growth | Pro Job | Pro Poor | Pro Environment |

Fiscal Policy Direction for the year 2013
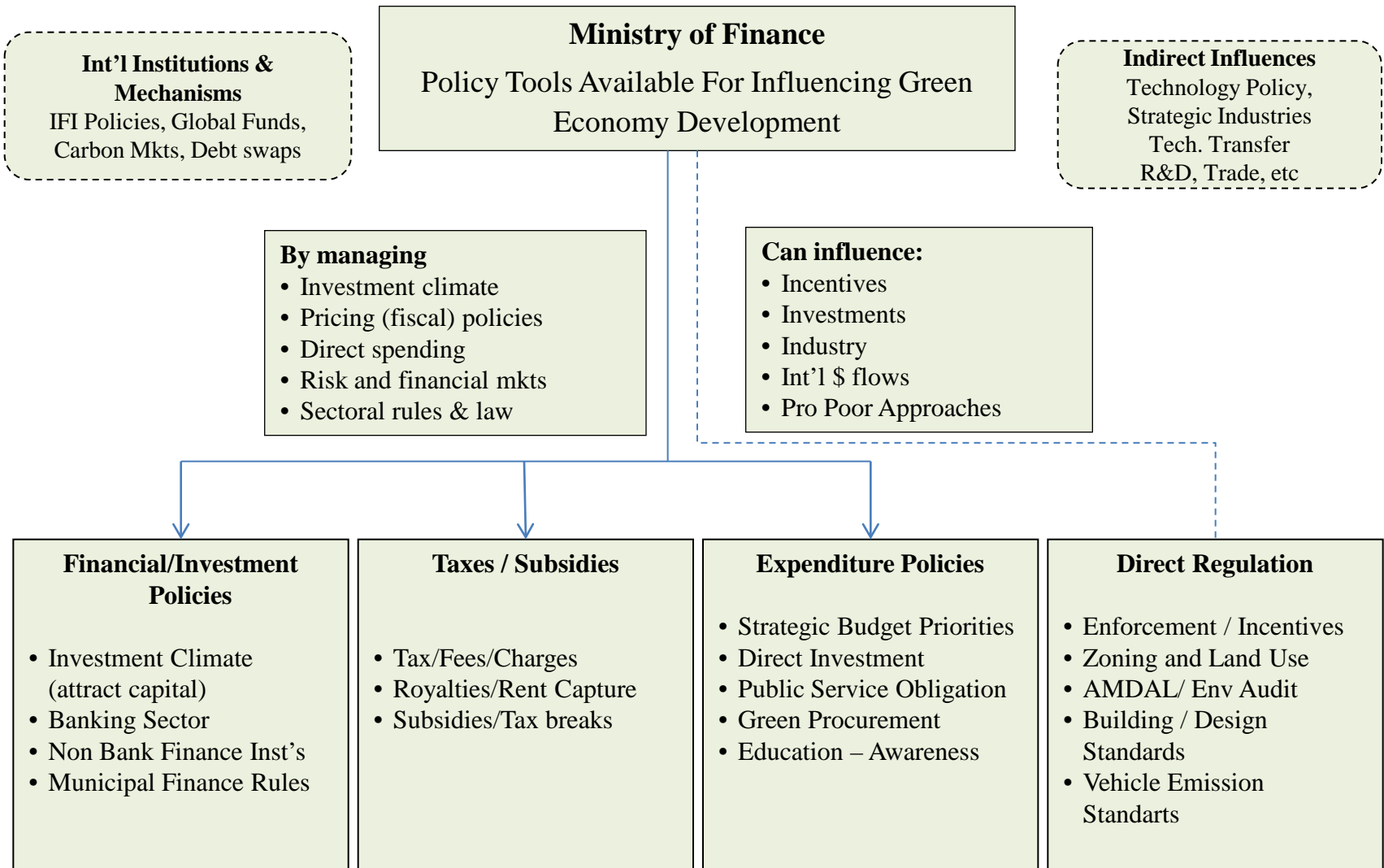Strengthen Domestic Economy for Social Welfare Improvement and Extention

