1 Indonesia

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1.1 Introduction

Geography

The Republic of Indonesia is located between 6°08' north and 11° 15' south latitude, and from 94°45' to 141°05' east longitude. It is between Asia and Australia, and between Pacific Ocean and Indian Ocean. The Republic of Indonesia is the largest archipelago country in the world, comprising 17,508 islands stretching along 5,120 kilometers from east to west, and 1,760 kilometers from north to south. The main islands are Sumatra (425,606 km2), Kalimantan (539,460 km2), Sulawesi (174,219 km2), Irian Jaya (421,981 km2), and Java (129,187 km2) which is home to about 70% of the country's population. The islands scatter over more than one tenth of the equator between Southeast Asia and Australia, covering a land area of around 2 million square kilometers and territorial waters nearly four time of that size. Total territorial area is 9.8 million km2, a large part of which (7.9 million km2 or 81%) is sea, while the rest (1.9 million km2 or 19%) is terrestrial land. Total coastline length of all islands is 54,716 km. Having such figures, Indonesia is recognized as the greatest maritime country in the world.

Politic

The Republic of Indonesia is formally a constitutional democracy with a strong executive presidency. Amid deepening economic troubles, the former president, Soeharto, resigned in May 1998 after more than 32 years in office, having lost both popular and elite support. He was replaced by his vice-president, Bacharuddin Jusuf Habibie, who held a democratic election to select a legitimate successor. At a parliamentary election on June 7th 1999 no single party won an outright majority. On October 20th 1999 the People's Consultative Assembly (MPR) appointed Abdurrahman Wahid, a moderate Muslim cleric, as president, and Megawati Soekarnoputri, the daughter of Indonesia's first president, Soekarno, as vice-president. The administration quickly ran into problems, with mounting tensions in the multiparty cabinet and between Mr Wahid and parliament. On July 23rd 2001, after only 21 months in office, Mr Wahid was formally impeached by the MPR on the grounds of incompetence and Ms Megawati was elected president. Shortly thereafter Hamzah Haz, the leader of the Islamic United Development Party (PPP), was elected vice-president.

Tourism: After the Bomb-Bali, Indonesia finds a new type of tourist

In the days after the catastrophe, almost all tourists deserted Bali. Airlines had to lay on extra flights to cope with the exodus. November saw less than half as many visitors as the year before, and less than a third as many as November 2000. The country as a whole, which suffered from a reputation for poor security even before the bombing, earned only $3.8 billion from tourism in 2002, against an official projection of $5.8 billion. The government responded by trying to drum up business wherever it could find it. It has persuaded travel associations and donor agencies to hold conferences in Bali as a gesture of solidarity. It is trying to promote the island with domestic and regional tourists, in the hope that they feel less vulnerable to terrorist attacks. In December, tourist arrivals doubled compared with the previous month, and were down by just 30% compared to the year before. But the new arrivals in Bali have been lured by discounts as steep as 50%.

1.2 Overview of Macroeconomic Activity and Fiscal Position

During 2002, Indonesia's economy developed quite favorably as indicated by more stable macroeconomic conditions. Consistent monetary and fiscal policies, supported by progress in several aspects of economic restructuring, helped to achieve economic and monetary stability throughout the reporting year. During the year, SBI rates declined significantly from 17.62% to 12.93%. The exchange rate appreciated by a considerable amount, 10.10%, to an average level of Rp9,316 per dollar. Base money grew by 9.1%, lower than the indicative target of 13%-14%. Such favorable monetary conditions caused CPI inflation to trend downward to 10.03%, slightly above the target of 9%-10%.

Nonetheless, economic results were constrained by certain structural problems, so that the Indonesian economy was not fully responsive to the improved financial climate. High risks in the real sector (prompted by structural weaknesses, such as legal uncertainty, uncertainty in investment regulations due to regional autonomy, labor issues, and security factors) limited the growth of investment and exports. Burdened by such structural problems, overall growth of the Indonesian economy in 2002 was 3.7% and was largely driven by consumption. Growth in investment and exports was still quite limited.

On the labor front, the moderate economic growth of 3.7% is estimated to absorb only 0.8 million workers, out of 1.7 million new entrants into the labor force last year. Consequently, open unemployment reached 9.1 million, representing an (open) unemployment rate of 9.1%.

On the demand side, consumption grew appreciably, despite its earlier prediction to slowdown over the previous year. Private consumption grew by 4.7% during 2002, while government consumption grew by 12.8%.

Investment, which had been predicted to improve in the second half of 2002, turned out to be unfavorable. For the year as a whole, it contracted by 0.2%, much lower than in 2001 (7.7%) and in 2000 (13.8%).

From the financing side, weak investment was reflected in limited bank investment credits. On the external side, exports dropped by 1.2%, much lower than the growth of 1.9% in the previous year. Low investment and exports are inherent in the high investment risk and deteriorating competitiveness of the Indonesian economy due to the structural problems. In addition, investment and exports were hurt by the weak global economy, more intense global and regional competition and on-going protectionism in several countries. In line with this, imports also declined, by 8.3%

On the fiscal side, implementation of the government budget during 2002 reflected financial consolidation to ensure medium-term fiscal sustainability. However, the deficit narrowed much more than expected, mainly due to very low realizations of development spending. The fiscal deficit for 2002 is estimated at 1.7% of GDP, lower than the budget target of 2.5%. On the revenue side, the tax ratio reached only 12.7% of GDP, mainly due to the under-performance of non-oil/gas income taxes and the VAT. Shortfalls in these tax revenues were offset by higher oil/gas revenues in line with the increase in world oil prices and other non-tax revenues. The overall revenue was 18.0% of GDP or roughly the same as the budgetary target.

Total realized spending was 19.7% of GDP or 4.7% lower than the initial target. As regards the impact of government spending on the economy, the fiscal stimulus was the same as last year, namely 11.8% of GDP. Of this stimulus, 7.0% of GDP was in the form of consumption and 4.8% of GDP in the form of investment. By contrast, transfer payments (mainly subsidies) declined significantly, from 5.2% to 2.4% of GDP.

On the monetary side, government rupiah spending was quite conducive to supporting monetary control. The net expansionary impact of government spending declined from Rp32.2 trillion last year to Rp19.5 trillion. Bank Indonesia was able to absorb this amount, due to a net inflow of foreign exchange from the government sector equivalent to Rp24.3 trillion.

During 2002, non-oil/gas exports reached only $45.3 billion in the reporting year, up by only 1.0% from 2001. Oil/gas exports reached $12.7 billion, representing a rise of 1.3%. Total imports increased by 0.5% to $34.8 billion; oil/gas imports increased by 15% while non-oil/gas imports declined by 2.4%.

The deficit on the services account is estimated to be $15.9 billion in the reporting year, virtually unchanged from 2001 ($15.8 billion). The Bali tragedy, which reduced inflows from tourism, was roughly offset by lower foreign interest payments and by lower oil sector payments in line with a lower volume of oil production. The overall surplus in the current account in 2002 was estimated to reach $7.3 billion (3.9% of GDP), higher than the pervious year's surplus of $6.9 billion (4.7% of GDP).

For its part, the capital account improved with the rescheduling and restructuring of debt and inflows on private account. The success of the government in rescheduling debts through the Paris and London Clubs contributed appreciably to the narrower (by $0.6 billion) deficit on the official capital account. The deficit on the private capital account narrowed significantly in line with the success in debt restructuring, and inflows from privatization and divestment. These positive developments caused the deficit on private account to narrow to $3.0 billion, compared with $8.3 billion in the previous year. Hence, the deficit on capital account narrowed to $3.6 billion from $9.0 billion last year. On this basis (and considering the wider surplus on current account, noted earlier), the overall balance of payments was in a surplus of $3.6 billion, much better than the previous year's deficit of $1.38 billion. With this surplus, official international reserves reached $31.6 billion by the end of 2002, equivalent to 6.6 months of imports and government debt service.

The appreciation of the exchange rate and the ongoing weak aggregate demand caused inflation to trend down. On average, the rupiah appreciated by 10.10% in 2002, from Rp10.255 to Rp9.316 per dollar; on a point-to-point basis, it appreciated by 16.2%, from Rp10.400 to Rp8.950 by the end of 2002. Concerning fundamentals, the appreciation was driven by a shift in the balance of payments from a deficit to a surplus. Regarding market sentiment, the stronger rupiah was supported by positive sentiment driven by success in debt rescheduling; disbursements of the IMF loan; up-grading of Indonesia's debt rating by Fitch and Standard & Poor's; and the implementation of privatization and the divestment of BCA down to 6.96% from 10.04% in the previous year. Inflationary pressures originated in, among others, government policy on prices and incomes. These pushed up prices by 3.31%, compared with 3.83% in 2001.

Table 1 Selected Macroeconomic Indicators, Fiscal Years 1998-2002, Inclusive.

Macroeconomic Indicator (%)	1998	1999	2000	2001	2002
GDP Growth	-13.1	0.8	4.9	3.4	3.7
Inflation	77.6	2.0	9.4	12.6	10.0
Average Interest*	39.0	12.8	14.3	17.6	13.1
Unemployment	5.5	6.3	6.2	8.1	9.1
Current Account to GDP	4.2	4.1	5.3	3.4	3.9
DSR	57.9	56.8	41.1	41.4	32.2
GNP	348.409.500	357.207.400	372.625,800	392.291.900	404.522.700
GDP	376.374.700	379.352.500	398.016,900	411.691.000	426.740.500
Per Capita GDP (million rupiah)	1.87	1.87	1.93	1.97	2.01

Source: BPS-Statistics Indonesia, Bank of Indonesia, Ministry of Manpower

* Three-monthly certificate of Bank of Indonesia

1) Macroeconomic Activity

a. International Environment

Trade Balance

During the reporting year, the overall balance of payments improved from the year before. This was reflected in a widening of the current account surplus and a narrowing of the deficit on capital account. The source of current account surplus came from exports that increased more rapidly than imports. The export performance was especially encouraging because export had declined sharply in 2001. On capital account, successful rescheduling of offshore loans by both the government and private sector contribute to smaller deficit in government and private net capital flows.

Although exports improved in 2002, they still faced several problems coming from external and internal sources. Externally, global economic conditions remained sluggish, particularly in several advanced countries that are Indonesia's major export markets.

In addition, Indonesia's exports continue to face several problems related to heightened global competition and tighter quality standards imposed on several commodities by trading partners. Internally, exports in 2002 were hindered by various structural problems, such as labor and law enforcement problems, security conditions, and ongoing low investment. This was reflected in a drop in non-oil/gas imports, especially raw materials and capital goods, which are mostly used by industries that produce exports.

On the capital account side, the narrower deficit on private capital flows was the result of privatization and divestment, rescheduling of private debts, issuance of several corporations' bonds abroad and larger loan drawdown by foreign investment companies. For its part, the narrower deficit on government capital flows mainly stemmed from declining payments on offshore debts due to successful rescheduling of government foreign debts and from larger disbursements of IMF loans.

On the basis of these developments, Indonesia's overall balance of payments shifted to a surplus of $3.6 billion in 2002 from a deficit of $1.4 billion in 2001. Reflecting this surplus, official foreign exchange reserves at the end of 2002 stood at $31.6 billion.

