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Dependence On Debt Financing To Cover The Budget Deficit: Implications For Fiscal Sustainability

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Abstract*. This research examines the dependence on debt financing to cover budget deficits and its implications for fiscal sustainability. Using secondary data analysis from government financial reports during the 2010-2023 period, this study finds that the increasing debt-to-GDP ratio has exceeded the limits established within the fiscal sustainability framework. The results indicate that dependency on debt has created pressure on interest payments that absorb a significant portion of the annual budget and reduce fiscal space for priority sector financing. This research concludes that fiscal policy reforms emphasizing enhanced domestic revenue, spending efficiency, and strategic debt management are necessary to ensure long-term fiscal sustainability.*
Keywords*: budget deficit, debt financing, fiscal sustainability, fiscal space, policy reform*

INTRODUCTION

Budget deficits are a common condition experienced by various countries worldwide, including Indonesia. A deficit occurs when government expenditures exceed revenues obtained within a certain period. To close this gap, the government often relies on debt financing. Although this practice can facilitate smooth government operations and the implementation of development programs, it has the potential to cause problems for long-term fiscal sustainability. In the last decade, Indonesia's dependence on debt financing to cover budget deficits has increased significantly. According to data from the Ministry of Finance, Indonesia's debt-to-Gross Domestic Product (GDP) ratio rose from 24.5% in 2010 to around 41% in 2023. Although this figure is still below the 60% limit set in Law Number 17 of 2003 concerning State Finance, the consistent increasing trend raises concerns about fiscal sustainability (Ministry of Finance, 2023).

As revealed by Basri (2021), dependence on poorly managed debt financing has the potential to create fiscal burdens in the form of increasing interest and principal debt payments. This situation can result in reduced fiscal space for financing priority sectors such as education, health, and infrastructure. This study aims to analyze the impact of dependence on debt financing in covering budget deficits on Indonesia's fiscal sustainability. Specifically, this study focuses on three main aspects: first, the patterns and trends of deficit financing during the period 2010-2023; second, the implications of increased debt on fiscal space and budget allocation; and third, policy alternatives to maintain long-term fiscal sustainability.

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LITERATURE REVIEW

Fiscal economic literature has long explored the relationship between deficit financing through debt and its implications for macroeconomic stability as well as fiscal sustainability. The Ricardian Equivalence Theory proposed by Barro (1974) states that deficit financing through debt or taxes has equivalent impacts on the economy. However, empirical studies such as those by Reinhart and Rogoff (2010) show that a high debt-to-GDP ratio, especially when exceeding 90%, correlates with lower economic growth. In Indonesia, Djuanda (2019) analyzed the structure of budget deficit financing and found that increased dependence on debt has led to a significant rise in interest payment burdens. As a result, the budget portion allocated for debt interest payments increased from 8% in 2010 to nearly 16% in 2019. This phenomenon reduces budget flexibility to finance government priority programs.

Furthermore, Suryani (2020) studied the impact of debt accumulation on fiscal sustainability in Indonesia and found that although the debt-to-GDP ratio remains within safe limits, its rapid upward trend raises concerns. Suryani argues that to maintain fiscal sustainability, the government needs to prioritize the use of debt for productive activities that can increase economic capacity and future state revenues. From a global perspective, Ostry et al. (2015), in a study for the IMF, developed the concept of "fiscal space," defined as the difference between the current debt level and the debt ceiling at which fiscal sustainability is threatened. Their research highlights the importance of maintaining adequate fiscal space to withstand economic shocks and ensure fiscal policy flexibility.

Along with understanding the risks of debt dependence, academic discussions also cover alternative deficit financing strategies. Widodo (2021) proposes diversifying deficit financing sources through increasing tax revenue, optimizing state assets, and developing innovative financing instruments such as sukuk and green bonds. Meanwhile, Kurniawan (2022) emphasizes the importance of strategic debt management including expanding the investor base, optimizing maturity structure, and managing exchange rate risks.

RESEARCH METHODS

This study uses a descriptive analytical approach relying on secondary data obtained from various official sources. The primary data used include government financial reports, government debt statistics, and budget information from the Ministry of Finance of the Republic of Indonesia for the period 2010-2023. Additional data were obtained from reports by Bank Indonesia, the Central Statistics Agency, and international institutions such as the World Bank and the International Monetary Fund (IMF).