Taxation Policy Strategies

Tax Reform and Modernization:
- Equality
- Simplicity
- High integrity

Encourage Direct Investment for Priority Sectors/Industries/Regions

Role of Ministry Of Finance
In Climate Change Action

Int'l Institutions & Mechanisms
IFI Policies, Global Funds, Carbon Mkts, Debt swaps

Ministry of Finance
Policy Tools Available For Influencing Green Economy Development

Indirect Influences
Technology Policy, Strategic Industries
Tech. Transfer
R&D, Trade, etc

By managing
- Investment climate
- Pricing (fiscal) policies
- Direct spending
- Risk and financial mkts
- Sectoral rules & law

Can influence:
- Incentives
- Investments
- Industry
- Int'l $ flows
- Pro Poor Approaches

Financial/Investment Policies

- Investment Climate (attract capital)
- Banking Sector
- Non Bank Finance Inst's
- Municipal Finance Rules

Taxes / Subsidies

- Tax/Fees/Charges
- Royalties/Rent Capture
- Subsidies/Tax breaks

Expenditure Policies

- Strategic Budget Priorities
- Direct Investment
- Public Service Obligation
- Green Procurement
- Education – Awareness

Direct Regulation

- Enforcement / Incentives
- Zoning and Land Use
- AMDAL/ Env Audit
- Building / Design Standards
- Vehicle Emission Standarts

Green Fiscal Policy Strategy

Investing for Future

- Apply Principles of Medium Term Expenditure Framework and Performance Based Budgeting in the Medium Term Development Plan 2010-2014. Green Budgeting

- Improve policy framework design for promoting geothermal development and identify financing needs to mitigate upstream risk of geothermal projects.

- Develop incentives for renewable energy development and acceleration of power plant development using renewable energy

- Introduce and use Green GDP and apply Economic Instruments to give incentives for sectoral development,more environmentally friendly industries

Reducing Distortions

- Rationalize subsidy policy of electricity (and others…), ore cost-oriented pricing

- Better pricing and resource valuation to protect and deliver environmental services

- Contribute to reducing both GHG emissions and energy subsidies

Green Fiscal Policy: Examples
(Tax Incentives for Greener Outcomes)

- Minister of Finance (MoF) Regulation on Taxation and Customs Facility for Renewable Energy Sources Utilization Activities

- MoF Regulation on Exemption or Reduction of Corporate Income Tax

- MoF Regulation on VAT borned by government on the Import of Goods for Geothermal Activities

- Tax allowance for certain industry related to renewable energy i.e biofuels, biodiesels

- Revolving fund for geothermal exploration

Green Fiscal Policy: Managing Tax Incentives and Trade Offs

Environmental policies cause an adjustment of economic structures

The price of using environmental resources should thus be brought closer in line with the social cost, with the consequence that pollution should decline, and GDP become less pollution intensive.

Polluting industries will thus be held in check while cleaner industries will be boosted, and the **net effects on welfare**

– though not necessarily on economic activity as measured in national accounts statistics – **should be largely Positive**

A cost-effective environmental policy should aim to minimize the costs incurred in achieving an environmental objective

Green Fiscal: Strategy for Fuel Subsidy Reform (Improving Incentives, Greening the Budget)

Phasing out of inefficient fossil fuel subsidies:

- Gradual with protection for poor (transfers)

- Sequenced through managing the demand side to reduce consumption

- Narrowing the gap between domestic and international prices.

Opportunities & Challenges

Opportunities

- **Leader's commitment** is strong, yet domestic agenda also important -- democratization and decentralization.

- **Public awareness** and stakeholders' involvement: positive signal shown by sucessful LPG conversion program.

- **Indonesia Modalities in Fiscal Policy** Development support more climate investment on green economy such as renewable energy, energy efficiency, green building, etc

- **Capacity building** on initiative domestic flexible mechanisme (ICCTF,IGIF) on financing instrument on Green Economy is underway.

Challenges

- **Resource efficiency**:

  - **Energy efficiency**: need innovative technology and to generate awareness and participation from the society

  - **Natural resources efficiency**: need best practice for sustainable fisheries, sustainable agriculture, sustainable forestry, etc.

- **Aligning Incentives and Coordinating Across Government**

- **Renewable energy resources**: Barriers beyond pricing and risk: e.g. IDR 2T for geothermal power plant has not been used.

- **Limited human capital / resources.**

Thank You