Table 2 Balance of Payment

Balance of Payments (millions of $)					
Item	**1998**	**1999**	**2000**	**2001**	**2002**
A. Current Account	4,097	5,783	7,991	6,901	7,262
1. Merchandise	18,429	20,644	25,042	22,696	23,147
a. Export f.o.b	50,370	51,242	65,407	57,365	57,970
- Non-oil and gas	42,961	40,988	50,341	44,905	45,253
- Oil and gas	7,419	10,256	15,066	12,560	12,717
b. Import f.o.b	-31,942	-30,596	-40,365	-34,668	-34,823
- Non-oil and gas	-29,087	-26,631	-34,378	-28,961	-28,269
- Oil and gas	-2,855	-3,967	-5,688	-5,707	-6,564
2. Services (net)	-14,332	-14,861	-17,051	-15,796	-15,885
- Non-oil and gas	-11,420	-11,660	-12,500	-11,501	-11,641
- Oil and gas	-2,911	-3,201	-4,551	-4,294	-4,244
B. Capital Account	-3,876	-4,571	-6,772	-8,992	-3,592
1. Official capital movement (net)	9,970	5,352	3,217	-741	-556
a. Inflows	13,174	7,932		1,107	1,266
- Program aid	1,821	3,870	1,361	507	773
- Food aid	160	273	76	0	0
- IGGI/CGI	2,787	2,408	2,420	1,963	1,358
- Non-IGGI/CGI	8,406	1,381	1,130	-1,363	-965
b. Debit repayments[1)]	-3,204	-2,581	-1,769	-1,847	-1,823
2. Private capital movement (net)	-13,346	-9,923	-9,989	-3,252	-3,035
a. Direct investment (net)	-356	-2,745	-4,550	-5,976	-6,940
b. Others (net)	-13,490	-7,178	-5,439	-2,375	3,905
C. Total (A+B)	221	1,213	1,219	-2,091	3,670
D. Errors and ommissions (net)	2,123	2,079	3,823	713	-115

E. Monetary Movement[2]	-2,346	-3,292	-5,042	1,378	-3,556
[1] including rescheduling					
[2] minus (-): surplus, vice versa					

*Source: Bank of Indonesia, 2003

Various government policies contributed to these encouraging balance of payments developments. In the areas of exports and imports, the government established the Coordinating Team for Increasing Smooth Flows of Export and Import Goods. The task of the coordinating team is to formulate integrated and coordinated policy measures to facilitate smooth flows of international trade and to increase Indonesia's export competitiveness.

Current Account

During 2002, the current account recorded a surplus of $7.3 billion, up from $6.9 billion in the previous year. This rises in the current account surplus mainly originated in the trade account, which was in a surplus of $23.1 billion. Furthermore, the improved trade account stemmed from higher exports (both oil/gas and non-oil/gas) and a decline in non-oil/gas imports, although oil and gas imports rose appreciably. The decline in non-oil/gas imports largely occurred in raw materials and capital goods, reflecting continuing weak domestic investment and production.

Export

Indonesia's export performance during the reporting year improved relative to the previous year. Total exports reached $58.0 billion, up from $57.4 billion last year. Non-oil/gas exports amounted to $45.253 billion, whereas oil and gas exports reached $12.717 billion.

Table 3 Exports of Oil and Gas

Exports of Oil and Gas (millions US $)					
Countries	**1998**	**1999**	**2000**	**2001**	**2002**
Export value [1]					
Oil and oil products	4,141	5,680	7,954	6,921	6,679
Gas					
- LNG	3,046	4,207	6,756	5,270	5,728
- LPG	233	369	356	369	310
Export Volume					
Oil and oil products	340	336	291	297	275
Gas					
- LNG(millions ofMMBTU)[2]	1,364	1,511	1,400	1,222	1,377
- LPG (millions of Mton)	1,620	1,865	1,215	1,458	1,297

1) Consist of crude oil and oil product (in millions $)
2) MMBTU: Million British Thermal Unit

* Source: Bank of Indonesia, 2003

During the reporting year, non-oil/gas exports increased by 1.0%, compared with a decline of 11.0% the year before. By sector, this increase stemmed from the agricultural and industrial sectors, which grew by 10.2% and 0.9%, respectively. Exports from mining sector declined by4.4%. As was the case last year, the structure of non-oil/gas exports was still dominated by industrial sectors, which accounted for 79.5% of total non-oil/gas export values. Mining and agriculture had shares of 11.9% and 8.7%, respectively.

Table 4 Export Value of Non-oil and gas by Commodity

Export Value of Non-oil and Gas by Company (millions of US$)					
Item	**1998**	**1999**	**2000**	**2001**	**2002**
Total Exports	42,951	40,907	50,341	44,805	45,253
Agriculture	5,091	4,179	4,152	3,657	3,921

Wood	53	86	97	105	58
Rubber	1,006	854	883	810	963
Coffee	602	465	327	161	220
Tea	169	102	115	97	114
Pepper	196	183	227	106	77
Tobacco	138	108	80	96	74
Tapioca	21	23	11	12	4
Animal and animal products	1,779	1,574	1,622	1499	1467
- Shrimps	1,041	866	971	864	772
Skins	72	74	94	81	68
Others	1,056	710	695	592	875
Mining	4,703	4,130	5,566	5,620	5,370
Tin	260	242	234	245	207
Copper	1,792	1,441	2,272	2,416	2,224
Nickel	165	219	360	299	47
Aluminum	202	138	260	212	233
Coal	1,669	1,665	1,635	1,945	2,144
Others	614	425	805	503	436
Manufacturing	33,157	32,678	40,623	35,628	35,962
Textiles and textile products	7,034	6,291	7,317	6,752	6,116
- Garments	3,769	3,450	4,067	3,821	3,256
Handicrafts	2,089	569	548	532	501
Woods and wood products	4,245	4,526	4,495	3,962	3,783
- Plywood’s	2,329	2,259	1,966	1,725	1,515
Rattan products	38	255	296	272	200
Palm oil	868	1,369	1,265	1,343	2,068
Copra oil-cake	51	47	62	49	64
Chemical product	2,096	1,835	2,259	2,146	2,242
Metal products	1,387	1,078	1,217	1,131	1,043
Electrical appliances	2,813	3,365	6,366	5,115	6,562
Cement	87	143	141	170	113
Paper	2,471	2,645	3,046	2,677	2,500
Rubber products	415	374	440	429	520
Glass and glass-ware	269	279	349	306	309
Footwear	1,583	1,519	1,620	1,433	1,349
Plastic products	935	860	1,216	1,024	1,063
Machinery and mechanical	1,478	1,863	3,783	3,054	3,128
Others	5,275	5,670	6,205	4,233	4,309

Source: Bank of Indonesia, 2003

Compared with the previous year, industry’s share of exports is relatively unchanged; the share of mining dropped from 12.5%, while agriculture’s share sector rose from 7.9%. In the agricultural sector, export values reached $3.9 billion, up from $3.6 billion the year before. Rising exports occurred in several main commodities, such as raw rubber (19.0%) and coffee (36.7%).

In the industrial sector, the value of total exports reached $36.0 billion, which is up 0.9% from the year before. In the mining sector, exports amounted to $5.4 billion, a drop of 4.4% from the year before. There was a drop in exports of several commodities, such as copper (-8.0%) and nickel (-84.4%), attributed to falling prices in the international market. Nonetheless, the export value of aluminum, coal and tin rose by 10.1%, 10.2%, and 16.8%, respectively.

Import

In line with rising exports, import edged up by 0.5% in 2002 to $34.8 billion. This was accounted for by rising oil and gas imports, to $6.6 billion from $5.7 billion in 2001. On the other hand, non-oil/gas imports declined, from $29.0 billion to $28.3 billion. By category of goods, the decline in non-oil/gas import value occurred in raw materials and capital goods. These dropped by 2.9% and 6.7%, respectively while imports of consumer goods rose by 12.7%.

Table 5 Non-Oil and Gas Import

Non-Oil and Gas Import by Goods Categories *						
Item	Value (million of $)		Growth (%)		Share (%)	
	2001	2002	2001	2002	2001	2002
Consumption goods	2.287	2.576	-5,8	12,7	7,9	9,1
Raw Material goods	20.886	20.281	-15,7	-2,9	72,1	71,8
Capital goods	5.789	5.402	-19,2	-6,7	20,0	19,1

* Source: Bank of Indonesia, 2003

These developments reflected continuing low investment and production activities in Indonesia. Meanwhile, the rise in oil and gas imports was largely accounted for by oil, which jumped by 16.4%; gas was little changed from the previous year. As was the case in the previous year, non-oil/gas imports in 2002 were dominated by raw materials category, followed by capital and consumer goods.

Viewed by country of origin, the shares of non-oil gas imports (cif) from countries in Asia reached 59.0%, Europe 18.5%, American region 14.3%, Australia Oceania 7.0% and Africa 1.3%.

The largest non-oil/gas exporter to Indonesia from Asia was Japan, followed by ASEAN and China. On a country basis, import shares from Japan and China in 2002 experienced rises relative to the year before, from 16.9% and 6.7% to 18.1% and 8.6%, respectively. Meanwhile, the share from America was 14.3%, down from 15.8% the year before.

Table 6 Import Value of Non-oil and gas by country of origin (FOB) (millions of $)

Continent/Country	2000		2001		2002[1]	
	Value	Share	Value	Share	Value	Share
Africa	496	1,3	540	1,7	390	1,3
America	6.086	16,4	4.943	15,8	4.340	14,3
United State	4.362	11,8	3.926	12,5	3.229	10,6
Latin America	722	1,9	469	1,5	557	1,8
Canada	868	2,3	486	1,6	512	1,7
Others	133	0,4	61	0,2	42	0,1
Asia	20.996	56,6	17.657	56,4	17.916	59
ASEAN	5.077	13,7	4.675	14,9	4.693	15,4
Brunei	2	0	2	0	2	0
Malaysia	906	2,4	882	2,8	948	3,1
Philippines	159	0,4	122	0,4	142	0,5
Singapore	2.613	7	2.414	7,7	2.221	7,3
Thailand	1.397	3,8	1.255	4	1.380	4,5
Hong Kong	488	1,3	326	1	293	1
India	627	1,7	638	2	794	2,6
Iraq	0	0	3	0	0	0
Japan	7.094	19,1	5.298	16,9	5.500	18,1
South Korea	2.474	6,7	2.264	7,2	1.790	5,9
Myanmar	29	0,1	26	0,1	46	0,2
Pakistan	73	0,2	89	0,3	61	0,2
Republic of China	2.414	6,5	2.089	6,7	2.600	8,6
Saudi Arab	301	0,8	264	0,8	211	0,7
Taiwan	1.718	4,6	1.430	4,6	1.283	4,2
Others	700	1,9	557	1,8	644	2,1
Australia/Oceania	2.558	6,9	2.386	7,6	2.114	7
Europe	6.950	18,7	5.803	18,5	5.628	18,5
European Community	5.255	14,2	4.543	14,5	4.281	14,1
Netherlands	611	1,6	440	1,4	446	1,5
Belgium	395	1,1	270	0,9	247	0,8
UK	934	2,5	757	2,4	526	1,7
Italy	455	1,2	522	1,7	566	1,9
Germany	1.727	4,7	1.644	5,2	1.648	5,4
France	648	1,7	517	1,6	523	1,7
Others	485	1,3	392	1,3	324	1,1
Former Soviet Union	319	0,9	210	0,7	226	0,7

Other Eastern Europe	65	0,2	57	0,2	92	0,3
Others	1.312	3,5	992	3,2	1.030	3,4
TOTAL	37.087	100	31.328	100	30.388	100
[1] Projection figures						

* Source: Bank of Indonesia, 2003

Capital Account

During 2002, the capital account was in a deficit of $3.6 billion, much narrower than the previous year's $9.0 billion. Both the private and government capital account made contributions in this regard; their deficits declined from $8.3 billion and $0.7 billion to $3.0 billion and $0.6 billion, respectively. The main factor was the rescheduling of government and private foreign debts.

International Reserves

With the balance of payments in an overall surplus of $3.6 billion, gross official international reserves rose by 12.7% during 2002, to $31.6 billion. This is equivalent to 6.6 months of imports plus government foreign debt payments.

Exchange Rate and Exchange System

The rupiah exchange rate appreciated significantly with lower volatility due to stronger fundamentals and improved sentiment, supported by intervention policy. After depreciating during 2001, the rupiah exchange rate appreciated significantly. Overall, it strengthened significantly, by 10.1% from an average of Rp10.255 per dollar in 2001 to Rp9, 316 in 2002.