Data analysis was conducted through several stages. First, the researcher performed trend analysis to identify patterns of budget deficit financing during the specified period, focusing on the evolution of the financing structure and changes in the composition of government debt. Second, financial ratio analysis was carried out to evaluate fiscal sustainability indicators, including the debt-to-GDP ratio, interest payment ratio to state revenue, and the primary balance. Third, the researcher conducted a comparative analysis to compare Indonesia's fiscal conditions with other developing countries with similar economic characteristics.

To enrich the analysis, this study also applies the Debt Sustainability Framework developed by the IMF and the World Bank. This framework enables the assessment of medium- to long-term fiscal risks based on projections of various economic and fiscal scenarios. The limitations of this study lie in the use of publicly available secondary data, which may not capture the full details and complexities of government fiscal dynamics. Additionally, various assumptions used in the projections may affect the accuracy of long-term analysis.

RESULTS AND DISCUSSION

The data analysis shows that Indonesia's budget deficit during the period 2010-2023 consistently ranged between 1.8% and 6.1% of GDP, with the highest deficit occurring in 2020 due to the COVID-19 pandemic. To finance this deficit, the government relied on various financing sources, with debt being the dominant component, averaging 85% of the total deficit financing during the studied period. The structure of government debt experienced significant shifts during this period. The proportion of foreign currency debt decreased from 45% in 2010 to around 30% in 2023, reflecting the government's strategy to reduce exposure to exchange rate risk. At the same time, there was diversification of domestic debt instruments with an increase in the issuance of conventional bonds, sukuk, and retail bonds aimed at individual investors.

Despite improvements in the debt structure, fiscal sustainability analysis shows some worrying signs. The debt-to-GDP ratio increased significantly from 24.5% in 2010 to 41% in 2023. As stated by Amir (2021), this increase reduces Indonesia's fiscal space to face future economic shocks. Even more concerning, the ratio of interest payments to state revenue rose from 9.5% in 2010 to 16.8% in 2023, indicating a significant portion of state revenue is allocated to paying interest on debt rather than financing development programs.

The analysis of the primary balance, which is the difference between government revenues and expenditures excluding interest payments, shows a persistent deficit throughout most of the study period. According to Tambunan (2022), this situation reflects the government's inability to generate a sufficient surplus to at least cover interest payments, thereby increasing dependence on new debt to pay off maturing debt. Compared to other developing countries with similar credit ratings, Indonesia exhibits a relatively moderate debt-to-GDP ratio. However, the ratio of interest payments to state revenues is above the group average, indicating problems in tax capacity and government spending efficiency.

Based on projections using the debt sustainability framework, if the current trend continues without significant fiscal consolidation, Indonesia's debt-to-GDP ratio could reach 60% by 2035. This scenario, as explained by Rafi and Haryanto (2023), would place Indonesia at higher fiscal risk and potentially trigger credit rating downgrades and increased borrowing costs. International experiences, as summarized by Ibrahim (2022), show that countries successfully addressing fiscal sustainability issues generally implement structural reforms including improvements in tax administration, spending rationalization, and strategic debt management. In Indonesia, tax reform efforts such as the implementation of the Tax Regulation Harmonization Law have shown positive results in increasing the tax-to-GDP ratio, although it remains below its true potential.

CONCLUSION

This study concludes that Indonesia's dependence on debt financing to cover budget deficits has created pressure on long-term fiscal sustainability. Although the debt-to-GDP ratio remains within the legally established safe limits, the consistent upward trend and the increasing burden of interest payments indicate the need to formulate more sustainable fiscal strategies. To address these challenges, a multidimensional approach is required, including revenue reforms, spending efficiency, and strategic debt management. On the revenue side, the government needs to prioritize increasing the tax-to-GDP ratio through improvements in tax administration, broadening the tax base, and reducing unproductive tax exemptions. On the expenditure side, rationalizing subsidies and operational spending as well as improving public spending effectiveness are crucial to create greater fiscal space.

In debt management, the government should continue diversifying instruments and investor bases, optimize the maturity structure, and prioritize the use of debt for productive activities that can enhance economic capacity and state revenue in the future. Furthermore, strengthening the medium-term fiscal framework and implementing credible fiscal rules can help maintain fiscal discipline and prevent excessive debt accumulation. In conclusion, this study emphasizes that fiscal sustainability is not only a technical issue but also a fundamental prerequisite for macroeconomic stability and the government's ability to provide adequate public services and respond to various development challenges. Without meaningful reforms, dependence on debt financing could impose burdens on future generations and limit policy space to address future challenges.

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