Table 7 Average Prices of Foreign Currencies and Gold in Jakarta Market (rupiah)

Period	U.S $	Yen	Gold
December, 2001	10.260	79.83	85.000
2002 (Average)	9.316		
January	10.393	78.36	85.000
February	10.229	76.67	85.000
March	9.912	73.99	80.000
April	9.495	73.13	80.000
May	9.118	74.36	80.000
June	8.703	72.27	80.000
July	8.972	76.81	80.000
August	8.923	75.51	80.000
September	8.958	74.08	80.000
October	9.142	75.36	85.000
November	9.067	73.88	85.000
December	8.921	73.6	85.000

* Source: Bank of Indonesia, 2003 and BPS-Statistic Indonesia, 2003

The exchange rate's movements during 2002 were attributable to several factors, including fundamentals, sentiments and Bank Indonesia policy. From the side of fundamentals, the general strengthening during 2002 was mainly due to the balance of payment surplus accounted for by a narrowing deficit on capital account and a widening surplus on current account.

Concerning sentiments, positive factors were mainly associated with progress in economic restructuring, such as rescheduling foreign debts, disbursements of IMF loans, implementation of the banking divestment program and privatization of state owned enterprises. This positive development is confirmed by improvement in risk indicators such as credit ratings, risk premium and swap premium.

On the policy side, Bank Indonesia undertook various efforts, mainly in minimizing fluctuations of the rupiah. These included foreign exchange intervention and other less conventional policies, such as moral suasion vis-à-vis market players and monitoring foreign exchange transactions by banks and major non-bank market players.

Foreign Direct Investment

The total projects of foreign investment during January-March 31, 2003 were 239 projects with the investment value of US $ 2,491.4 million. There were also 66 approvals for extension for existing foreign companies with the investment value of US$ 181.2 million. These data figure-out that in spites of the foreign investor enter the green fields' activities (new investment), most importantly, the existing companies still have the opportunities to develop and expand their business activities in Indonesia. The investment comparison of the year 2003 to 2002 in the same period is as follows.

Table 8 Foreign Direct Investments

	Jan-March, 2002		Jan-March, 2003		Ratio	
	P (1)	I (2)	P (3)	I (4)	P (3:1)	I (4:2)
New Project	205	765,8	210	246,2	102,4	31,1
Expansion Project	57	482,2	66	181,2	115,8	37,6
Change of Status	19	58,7	29	2.064,4	152,6	3,516,2
Total	224	1,306,7	239	2,491,4	106,7	190,7

Sources: Investment Coordinating Board, 2003

P= Number of Project

I= Investment Value in US $ Million

Total Project = New Project + Expansion Project + Change of Status

Approved FDI (foreign direct investment) decreased significantly in 2002 compare to 2001, except for construction. Foreign investment on Trade, restaurant and hotel decreased 6,102.1 comparison of the year 2001 (7,232.6) to 2002 (1,130.5).

Since 1967, Japanese investments ranked number one in value of US$38.0 billion as 15% of total foreign investments, and ranked number three in project number of 1,344 as 12.8% of total foreign investment projects.

Table 9 Approved Foreign Investment Projects by Economic Sector (in million dollars)

Economic Sector	Project			Investment		
	2000	2001	2002	2000	2001	2002
Total	1.587	1.366	1.162	16,612.1	15,447.9	10,284
Agriculture, forestry, fishery	46	33	27	536.2	392.0	458.9
Mining and quarrying	28	22	14	58.6	119.7	49.3
Manufacturing	499	425	331	10,760.1	5,148.3	3,252.6
Electricity, gas, and water	2	4	3	1.2	37.3	90.2
Construction	30	29	40	194.9	47.6	282.1
Trade, restaurant and hotel	554	498	490	2,258.6	7,232.6	1,130.5
Transport and communication	68	84	66	1,163.4	376.4	3,713.3
Finance, insurance, estate, etc	29	20	6	174.7	177.5	7.3
Community, social and personal	285	218	164	928.2	1,524.5	804.9

Source: Investment Coordinating Board 2003, and BPS-Statistics of Indonesia, 2003.

Borrowing from Abroad, Aid

During 2002, Indonesia's foreign debt dropped by1.6% to $130.9 billion at year end.
This drop mainly originated in private debts, which fell sharply, by around $4.8 billion, as re-payments came due. Meanwhile, government debt rose by around $2.8 billion, largely due to the Japanese yen's appreciation against the dollar. The impact of this appreciation was quite significant because the share of government debt denominated in Japanese yen is around 33.7% of total government foreign debt.

At the end of 2002, total outstanding government foreign debts amounted to $74.2 billion. Of that total, multilateral debts were $28.8 billion; bilateral debts were $26.2 billion; export credit facilities were $16.4 billion; leasing debts were $369 million, commercial debts were $2.3 billion; and debts in the form of marketable securities owned by foreign investors were $95 million.

At the same time, private foreign debts were $56.7 billion, down 8.1% from the end of 2001. Of that total, financial institutions' debt was $7.4 billion; non-financial institutions' was $47.8 billion; and marketable securities held by foreign investors totaled $1.5 billion.

Table 10 Foreign Debt (in billion of dollars and Growth (%)

Economic Sector	Value			Growth	
	2000	2001	2002	2001	2002
Total	141.7	133.2	130.9	-8.5	-2.3
1. Government	74.9	71.4	74.2	-3.5	2.8
2. Private	64.6	60.1	55.2	-4.5	-4.9
Bank	8.9	6.6	4.9	-2.3	-1.7
Non Bank	7.7	1.1	2.6	-6.6	1.5
Non Finance Board	55.7	52.4	47.8	-3.3	-4.4
3. Securities	2.2	1.6	1.5	-0.6	-0.1

Source: Bank of Indonesia, Annual Report 2002

In 2002, the debt service ratio (DSR) was 32.2%, whereas the ratios of total debt to exports and GDP were 194.0% and 68.7%, respectively, at year end. Both these ratios improved from the year before. Except for the DSR, these ratios were getting closer toward the normal ranges set by the World Bank. On the overall, these ratios reflect less foreign debt burden and Indonesia's dependency on overseas financing.

Table 11 Debt Indicators (%), Debt to GDP, Debt to Export, and DSR

Debt Indicator	1997	1998	1999	2000	2001	2002
Debt to GDP	62.2	146.3	105	93.8	91.1	68.7
Debt to export	207.3	261.8	252.1	191	200.7	194
DSR	44.5	57.9	56.8	41.1	41.4	32.2

Source: Bank of Indonesia, Annual Report 2002

Viewed by creditor country, Japan was the largest creditor with total outstanding loans of $38.9 billion or 29.7% of Indonesia's total foreign debt. The US was second with total outstanding loans of $11.9 billion (9.1%), followed by Singapore, the Netherlands, Germany and Britain with total outstanding loans of $7.3 billion (5.6%), $6.4 billion (4.9%), $6.3 billion (4.8%), and $4.7 billion (3.6%), respectively. As was the case last year, international financial institutions such as the IBRD, IMF, and ADB constituted the largest institutional lenders with total outstanding loans reaching $10.7 billion (8.2%), $8.8 billion (6.7%), and $8.1 billion (6.2%), respectively.

b. Domestic Environment

Economic Growth Rate (GDP)

GDP increased by 3.7% in 2002, up from 3.4% in the previous year, but there was no improvement in the economic structure. On the domestic side, consumption remained the driving force of growth while investment declined. On the external side, net exports widened due to a sharp drop in imports that was larger than a contraction in exports. Recover in 2002, accompanied by several improved macro monetary indicators, such as inflation, the exchange rate, and interest rates. Gross Domestic Product (GDP) in nominal terms reached Rp1.610 trillion, and real GDP expanded by 3.7%, up from 3.4% in 2001.

Table 12 Economic Growth Rate (GDP) (%)

Items	2000		2001		2002	
	Growth	Contribution	Growth	Contribution	Growth	Contribution
Gross Domestic Product (real)	4.0	4.0	3.4	3.4	3.7	3.7
Consumption	3.0	3.1	4.8	3.7	5.5	4.3
Household consumption	3.6	2.6	4.4	3.1	4.7	3.3
Government consumption	6.5	0.5	9,0	0.7	12.8	1.0
Investment	13.8	2.3	7.7	1.7	-0.2	-0.1
Export of goods and services	26.5	6.4	1.0	0.6	-1.2	-0.4
Import of goods and services	21.1	4.4	8,1	2.0	-8,3	-2.2

Source: Bank of Indonesia, Annual Report 2002 and BPS-Statistics of Indonesia

With that growth, the level of GDP in constant prices reached Rp426.7 trillion, which is still below real GDP in 1997 (Rp433.2 trillion). This indicates that the Indonesian economy has not fully recovered from the crisis that has been going on for the past five years. GDP, as overall GDP recorded higher growth. While consumption still grew, the slowing growth of manufacturing was matched by an increased supply of imported consumption goods. This adequate supply of goods in domestic market created a tolerable demand pressure on prices. Declining investment caused economic capacity (especially in manufacturing) to slow down. At the same time, actual output did not increase significantly.

Table 13 Gross Domestic Product by Expenditure and Sector (trillion of rupiah)

Component	Constant 1993 Market Prices			Current Market Prices		
	2000	2001	2002	2000	2001	2002
By expenditure:						
Consumption	305.1	319.9	337.5	941.6	1,089.1	1,269.9
Private	276.4	288.5	302.1	850.8	975.7	1,137.7
Government	28.7	31.4	35.4	90.8	113.4	132.2
Investment	89.4	96.2	96.1	275.9	316.2	325.3
Change in stocks	-13.8	-15.9	-25.7	-72.2	-63.3	-95.6
Export of goods, service	116.2	118.4	116.9	542.9	612.5	569.9
Import of good service	99.9	106.9	97.9	423.3	505.1	459.6
Gross Domestic Product	398.0	411.7	**426.7**	1,264.9	1,449.4	**1,610.0**
Net factor income from abroad	-25.4	-17.4	-22.2	-92.2	-58.1	-77.8
Gross National Product	372.6	394.3	404.5	1,172.7	1,391.3	1,532.2
Less Net Indirect Tax	-11.7	8.9	18.9	-37.8	31.4	71.2
Less Depreciation	19.9	20.6	21.3	63.2	72.5	80.5
National Income	364.5	364.7	**364.3**	1,147.3	1,287.4	**1,380.5**
By sector:						
Agriculture, forestry	66.2	66.9	68.0	217.9	246.3	281.3
Mining and quarrying	38.9	38.9	39.8	175.3	191.7	191.8
Manufacturing	104.9	109.3	113.7	314.9	362.0	402.6
Electricity, gas, and water	6.6	7.1	7.5	16.5	21.2	29.1
Construction	23.3	24.3	25.3	76.6	85.3	92.4
Trade, restaurant and hotel	63.5	66.9	69.3	199.1	234.3	258.9
Transport and communication	29.1	31.2	33.6	62.3	75.8	97.3
Finance, rental and business	27.4	28.4	29.9	80.5	91.4	105.6
Services	38.0	38.8	39.6	121.9	141.4	150.9
GDP	398.0	411.7	**426.7**	1,264.9	1,449.4	**1,610.0**
GDP without oil and gas	363.8	379.0	393.7	1,081.4	1,261.4	1,421.7
GDP of oil and gas	34.2	32.7	33.0	163.5	188.0	188.3

Source: Bank of Indonesia, Annual Report 2002, BPS-Statistics Indonesia

Inflation

Inflation during 2002 was recorded at 10.03% lower than the previous year's 12.6%. The decline mainly occurred in the first semester when the drop was quite sharp, although it was abated in the second semester. This was mainly due to appreciation of the exchange rate and declining inflationary expectations. The exchange rate appreciated significantly during that period and was accompanied by low volatility, which held down inflationary pressures from the external side. The appreciating rupiah was particularly apparent in the traded goods category of the Consumer Price Index (CPI); those prices declined significantly in the middle of the reporting year.

By category, housing made the largest contribution to inflation during 2002, followed by food materials, transportation and communications, and processed food, beverages, and cigarettes clothing made a low contribution. Looking at the rise in prices among the broad categories, transportation and communications recorded the highest inflation (15.52%). This mainly originated in rising prices of transportation sub-categories (prices for fuel, diesel, and transportation tariffs) and communications sub-categories (telephone tariffs). By city, the highest inflation was recorded in Manado (15.22%) and the lowest in Ternate (6.40%). However, the largest contribution to overall inflation comes from a few major cities, mainly Jakarta (3.09%) and Surabaya (0.74%), because their weights in the index are large.

Table 14 Inflation Rates (%)

Category	1998	1999	2000	2001	2002
General	77.6	2.0	9.4	12.6	10.03
Food	118.4	-5.3	4.0	12.0	9.18
Housing	47.5	5.2	10.1	13.6	2.8
Prepared food	94.3	3.6	11.1	14.5	9.13
Transportation, communication	55.6	5.2	12.7	14.2	15.5
Education, recreation, sport	38.0	5.3	17.5	11.9	10.9
Clothing	98.7	6.5	10.2	8.1	2.7
Health	86.1	3.9	9.6	8.9	5.6

Source: Bank of Indonesia, Annual Report 2002, BPS-Statistics Indonesia

Consumption

In 2002, the contribution of consumption to GDP growth was 4.3%, up from 3.7% in 2001. This was due to higher consumption growth in both the private and public sectors. The growth of private consumption spending increased from 4.4% to 4.7% in the reporting year; government consumption increased by 12.8% in 2002, substantially above the previous year (9.0%). The growth of public consumption has exceeded that of private consumption since 2000.

Investment

Investment, which had been forecast to improve in the second half of 2002, remained weak. For the year as a whole, it contracted by 0.2%, far below the results for 2001 (7.7%) and 2000 (13.8%). Low investment reflected high risks and deteriorating competitiveness brought on by labor disputes, the implementation of regional autonomy, legal uncertainty, and security concerns that were heightened by the Bali tragedy. Other indicators of deteriorating investment include plunging (foreign and domestic) investment approvals and falling imports of capital goods and raw materials. The value of domestic investment (PMDN) approvals fell sharply by 57.0% in 2002, from Rp58.8 trillion (264 projects) in 2001 to Rp25.3 trillion (184 projects) in 2002.

Table 15 Approved Domestic Investment Projects by Economic Sector (in billion rupiah)

Economic Sector	Project			Investment		
	2000	2001	2002	2000	2001	2002
Total	392	264	184	93,897.1	58,816,0	25,307.6
Agriculture, forestry, fishery	42	18	10	4,482.7	1,318.4	1,453.8
Mining and quarrying	13	10	11	843.7	1,198.1	803.6

Manufacturing	211	141	100	84,069.1	44,387.3	15.851.4
Electricity, gas, and water	1	0	1	100.0	0	5.4
Construction	5	9	7	62.2	2,021.8	1,623.9
Trade, restaurant and hotel	36	12	28	445.1	2,541.9	1,188.5
Transport and communication	50	59	15	2,462.2	1,510.1	3,125.7
Finance, insurance, estate, etc	6	6	0	265.6	4,296.1	3.1
Community, social and personal services	28	9	12	1,166.5	1,542.3	1,252.2

Source: Investment Coordinating Board 2003, and BPS-Statistics of Indonesia, 2003.

Physical Capital

Within the raw materials and capital goods categories, imports of almost all goods declined, particularly mechanical machinery (in the capital goods category). Declines in this industry-supporting subcategories showed that there had been a decline in additions to machinery, due in part to continuing weak domestic investment

Table 16 Imports of Capital Goods

Item	2000	2001	2002	2002	
	Growth (%)	Growth (%)	Growth (%)	Value (million of US$)	Share of Growth (%)
Tractor & Agriculture equipment	144.1	-49.5	51.8	34	0.1
Handicraft & Accessories	-95.8	-16.8	-22.3	0	0.0
Container & Storage box	-21.3	23.1	3.2	61	0.2
Machinery	23.3	-7.8	-12.1	3,225	11.4
Generator & Electronics	26.8	-2.4	12.1	714	2.5
Locomotive, Ship & Aircraft	50.8	-44.2	-2.4	910	3.2
Craftsmanship Tools	30.5	-1.7	-2.8	39	0.1
Optical & Measurement Devices	57.0	-41.1	-7.3	326	1.2
Passenger Cars	797.4	-39.3	22.7	93	0.3
Total	33.6	-19.2	-6.7	5,402	19.1

Source: Bank of Indonesia, Annual Report 2002.

Capital Stock

In line with the firmer exchange rate and relatively stable domestic political and security conditions, the stock market improved during the first 4 months of 2002 before deteriorating through end-October. It closed the year on a minor up-tick. During the first 4 months, the composite index raised fairly steadily through April, reaching a peak of 551.07, the best since May 2000.

The volume of shares traded peaked at 35.72 billion shares (with a value of Rp20.3 trillion) in April, before dropping to 6.29 billion shares (with a value of Rp10.2 trillion) in December 2002. However, this value was still higher than the Rp6.6 trillion at the end of 2001. Market capitalization reached its highest value of Rp344 trillion (with 889.9 billion shares) in April, when it started on a downward trend, falling to Rp268.8 trillion (with 939.5 billion shares) at the end of 2002. This was still substantially above the end of 2001 when capitalization stood at Rp239.3 trillion (884.2 billion shares).

Table 17 Shares Trading at the Jakarta Stock Exchange, Year 2002

Month	Number of company	Shares trade volume			Average daily shares traded	
		Shares (billion)	Change	Value (trillion rupiah)	Shares(pc) (billion)	Value (trillion)
January	318	11.5	0,90	11.6	0.52	0.53

February	318	11.9	0,03	8.9	0.66	0.49
March	317	21.4	0,79	9.8	1.13	0.51
April	321	35.7	0,66	20.3	1.62	0.92
May	322	17.8	-0,5	11.7	0.80	0.53
June	324	12.4	-0,91	9.9	0.62	0.49
July	327	14.3	0,15	10.3	0.62	0.44
August	328	10.0	-0,29	7.0	0.46	0.32
September	327	8.4	-0,16	6.1	0.40	0.29
October	327	11.6	0,38	8.5	0.53	0.38
November	329	9.7	-0,16	6.3	0.63	0.30
December	331	6.3	-0,35	10.2	0.48	0.78

Source: BPS-Statistics of Indonesia, 2003 and Bank of Indonesia, Annual Report 2002.

Money Supply

On average during 2002, economic liquidity declined; real M1 and M2 were down by 1.9% and 3.5%, compared with the expansions of 7.5% and 3.0% in 2001.By the end of 2002, M1 reached Rp191.9 trillion, which is up Rp14.2 trillion from the previous year or reaching an annual growth of 8.0%. By component, this rise in M1 originated from expansions of Rp4.3 trillion in currency and Rp9.9 trillion in demand deposits.

Table 18 Money Supply in Circulation

Money in Circulation (trillion of rupiah)				
Item	**2000**	**2001**	**2002**	**Change**
M2	747.0	844.1	883.9	39.9
M1	162.2	177.7	191.9	14.2
Currency	72.4	76.3	80.7	4.3
Demand deposits	80.8	101.4	111.3	9.9
Quasi money	584.3	666.3	692.0	25.6
Time deposits in rupiah	292.0	340.0	359.8	18.9
Saving in rupiah	152.6	170.7	101.7	21.0
Deposits in foreign currency	140.2	154.8	140.5	-14.3
Factors affecting M2	747.0	344.1	383.9	30.9
Net foreign assets	210.7	234.0	250.7	16.7
Bank Indonesia	201.2	192.6	212.4	19.8
Commercial banks	9.5	41.4	38.3	-3.1
Net domestic assets	536.3	610.1	633.2	23.1
Net claims on central government	520.3	529.7	510.4	-19.4
Bank Indonesia	133.7	160.8	166.5	7.8
Commercial banks	386.6	368.9	341.8	-27.1
Claims to business sector	294.0	329.2	380.3	60.1
Total credit	269.0	307.6	365.4	57.8
Credit in rupiah	152.5	211.6	271.8	60.2
Credit in foreign exchange	116.5	105.0	93.6	-11.4
Other claims	25.0	21.6	23.9	2.3
Others (net)	-273.0	-248.8	-266.4	-17.7

Source: Bank of Indonesia, Annual Report 2002.

Employment

At the end of 2002, the working age population reached 148.4 million people, 5 up from 144 million a year previously. Of that number, 67.7% or 100.5 million belonged to the work force. Also in 2002, total employment (that is, the number of citizens who are working) reached 91.6 million, which is up 1.7% compared to 2001. On this basis, the employment ratio (that is, total employment as a percentage of total labor force) slipped to 91.2% from 91.9% in 2001. On the other hand, the total of ***open unemployment***, which probably is the most common indicator of unemployment, but has actively, sought employment, also reached 1.1 million (9.1 million in 2002 and 8.0 million in the previous year).

Table 19 Labor Force and Unemployment

Labor Force and Unemployment (million of people)						
	1997	1998	1999	2000	2001	2002
Population	195.8	198.5	200.3	205.8	208.9	212.
Economically Active Population	135.1	138.6	141.1	141.2	144.0	148.4
Labor Force	89.6	92.7	94.8	95.7	98.8	100.5
Labor Force Participation Rate (%)	66.3	66.9	67.2	67.8	68.6	67.8
Employed	85.4	87.7	88.8	89.8	90.8	91.6
Open Unemployment	4.2	5.1	6.0	5.8	8.0	9.1
Non-Labor Force	45.5	45.8	46.3	45.5	45.2	48.3
Not Economically Active	60.7	59.9	59.2	64.6	64.9	63.6

Source: Bank of Indonesia, Annual Report 2002.

Minimum Wages

On average, the provincial minimum wage (UMP) in 2002 reached Rp362,743 per month, which is up 18.1% from the previous year. However, this increase is still lower than the rise in basic needs (KHM) which reached around Rp422.347/month in 2002, up 23.0% over 2001. Relatively high inflation limited gains in workers' purchasing power; the increase in real minimum wages declined from 22.4% in 2001 to 7.3% in 2002.

Income Per Capita

In 2002, the total population of Indonesia was estimated to reach some 212 million. Nominal income per capita in 2002 reached Rp7.6 million or equivalent to $811, which is up substantially from $677 in 2001. In real terms, income per capita in 2002 reached around Rp2 million, or equivalent to $215.

2. Fiscal Position

a. Government Expenditure and Public Borrowing

Government Expenditure

Realization of government expenditures is below target. In nominal terms, realizations reached Rp327.9 trillion or 4.7% below target; in percentage of GDP, they were 19.7% or below the budget plan of 20.4%. Relative to last year, this percentage is down appreciably; in 2001, it was 22.9%. The decline in 2002 is mainly due to a significant drop in funds allocated for subsidies.

Table 20 Government Revenues & Expenditures and Budget Deficit (billions of rupiah)

Items	2000	2001	2002		2003[1]
			Budget	Realization	

Revenue and grand	**205.334**	**301.078**	**301.874**	**300.188**	**336.156**
Domestic Revenue	205.334	300.600	301.874	299.887	336.156
Domestic taxes	108.884	175.974	207.029	200.325	241.742
International trade taxes	7.028	9.567	12.599	10.625	12.398
Non-tax revenue	89.442	115.059	82.247	88.933	82.015
Grants	0	478	0	301	0
Expenditure	**221.467**	**341.563**	**344.009**	**327.863**	**370.591**
Central government	188.392	260.508	246.040	229.341	253.714
Current	162.577	218.923	193.741	189.069	188.584
Personnel	29.613	38.713	41.298	39.687	50.240
Goods	9.605	9.931	12.863	12.433	15.427
Interest	50.068	87.142	88.500	89.868	81.975
Subsidy	62.745	77.443	41.586	40.006	25.465
Other	10.546	5.694	9.494	7.076	15.476
Development	25.815	41.585	52.299	40.271	65.130
Program aid	8.845	21.371	26.469	27.639	46.230
Project aid	16.970	20.214	25.830	12.632	18.900
Regional	33.075	81.054	97.969	98.522	116.878
Balanced fund	33.075	81.054	94.532	94.763	107.491
Revenue share	4.268	20.008	24.600	24.992	27.896
General allocation	28.807	60.346	69.114	69.135	76.978
Specific allocation	-	701	817	636	2.617
Autonomous fund	-	-	3.437	3.759	9.387
Budget deficit	**-16.133**	**-40.485**	**-42.131**	**-27.675**	**-34.435**
Domestic Financing	5.937	30.218	23.501	20.561	22.450
Domestic bank	-12.964	-1.227	-	-4.713	8.500
Domestic non bank	18.900	31.445	23.501	25.274	13.950
Privatization	-	3.465	3.952	7.665	8.000
Assets selling	18.900	27.980	19.549	19.549	18.000
Government bond	-	-	-	-1.939	-12.050
Foreign Financing	10.196	10.267	18.630	7.116	11.986
Gross drawing	17.818	26.152	35.360	19.374	29.250
Program loan	849	6.416	9.530	7.042	10.350
Project loan	16.970	19.736	25.830	12.332	18.900
Amortization	-7.623	-15.885	-16.730	-12.259	-17.264
Net Financing	**16.132**	**40.485**	**42.131**	**27.675**	**34.435**

Source: Ministry of Finance (Jakarta, 2003) and Bank of Indonesia, Annual Report 2002.
[1] Budgets

Composition

By major expenditure category, central government routine expenditure was 57.7% of total government expenditures, followed by regional budget expenditure (30.0%) and development expenditures (12.3%). Compared with budget plans, central government routine expenditures (2.4%) and development expenditures (23.0%) under budget estimates, whereas budget allocation for regional expenditure was a bit higher than budgeted. Other notable budget allocations included interest on loans (27.4% of total government expenditures), general allocation funds for the regions (21.1%) and subsidies (12.2%).

Sector

Sector of trade, finance, and cooperatives dominated current expenditure by 77.89% in 2003 (146.9/188.6 x 100%), while education and culture dominated development expenditure by

23.12% (15.06/65.13 x 100%). Allocation to local government decreased either current expenditure from 0.1 trillion in 2002 to 0.09 trillion in 2003 or development expenditure from 3.7 trillion in 2002 to 2.98 trillion in 2003, due to decentralization in 2003 and allocation to regional expenditure. Allocation of expenditure by sector showed some improvement.

Table 21 Budgets of Current and Development Expenditure (trillion of rupiah)

Sector	Current		Development	
	2002	2003	2002	2003
Total	195.0	188.6	52.3	65.13
Manufacturing	0.0	0.03	1.8	1.07
Agriculture, forestry, fishery	0.8	0.9	3.7	4.73
Irrigation	0.0	0.03	3.7	4.76
Manpower	0.2	0.2	0.2	0.35
Trade, finance, cooperative	160.6	146.9	0.9	1.59
Transportation, geophysics	0.4	0.52	7.8	9.05
Mining and energy	0.3	0.37	3.8	3.18
Tourism, communication	0.1	0.21	1.7	0.44
Local government	0.1	0.09	3.7	2.98
Environment, resources	0.5	0.57	0.7	0.51
Education, culture, sport	4.5	5.38	11.3	15.06
Demography and family	0.7	0.81	0.3	0.45
Social affair, health	0.7	0.40	4.9	6.59
Dwelling and residence	0.1	0.06	1.1	1.85
Religious	1.4	1.61	0.1	0.13
Science and technology	0.7	0.76	0.7	1.11
Law	1.4	1.76	0.5	1.02
Civil servant, control	5.5	5.96	1.3	2.72
Domestic politics, int'l	2.4	3.14	0.2	0.33
Defense and security	14.6	18.76	3.9	7.19

Source: Ministry of Finance (Jakarta, 2003)

Public Borrowing

Government foreign debts at the end of the reporting year represented 56.7% of Indonesia's total foreign debts. Meanwhile, the shares of private financial and non-financial institutions' debts (including marketable securities) stood at 5.7% and 37.6%, respectively.

b. Aggregate Tax Revenue

The main contributor to government revenues continued to be tax revenues, which covered 70.1% of total revenues in Year 2002. However, the tax ratio was only 12.4% of GDP in Year 2001. Relatively low taxes mainly originated in the most important components of tax revenues, namely non-oil/ gas income tax and value added tax. This was due to postponement of the implementation of several tax measures and economic activity that was lower than assumed.

Table 22 Tax Revenue in Domestic Revenue of Directorate General of Taxes (DGT)

Year	DGT's Tax Revenue (Rp billion)	Domestic Revenue (Rp billion)	DGT's Role (%)
1996/1997	50.417,2	87.630,3	57,5
1997/1998	62.705,8	112.275,5	55,8

1998/1999	87.725,7	158.042,5	55,5
1999/2000	110.534,2	204.432,6	54,1
2000	97.597,6	205.334,5	47,5
2001	158.580,1	300.599,5	52,7
2002	210.162,0	299.755,0	70,1
2003	254.140,2	336.156,0	75,6

* Source: Ministry of Finance the Republic of Indonesia 2003

III. Tax Structure: Institutions and the Reality

1. Tax Structure

Introduction

The 1984 tax reform has changed the Indonesian tax system, which was based on the official assessment to the self assessment system. In order to encourage higher voluntary compliance, the Directorate General of Taxes keeps on performing counseling continually, increasing services provided for taxpayers, controlling tax compliance and enforcing fines for those who break the laws.

Profile of the Directorate General of Taxes

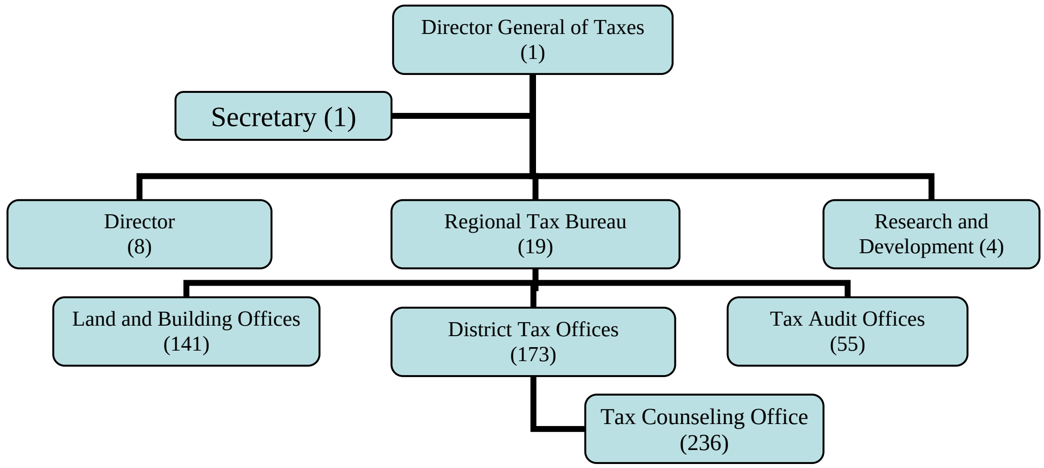
The head office of the Directorate General of Taxes (DGT) is located on Jalan Jenderal Gatot Subroto 40-42, Jakarta. The Directorate General of Taxes has 8 director, 19 regional tax offices, 55 tax audit and investigation offices, 173 district tax offices, 141 land and building tax offices, and 236 tax counseling offices. Staff based on Echelon and Function.

Table 23 Human Resources Directorate General of Taxes

Echelon	Number	Function
I	1	Director General
II	32	Secretary of the Directorate General of Taxes, Director, and Head of Regional Offices
III	510	Deputy Directors, Head of Division, Head of Department, Head of Tax Districts Offices, Head of Tax Audit and Investigation Offices, Head of Land and Building Tax Offices
IV	3.449	Head of Section, Head of Sub Department, Head of Tax Counseling Offices
V	4.868	Staff Coordinator
-	1.896	Functional Officer Tax Auditor Land and Building Tax Appraiser Programmer
Total	10.752	

Source: Directorate General of Taxes, annual report 2001

The structure of Directorate General of Taxes is as follows:



Analysis on the Performance of Tax Revenue Collection

The performance of tax revenue collection usually is measured by using following indicators: tax ratio and cost of tax collection. Tax ratio is the ratio of total tax revenue (realization) to gross domestic product.

Table 24 Tax Ratios (%)

Year	Directorate General of Taxes	Non Directorate General of Taxes	Total
1995/1996	9.7	1.6	11.2
1996/1997	9.9	1.4	11.2
1997/1998	9.9	1.3	11.2
1998/1999	9.3	1.5	10.8
1999/2000	9.7	1.4	11.1
2000	9.9	1.9	11.8
2001	10.6	1.8	12.4

Source: Directorate General of Taxes, annual report 2001

Table 25 Cost of Tax Collection Ratio

Year	Cost Incurred (billion Rp)	Tax Revenue (billion Rp)	Ratio (%)
1995/1996	213.7	41,878.1	0.51%
1996/1997	251.1	50,417.2	0.50%
1997/1998	168.6	62,705.8	0.27%
1998/1999	294.0	87,725.8	0.34%
1999/2000	N/A	N/A	N/A
2000	334.1	97,484.8	0.34%
2001	516.8	135,478.4	0.38%

Source: Directorate General of Taxes, annual report 2001

Taxpayers' Compliance

The Directorate General of Taxes continuously encourages taxpayer voluntary compliance with the tax laws and regulations. The Directorate General of Taxes also keep working to make compliance easier and lest costly, while being fair and firm with taxpayers who fail to comply. Besides carrying out enforcement activities such as tax audits and investigations, the Directorate General of Taxes also carries out activities that help taxpayers to comply, i.e. by providing tax counseling and excellent services. Compliance in the Submission of Annual Tax Return, The Annual Tax Return is a form used by a taxpayer to report the calculation, payment of tax due, tax objects and non tax objects, assets and liabilities within a tax year.

Table 26 Submission of Annual Tax Return

	1998	**1999**	**2000**
Income Tax Art. 25 Corporate	53.1%	54.7%	36.72%
Income Tax Art. 25 Individual	54.9%	50.7%	32.49%
Income Tax Art. 21	53.6%	52.6%	N/A

Source: Directorate General of Taxes, annual report 2001

The date-line for the submission of the annual tax return is at the latest three months from the end of a tax year. However, on the request of a taxpayer, the Directorate General of Taxes may extend the dateline for the additional six months. Taxpayers who fail to submit the tax return by the dateline will be fined Rp100.000.

Table 27 Registered Taxpayers

Types of Tax	Per 1 Jan 1997	Per 1Jan 1998	Per 1 Jan 1999	Per 1 Jan 2000	Per 31 Des 2000	Per 31 Des 2001
Income Tax Art. 21	637,586	694,187	737,306	808,617	873,437	845,283
Income Tax Art. 22	112,475	118,612	125,201	135,338	142,571	22,509
Income Tax Art. 23	477,307	524,654	551,556	598,783	635,008	666,325
Income Tax Art. 25 Individual	1,193,899	1,263,993	1,291,906	1,311,582	1,320,157	1,552,816
Income Tax Art. 25 Corporate	479,926	523,546	548,657	607,066	660,736	738,326
Value Added Tax	338,922	362,838	375,529	392,515	419,002	464.471

Source: Directorate General of Taxes, annual report 2001

On-line Payment System

On-line Payment System has been applied in six Land and Building Tax offices located in Surabaya, East Jakarta, Central Jakarta, West Jakarta, North Jakarta, and South Jakarta since August 1999. The system enabled taxpayers to pay taxes (currently only for land and building taxes) on-line through 162 banks in those cities. The system is a coordinated work between the Directorate General of Taxes and local governments. Telephone Information Service Taxpayers (especially land and building taxpayers) may ask any information related to land and building taxes by using a telephone. PIT has been applied in 37 of 107 lands and building tax service offices, particularly those located in Java. Currently, PIT is developed by Directorate General of

Taxes and third parties. In Fiscal Year 2002, Directorate General of Taxes has already applied on-line payment system in District Tax Officers. Taxpayer enabled pays their tax obligation in more than 80 banks in Indonesia by on-line system program.

Internet

The Directorate General of Taxes used internet to give information and to consult public regarding tax matters. On the Directorate General of Taxes' web site (www.pajak.go.id), people may find tax laws and regulations, the latest news, and also tax forms.

Human Resources

The Directorate General of Taxes in its human resources management focuses on professionalism improvement with integrity and high morale to generate staffs that are willing to provide excellent services to public. The Directorate General of Taxes is committed to develop its staff to their potential by providing them appropriate training and career developments (rotation and promotion).

Tax Reform

The rapid development of the economy over the subsequent decades, including the emergence of business forms and practices, led the government to enact amendment legislation twice, in the year of 1994 and 2000. The prime goals of the new legislation include a further broadening of the tax base in line with the enhanced economic capabilities of the taxpayers and securing increased revenues from taxes. In addition, its provisions also reflect wider aims of encouraging and supporting development through:

- Enhancing national self reliance in the development financing;
- The promotion of equity in development and investment throughout Indonesia;
- Supporting export growth, small scale business and human resources development;
- Creating a more efficient tax apparatus and securing improved enforcement of the tax regulation.

2. Tax Law Amendments

The Indonesian Government has recently passed a number of broad ranging amendments to the tax law arising from the recent tax reform review. On 2 August the President signed new laws covering the following taxes:

a. General Tax Provisions and Procedures (Law No. 16/2000)
b. Income Tax (Law No. 17/2000);
c. Value Added Tax ("VAT") and Luxury Sales Tax ("LST") (Law No. 18/2000);
d. Tax Collections through Distress Warrants (Law No. 19/2000);
e. Duties on the Acquisition of Title to Land and Buildings (Law No. 20/2000).

These new laws apply from 1 January 2001.

Summary of Major Changes:

The amending laws mentioned above contain numerous changes to the existing tax rules. In some cases they represent mere technical adjustments to clarify existing positions or to enshrine in the law positions that were previously only set out in Circulars or Decrees. In other cases, the amendments represent significant changes in taxation principles. Examples of these significant changes include:

- the requirement for all individuals to register for tax purposes
- the partial removal of the exemption for inter-company dividends
- the taxability of benefits in kind provided by "final tax" taxpayers
- the legislative support for Advanced Pricing Agreements
- the ability to apply for monthly refunds of VAT (rather than just annually), and

- the expansion of distress warrants to cover officers of taxpayer companies.

a. Tax Law of General Provision and Taxation Procedure

1) Tax Registration - Individuals

Under the existing law every "taxpayer" is required to register and obtain a tax identification number (NPWP), except that individuals need not register if their only income is from one employer. This "one employer" exemption has been repealed and all individuals are required to register unless their annual income is below the taxable threshold. This applies equally to all Indonesian residents regardless of nationality. This is one of the first steps in a program to increase individual tax compliance.

2) Tax Return Filing

Changes include:

a) Returns, including those for individuals, may now require information on assets and liabilities, allowing the DGT to focus on changes in a taxpayer's net worth.
b) The DGT can extend the time for filing a return up to 6 months (currently there is no provision on the length of extensions but in practice 3 month extensions have been given).
c) The penalty for failure to file a return will be Rp50.000 (monthly returns) and Rp100.000 (annual returns). This is double the current penalties.
d) A return can be revised within two years of the relevant tax period, provided an audit has not started. A tax audit will have started once a tax audit notification letter is delivered.

3) Tax Period

The DGT has been given the ability to approve a "tax period" of up to three months. This is a significant advantage as taxpayers who obtain approval for a tax period in excess of the standard one month will be able to file fewer tax returns.

4) Tax Refunds

The DGT will be able to make "advance refund payments" (i.e. prior to a tax audit). Taxpayers will need to meet certain criteria which include:

- Acceptable taxpayer compliance;
- No outstanding tax liabilities;
- An unqualified opinion in audited financial statements by a public accountant; and
- Further criteria yet to be determined by the Ministry of Finance (MoF).

The DGT can undertake an audit where a taxpayer has received an advance payment. If the audit results in an underpaid tax position, a 100% penalty will be imposed. This will significantly reduce the attractiveness of this concession.

5) Applications for Review

The current law allows the DGT to correct tax collection and assessment letters for mathematical errors, types etc. This will be extended to decisions on tax objections, reductions, write-offs of administrative fines, cancellations of tax assessments, and early repayments of overpaid tax. The current law has no time limit by which the DGT must decide on applications for corrections. The new law will require the DGT to issue a decision within 12 months of the receipt of an application. If no decision is issued within this period, the application is deemed to have been approved.

6) Interest on Tax Overpayments

Taxpayers are currently entitled to interest at 2% per month for a maximum of 24 months if a tax objection or appeal results in a tax overpayment. The new law will extend this to *interest penalties* on late payment of tax assessments.

7) Joint and Several Liabilities

The new law limits the joint and several liabilities for VAT and Luxury Sales Tax of a purchaser of goods or recipient of services. Provided a taxpayer can show evidence of payment of VAT and LST to the vendor or service provider they will no longer be jointly and severally liable.

8) Self-assessment System

The concept of self-assessment has been restored in the new tax laws after being dropped in the 1994 amended tax law. A return lodged by a taxpayer is now assumed to be in accordance with the law unless the DGT can prove that it is incorrect. This represents a favorable development for taxpayers in any referral of matters to the Tax Court.

9) Other Issues

There have been a number of other changes to the general rules and procedures including:
- Cancellation of registration;
- The treatment of unreported data;
- Petitions against the DGT; and
- Claims for additional losses after dispute resolution.

b. Tax Law on Income Tax

1) Tax Subjects and Taxpayers

The new law introduces a definition of an "organization" which includes "mutual funds, political and mass organizations and the like". The effect of this change is to confirm the taxability of mutual funds and extend the tax net to political parties.

2) Bonus Shares

The new law provides that bonus shares paid out of share premium reserves constitute dividends.

3) Dividend Exemption

From 1 January 2001 dividends between resident corporate taxpayers will be non-assessable only if they meet all of the following conditions:

a) the dividends must be paid out of retained earnings;

b) the shareholder must hold at least 25% of the paid-in-capital; and

c) the shareholder must have an active business other than shareholding.

The exemption does not extend to foundations and similar organizations. A circular is likely to be issued soon on what constitutes an active business. As indicated above it will be important to review group structures now to ensure dividend flows are not taxed, review the position of minority shareholdings and maximize dividends to holding companies.

4) Debt forgiveness and debt restructuring

Forgiven debt continues to generate income in the hands of the debtor. However, under a separate government regulation exemptions may be available for specified categories of small-scale debtors. Concessions are available, through the Jakarta Initiative Task Force, for the following forms of debt restructuring:

a) debt forgiveness;

b) transfer of assets for debt repayment;

c) debt-to-equity conversion.

The concessions apply to debt restructuring undertaken in the years 2000 to 2002 as follows:

a) A reduction of the income tax due on a debt forgiveness and approval to settle the remainder by installments;
b) Exemption from income tax on the transfer of assets for the settlement of debt provided that the assets are valued the same as the book value of the debts; and
c) Exemption from income tax on debt-to-equity conversion as long as the equity is considered to have the same value as the debt.

The provision on debt restructuring provides a legal basis for the concessions set out in the *ITO's Tax Treatments on Corporate Restructuring* of May 1999. The requirement that all debt restructuring be conducted through the Jakarta Initiative Task Force may not be disadvantageous as the Task Force has been accommodating of a number of recent debt restructuring proposals.

5) Bond Interest

Currently, bond interest earned by a mutual fund is not assessable. The new law provides that bond interest will only be eligible for this exemption for 5 years from the earlier of the establishment of the fund or its receipt of a business license.

6) Benefits in Kind

Benefits in kind from taxable employers continue to be non-assessable to the individual and non-deductible to the employer. However, the elucidation to the new law indicates that benefits provided by taxpayers earning only "final-taxed" income or assessed on a deemed-profits basis, (such as construction companies or foreign drilling companies) will constitute assessable income to the recipients and therefore be subject to Article 21 tax. This is a major change in policy.

7) Amil Zakat

Islamic alms given to government-approved charities ("amil zakat") are not assessable provided that there is no business, ownership or control relationship between the parties.

8) Bad Debts

Under the new law, bad debts will be deductible where the debt in question:

a) has been charged to the profit and loss account;
b) has been filed with the appropriate court, or forgiven pursuant to a written agreement;
c) has been appropriately published; and
d) is included in a list of debtors provided to the DGT

Previously these requirements were only set out in regulations. They have now been clearly codified in the law. Allowing forgiveness to be effected by written agreement, rather than requiring legal proceedings, is a positive development.

9) Food and Drink

A deduction will be allowed for the cost of food and drink where provided at the work place and where available to all employees.

10) Capital Expenditure

The new law requires that depreciation commence in the *month* instead of the year the asset is acquired. This will generally reduce first year depreciation claims.

11) Extension of land rights

Land acquisition costs remain non-amortizable. Costs incurred to extend certain rights over land can now be amortized over the useful life of the rights. These rights are:

- Hak Guna Bangunan (Right to build);
- Hak Guna Usaha (Right of commercial use); and

- Hak Pakai (Right to use).

12) Tax Rates

Tax rate on taxable income shall be as follows:

Table 28 Income Tax Rate by Bracket (in percentages), Individual, Corporate, and PE

Net Income Bracket (Rp)	Individual (%)	Corporate and PE (%)
0-25.000.000	5	10
25.000.001-50.000.000	10	10
50.000.001-100.000.000	15	15
100.000.000-200.000.000	25	30
200.000.000 over	35	30

Source: Republic of Indonesia, Law Number 17 Year 2000 on Income Tax Article 17 (Jakarta Government)

Tax credit for income tax shall be tax paid by taxpayers themselves plus principal tax payable in tax collection letters because income tax for the current year is not paid or underpaid, added by tax on income paid or owed abroad, minus amounts of preliminary restitution to overpaid tax which are deductible from tax payable. Tax credits include:

a) Article 21, withholding tax on employee.
b) Article 22, withholding tax on import.
c) Article 23, withholding tax on certain income.
d) Article 24, foreign tax credit
e) Article 25, tax prepayment
f) Article 26, withholding tax abroad

Table 29 Effective Tax Rate of Withholding Income Tax Article 23 (%) by Type of Payment, Dividend Received by Individual, and Other Type of Payments

Type of Payment	Rate (%)
Dividend receive by individual	15
Interest, premium, discount, and guarantee fee, except receive by bank	15
Royalties, except receive by bank	15
Gift and rewards	15
Rent and other income in connection with the use of non-land and non-building	6
Received by individuals and bodies, except bank	
Compensation in connection with services received, except by bank:	9
Brokerage services	6
Technical services	6
Management services	6
Law and tax consultant services	6
Interior designer services	6
Landscape designer services	6
Accounting and bookkeeping services	6
Forestry services	6
Surveyor services	6
Actuary services	6
Dubbing services	4.5
Oil and gas drilling services by non-PE	4.5

Other oil and gas mining services	4.5
Non-oil and gas mining services	4.5
Other non-oil and gas mining services	1.5
Cleaning services	

Source: Directorate General of Taxes

The imposition of tax on income in the form of interest of time deposits and other savings, income from transactions of shares and other securities in the stock exchange, income from transfer of assets in the form of land and/or building as well as other certain income shall be stipulated by a government regulation and regarded as final tax. They are as follows:

Table 30 Effective Tax Rate of Final Withholding Income Tax Article 4 (%) by Type of Income, Gifts from Lottery, and other Type of Income

Type of Payment	Rate (%)
Gifts from lottery	20
Interest on deposits, savings, discounts:	
Received by non-resident taxpayer	20
Received by resident taxpayer	15
Interest, discounts on bonds which are traded in stock market:	
Received by non-resident taxpayer	20
Received by resident taxpayer	15
Rent and other income in connection with the use of land and building:	
Rent by individual	10
Rent by bodies	6
Non-law and non-tax consultant services	4
Construction services:	
Construction planning services by company only	4
Construction supervision services by company only	4
Construction working services	2
Sales transaction in founders' shares	0.5
Income from transaction of shares in stock exchange	0.1
Sales of shares owned by venture capital company	0.1

Source: Directorate General of Taxes

State revenue from income tax on resident individuals and income tax article 21 withheld by employers shall be shared with a proportion of 80% to the central government and 20% to regional administrations where the taxpayers are registered.

13) Thin Capitalization

The Minister of Finance (MoF) continues to be authorized to determine an acceptable debt-to-equity ratio. Under the elucidation to the new law, reference must be made to accounting standards for the meaning of "equity". The ratio should also be referenced to "sound" business practices. These changes fall short of the introduction of debt to equity ratios for tax purposes. However, if at some stage in the future such ratios are introduced, the changes provide some guidance as to how the elements are to be determined.

14) Corporate Income Tax - Monthly Installments

Under the new law, installments for months before an annual corporate income tax return is required to be filed will be based on the installment for the last month of the previous year. Under the current law, the installment is the higher of the last month's installment or the average for the prior year. Under the new law, a current year's installment will be recalculated if a tax assessment relating to the previous year is issued in the current year. Under the current law, tax assessments for the last two years are considered and only a higher installment may be applied.

15) Non-Resident Withholding Tax

Interest swap premiums will be subject to 20% withholding tax unless reduced by double taxation agreements.

16) Transfer Pricing

The new law authorizes the DGT to enter into advance pricing agreements ("APAs"). APAs will be valid for agreed periods and renegotiable. The APA can involve a foreign tax authority. The change to the law to specifically allow APAs is a welcome development and a sign the DGT is beginning to focus on transfer pricing issues. As is the case in many other countries, unilateral or bilateral APAs can be an advantageous way of resolving transfer pricing uncertainties before they become acrimonious disputes.

17) Tax Incentives

Under the new law investments in encouraged sectors/regions may receive tax incentives. These incentives include:

a) A reduction in net income by up to 30% of the amount invested, pro-rated at 5% for 6 years;
b) Accelerated depreciation;
c) An entitlement to carry forward tax losses for a maximum of 10 years; and
d) A reduction in the withholding tax on dividends to 10%

18) Sharing of Tax Revenue

Revenue from income tax paid by individuals will be split 80:20 between the central and regional governments. Taxes will continue to be remitted by taxpayers to the Central Government.

c. Tax Law on VAT and Sales tax on Luxury Goods

1) Tax Invoices

Taxpayers may now be able to use one commercial invoice rather than being required to issue a further tax invoice. A commercial invoice can be considered a tax invoice if it contains the following information:

a) the name, address, and tax ID number of the taxpayer delivering the taxable goods or services;
b) the name, address, and tax ID number of the purchaser;
c) the type of good or service, the quantity, the sales price or compensation and any discounts;
d) the VAT that has been collected;
e) the LST that has been collected;
f) the code, serial number and date of issuance of the invoice; and
g) the name, position and signature of the authorized signatory to the invoice.

2) VAT Refunds

Under the current law, monthly refunds are only available to exporters or taxable enterprises making supplies to tax collectors. Others taxpayers had only annual refund entitlements. Under the new law, all taxable enterprises can claim monthly refunds whenever (creditable) inputs for a month exceed outputs. Refunds are also available where a taxpayer is yet to make deliveries of VAT able goods or services.

3) Asset Transfers

The VAT exemption that is currently available where all of the assets of a taxpayer are transferred has been repealed.

4) VAT Exemptions

The new law restricts the categories of goods that are exempt from VAT to the following:
- Unprocessed minerals;
- Basic commodities (such as rice);
- Food and beverage served at hotel restaurants food stalls and the like; and
- Money, gold bars and commercial paper.

Agricultural, forestry, fishing etc. products outside these categories will no longer be exempt.

5) Luxury Sale Tax ("LST")

The minimum LST rate remains 10%. The maximum LST rate is increased from 50% to 75%. New conditions for a luxury good are that the good:

a) does not constitute a basic need;
b) is consumed only by certain community members;
c) is consumed only by high-income earners;
d) is consumed to demonstrate status;
e) its consumption can harm public health and morals, and cause community disorder, e.g. alcoholic drinks.

6) VAT Base-Selling Price

The meaning of selling price has been changed. Under the current law, selling price does not include VAT and LST. Under the new law, LST will be included in the VAT base.

7) Timing of VAT Due

The new law provides clearer rules on when "deliveries" of VAT able goods or services take place. The times vary according to the VAT "event" (i.e., domestic supply, import etc.). The DGT is also authorized to designate appropriate times where the circumstances warrant.

8) Tax Collectors

Prior to the enactment of the new laws, it had been reported that the “tax collector” status of certain entities (e.g. Contract of Work companies) would be repealed.

d. Tax Law on Tax Collection by A Warrant

Distress warrants give taxpayers 24 hours to settle a tax liability. If the liability remains unpaid, the DGT can commence asset confiscation. Taxpayers can file a suit against the DGT with the Tax Court within 14 days. Unless the Tax Court decides differently, the DGT can sell the confiscated assets in an auction within 14 days after the auction announcement. The right to pursue distress warrants has been extended to “tax bearers”. These are defined as “a corporate or an individual who is responsible for the payment of tax, including the representative who undertakes the taxpayer’s rights and fulfill the taxpayer’s obligations in accordance with the tax law and regulations”. For a corporate taxpayer, the company’s officers are considered to represent the taxpayer. Accordingly the DGT can now pursue not only company assets but also those of company officers (directors, commissioners), management, and shareholders.

The DGT applies a decentralized system of tax collection. The collection process starts by implementing a Notice of Prompt and Outright Collection or notifying a Distress Warrant to a Tax Bearer by a tax bailiff. If the tax due has not been paid yet, the collection process shall continue by implementing the seizure of property of a Tax Bearer and confinement.

Table 31 Total Tax Arrears Directorate General of Taxes

Year	Total Arrears (Rp million)	% Growth
1996/1997	5.983.022	-
1997/1998	8.786.965	46,87 %
1998/1999	15.119.968	72,07 %
1999/2000	14.355.706	(5,05 %)
2000	15.036.886	4,75%
2001	16.958.868	12,78%
2002	17.043.354	0,5%

Source: Directorate General of Taxes, annual report 2001

e. Tax Law on Land and Building Transfer Duties

The highlight changes of the Law of Duties on the Acquisition of Title to Land and Buildings (Law No. 20/2000) are:

1) Title transferred in a heritage transaction is taxable
2) The acquisition value of non-taxable object is determined regionally at maximum of Rp60 million. However, in the case of acquiring right because of heirs or bequest receive by an individual who is a family member related by blood with the benefactor or bequest is determined regionally at a maximum of Rp300 million.

Duties for acquisition of rights to land and buildings shall be imposed on the acquisition of right to land and or buildings, hereinafter referred to as the tax. State revenue from fees for acquisition of rights to land and buildings is divided with balancing twenty percent for central government and eighty percent for relevant regional.

f. Tax Law on Land and Building Tax

The Law Number 12 Year 1994 on Land and Building Tax stipulates that land and building tax shall be imposed on land and buildings within Indonesia. A tax subject includes individuals or bodies that completely have a right on land and obtain benefit from land, and possess control and obtain benefit from building.

The tax base is the market value of land and building. The taxable objects are taxable at the minimum of twenty percent and maximum of hundred percent of the price of land and building, based on market value. Tax rate of land and building tax is 0.5%. The exemption ceiling is as much as amount of Rp8 million. The Minister of Finance determines the market value of land and building every 3 years in most areas and every year in rapidly developing areas.

g. Tax Law on Stamp and Duties

The Law Number 13 Year 1985 on Stamp and Duties and Government Regulation Number 24 Year 2000 dated on April 20, 2000 on Changes of Stamp Tariffs and Nominal Amount Due to Stamps stipulates that documents, which are subject to stamps duties. Stamp duty is nominal only at either Rp3.000 or Rp6.000 on certain documents. The rate of Rp6.000 is applicable for letters of agreement and other letters, Notary Deed and Land Deed including its copies. For all documents bearing a sum of money, the rate is Rp6.000 when the value stated in the document is more than Rp1 million, and Rp3.000 when the value is between Rp500.000 and

Rp1 million. Below Rp500.000 is not subject to stamp duty. For cheques, the rate is Rp3.000 regardless of money value stated.

3. Tax Audit and Investigation's Policy

Tax audit and investigation are two instruments out of many instruments employed for controlling tax compliance not only formally but also substantially. High tax compliance and law enforcement are very significant in the self-assessment system.

Tax Audit Policy

According to the scope of audit, there are two kinds of tax audit, namely field and office audit. The first one is an audit that covers previous years as well as current year with respect to all or specified types of taxes conducted at taxpayer's premises. It can be done in the form of comprehensive or simple field audit. The comprehensive audit is carried out by applying normal audit techniques; meanwhile the simple field audit is carried out by applying simple audit techniques in terms of degree and depth. The other one is office audit that covers previous years as well as current year only for specified types of taxes and conducted in the Tax's office.

Investigation

For performing tax investigation, the DGT has educated and trained the civil servant investigator in coordination with the National Police and the Supreme Attorney. Before it is conducted, there are two steps that have to be done: observation and preliminary evidence audit. Observation is a bundle of activities done by the observer to confirm with realities, to discuss and to develop in advance information, data and or reports that contain tension to do criminal offences in taxation. Those information, data and or reports could be received either from audit, information collection activities or denunciation from public.

The observation is previously carried out to get the required formal information, data and or reports to begin the investigation. Based on those information, data and or reports, the special audit of preliminary evidence audit is conducted to determine whether the case will be investigated or solved through general assessment procedure

Table 32 Performances of Tax Audit and Investigation

Year	Comprehensives Audit	Simple Audit	Investigation
1996	12.890	44.173	3
1997	11.873	89.148	56
1998	14.167	86.134	9
1999	13.437	66.669	7
2000	6.632	58.323	9
2001	8.545	59.763	9

Source: Directorate General of Taxes, annual report 2001

Objection and Appeal

A taxpayer has a right to file an objection to the Director General of Taxes for specified assessment notices. It should be submitted within 3 (three) months as from the issuance of assessments, unless the taxpayer can demonstrate that the period cannot be fulfilled due to circumstances beyond their control. The objection should be decided within 12 (twelve) months as from the date of receipt of application. The decision may be in the form of total or partial acceptance, refusal or increasing the amount of tax payable.

A request for appeals to the tax court can only be submitted against a Decision on Objection stipulated by the Director General of Taxes. The application for appeal should be submitted within 3 (three) months after the date of receipt of Decision on Objection.

Table 33 Objection and Appeal (Income Tax and Value added Tax)

	Objection and Request for Review	**Appeal**
Income Tax		
Request Received	11.658	631
Decided	5.527	631
▪ %	47,41%	100%
Value Added Tax		
Request Received	9.675	250
Decided	8.005	228
▪ %	82.74%	91.2%

Source: Directorate General of Taxes, annual report 2001

4. Tax Facilities

In 2002, fiscal stimulus through government consumption and investment spending is estimated to reach 11.8% of GDP, a bit below the target of 12.5% of GDP. In addition to this fiscal stimulus, the government also made transfers to the private sector in the forms of subsidies and interest payments on domestic loans. The largest were the interest payments that reached 3.9% of GDP, above the target; subsidies amounted to 2.4% of GDP.

Table 34 Fiscal' Stimulus 2002 (trillion of rupiah)

Items	Budget		Realizations		
	Nominal	% of GDP	Nominal	% of GDP	Change
1.Government consumptions	120.01	7,12	117.06	7.02	0.12
Domestic personnel					
expenditures	39.8	2,36	38.79	2.33	-0.27
Domestic material	11.71	0,69	11.84	0.71	0.04
expenditures	55.58	3,30	55.60	3.33	0.08
General allocation funds	3.44	0,20	3.76	0.23	0.23
Special autonomy	9.49	0,56	7.08	0.42	0.04
Other routine expenditures	91.25	5,41	79.44	4.76	-0.21
2. Gross domestic fixed capital	26.47	1,57	27.64	1.66	0.22
Rupiah financing	25.83	1,53	12.63	0.76	-0.60
Project aid	13.53	0,80	13.54	0.81	0.02
General allocation funds					
Revenue sharing and special	25.42	1,51	25.63	1.54	0.15
allocation funds	211.26	12,54	196.49	11.78	-0.09
3. Total I + II	101.11	6,00	104.47	6.26	-2.83
Memo items: transfer	59.52	3,53	64.46	3.86	-0.04
payment	41.59	2,47	40.01	2.40	-2.80
a. Domestic interest					
b. Subsidies					

a. Tax Facilities on Investment

All investment projects of PMA as well as PMDN projects which are approved by the Investment Coordinating Board or by the Office of Investment in the respective districts, including existing PMA and PMDN companies expanding their projects to produce similar product(s) in excess of 30% of installed capacities or diversifying their products, will be granted the following facilities:

- Relief from import duty so that the final tariffs become 5 %. In the case of tariffs of import duty which are mentioned in the Indonesian Customs Tariff Book being 5% or lower, the effective tariffs shall be those in Indonesian Customs Tariff Book. On the importation of capital goods namely machinery, equipments, spare parts and auxiliary equipments for an import period of 2 (two) years, started from the date of stipulation of decisions on import duty relief.
- On the importation of goods and materials or raw materials regardless of their types and composition, which are used as materials or components to produce finished goods for the purpose of two years full production (accumulated production time).
- Exemption from Transfer of Ownership Fee for ship registration deed / certificate made for the first time in Indonesia.

Based on tax law, the domestic and foreign investors will be granted tax allowances in certain sector and/or area as follows:

- An Investment Tax Allowance in the form of taxable income reduction as much as 30 % of the realized investment spread in 6 (six) years.
- Accelerated depreciation and amortization
- A Loss carried forward facility for period of no more than 10 (ten) years.
- A 10 % income tax on dividends, and possibly being lower if stipulated in the provisions of an existing particular tax treaty.
- Exemption from Value Added Tax and Sales Tax on Luxury goods and materials purchased domestically, to be used in the manufacturing of the exported products.

The industrial companies which are located in the bonded areas are provided with many incentives as follows;

- Exemption from import duty, excise, income tax of Article 22, Value Added Tax on Luxury Goods on the importation of capital goods and equipment including raw materials for the production process.
- Allowed to divert their products amounted to 50% of their export (in term of value) for the final products, and 100% of their exports (in term of value) for other than final products to the Indonesian customs area, through normal import procedure including payment of customs duties.
- Allowed to sell scrap or waste to Indonesian custom area as long as it contains at the highest tolerance of 5% of the amount of the material used in the production process.
- Allowed to lend their own machineries and equipments to their subcontractors located outside bonded zones for no longer than 2 (two) years in order to further process their own products.
- Exemption of Value Added Tax and Sales Tax on Luxury Goods on the delivery of products for further processing from bonded zones to their subcontractors outside the bonded zones or the other way around as well as among companies in these areas.

b. Tax Facilities on Debt Restructuring

Law Number 17 Year 2000 on Income Taxes Article 31 stipulates that taxpayers restructuring debts through special institutions established by the government can obtain limited taxation facilities, stipulated by government regulation, in certain periods and kinds which take the form of income tax relief due on:

1. Haircut

2. Transfer of assets to creditors for debts settlement
3. Conversion of debts into capital participation

The validity of taxation facilities granted is only limited to fiscal years of 2000, 2001, 2002. Government regulation Number 7 Year 2001 dated on February 14, 2001 on Income Tax Relief for Taxpayers restructuring Debts through Special Institutions established by the Government stipulates:

1. Income tax relief of thirty percent of income tax payable on hair cut
2. The rest of seventy percent can be paid in five years installments.

c. International Taxation Agreement

In handling international tax problem, it requires a tax jurisdiction reconciliation of relevant countries. The tax jurisdiction of each relevant country is regulated firmly on the reconciliation, which is called Avoidance of Double Taxation Agreement, in order to lessen the possibility of double taxation. The agreement regulates the tax right distribution; therefore countries conducting the agreement could not fully implement their domestic tax laws. In general, the agreement reduces tax rates on interest income, dividend, royalty, and technical service fee. Up to Year 2001, Indonesia has concluded tax treaty with 50 partner countries.

Table 35 Tax avoidance of Double Taxation Agreement

Country	Effective date	Portfolio Investment Dividend	Substantial Holding Dividend	General Interest	Specific Case Interest	General Royalty	Specific Case Royalty	Branch Profit Tax
Australia	1-7-1993	15	15	10	--	15	10	15
Austria	1-1-1989	15	10	10	--	10	--	12
Belgium	1-1-1975	15	15	15	10	10	--	15
Bulgaria	1-1-1993	15	15	10	--	10	--	15
Canada	1-1-1980	15	10	10	--	10	--	15
Czech	1-1-1997	15	10	12.5	--	12.5	--	12.5
Denmark	1-1-1987	20	10	10	--	15	--	15
Finland	1-1-1990	15	10	10	--	15	10	15
France	1-1-1981	15	10	15	10	10	--	10
Germany	1-1-1992	15	10	10	--	15	10.75	10
Hungary	1-1-1994	15	15	15	--	15	--	10
India	1-1-1988	15	10	10	--	15	--	10
Italy	1-1-	15	10	10	--	15	10	12

	1996							
Japan	1-1-1983	15	10	10	--	10	--	10
Jordan	1-1-1999	10	10	10	--	10	--	20
Kuwait	1-1-1999	10	10	5	--	20	--	10
Luxembourg	1-1-1995	15	10	10	--	12.5	10	10
Malaysia	1-1-1987	15	15	15	--	15	--	12.5
Mauiritius	1-1-1999	15	5	10	--	10	--	10
Mongolia	1-1-2001	15	10	10	--	10	--	10
Netherlands	1-1-1971	15	10	10	--	10	--	9
New Zealand	1-1-1989	15	15	10	--	15	--	20
Norway	1-1-1991	15	15	10	--	15	10	15
Pakistan	1-1-1991	15	10	15	--	15	--	10
Philippines	1-1-1983	20	15	15	10	15	--	20
Poland	1-1-1994	15	10	10	--	15	--	10
Romania	1-1-2000	15	12.5	12.5	--	12.5	10	10
Saudi Arabia[1]	1-1-1989	-	-	-	--	-	--	-
Seychelles	1-1-2001	10	10	10	--	10	--	20
Singapore	1-1-1992	15	10	10	--	15	--	15
South Africa	1-1-1991	15	10	10	--	10	--	10
South Korea	1-1-1990	15	10	10	--	15	--	10
Spain	1-1-2000	15	10	10	--	10	--	10
Sri Lanka	1-1-1995	15	15	15	--	15	--	20
Sudan	1-1-2001	10	10	15	--	10	--	10
Sweden	1-1-1990	15	10	10	--	15	10	15
Switzerland	1-1-1990	15	10	10	--	12.5	5	10
Syria	1-1-	10	10	10	--	20	15	10

	1999							
Taiwan	1-1-1996	10	10	10	--	10	--	5
Thailand	1-1-1983	15	15	15	--	15	10	20
Tunisia	1-1-1994	12	12	12	--	15	--	12
Turkey	1-1-2001	15	10	10	--	10	--	15
UAE	1-1-2000	10	10	5	--	5	--	5
UK	1-1-1976	15	10	10	--	15	10	10
Ukraine	1-1-1999	15	10	10	--	10	--	10
USA	1-1-1991	15	10	10	--	10	10	10
Uzbekistan	1-1-1999	10	10	10	--	10	--	10
Vietnam	1-1-2000	15	15	15	--	15	--	10
Venezuela	1-1-2001	N.A	N.A	N.A	N.A	N.A	N.A	N.A
Slovak	1-1-2002	N.A	N.A	N.A	N.A	N.A	N.A	N.A

Source: Directorate General of Taxes, annual report 2001

[1] limited to both countries "air line companies"

5. Tax Revenue by Composition

The improvement of economy after the monetary crisis since early 1999 has affected positively many sectors of Indonesian economy. This development resulted in higher tax revenue in fiscal year 2002. Total tax revenue increased by 19% to Rp 189.099,8 billion from Rp158.580, 1 billion in fiscal year 2001.

Table 36 Tax Revenue by year and composition (billion of rupiah)

Year	Income Tax	VAT	Land & Building	Other Taxes	Total
1996/1997	27.062,1	20.351,2	2.413,2	590,7	50.417,2
1997/1998	34.388,3	25.198,8	2.640,9	477,8	62.705,8
1998/1999	55.944,2	27.803,2	3.565,3	413,0	87.725,7
1999/2000	72.729,0	33.087,0	4.107,3	610,9	110.534,2
2000	57.073,0	35.231,8	4.456,1	836,7	97.597,6
2001	94.461,6	55.862,6	6.664,4	1.591,5	158.580,1
2002	101.493,6	65.243,7	7.985,8	35.438,9	210.162,0
2003	120.924.8	80.789,9	9.925,3	42.500,2	254.140,2*

* Budget

** Source: Ministry of Finance the Republic of Indonesia 2003 and Directorate General of Taxes, annual report 2001

IV. Country-Specific Fiscal Issues

1. Consequences and Preparations in Facing the End of IMF Program by End-2003

By the end of 2002, Indonesia had received total loan commitments of $15.1 billion from the IMF, of which $13.2 billion had been disbursed and $4.4 billion had been repaid. Consequently, at the end of 2002 Indonesia's outstanding loans from the IMF totaled $8.9 billion. The new Extended Fund Facilities (EFF) commitment is scheduled to end on December 31, 2003. In return for IMF loan disbursements, Indonesia is obliged to fulfill IMF conditionality as stated in an agreement known as a Letter of Intent (LOI), designed in the context of the IMF Program. Primarily, the LOI serves as the benchmark for the IMF in its periodic reviews to decide whether to release further amounts of financial assistance.

The Government of Indonesia plans to discontinue its IMF Program when it expires in late 2003. This raises several important questions. First, can Indonesia at the end of 2003 get approval from the IMF Executive Board to end its IMF Program, as in Korea and Thailand? Second, what consequences would Indonesia face by discontinuing its IMF Program? Third, what preparations should Indonesia undertake to minimize any shocks from ending its IMF Program? According to prevailing IMF regulations, whether a country can legally end its IMF Program largely depends upon the IMF Executive Board. The Executive Board's decision is based upon its judgment as to whether the policies and economic conditions of the program country have shown significant improvement.

What are the consequences of exiting from the IMF Program at the end of 2003? The most important consequence concerns losing the opportunity for Indonesia to obtain further official debt' rescheduling from the Paris Club. Only countries with an IMF Program (either an SBA or EFF) are eligible for debt rescheduling from the Paris Club. In addition, and taking into account that debt rescheduling under the Paris Club adheres to the principle of comparability of treatment for all Indonesia's creditors, debt rescheduling by the London Club would also be unlikely with the termination of the IMF Program.

A second consequence of discontinuing the IMF Program concerns the emergence of a financing gap in the state budget due to the lost opportunity for more debt rescheduling from the Paris Club. The lost opportunity to obtain debt rescheduling from the Paris Club would- in 2004 alone-force the Government to seek alternative financing of up to Rp30 trillion to cover debt service payments in that year. Significantly more would be needed if exit from the IMF program also disturbs the flow of bilateral and multilateral program loans. A third consequence of exit from the IMF Program will be the need for market agents and the international community to find alternative reference points for judging the state of the Indonesian economy. If this were to take place, strong Government credibility could serve as a reference point for market players and the international community. The alternative is declining confidence in the Indonesian economy.

A fourth consequence concerns the condition of Indonesia's balance of payments and foreign reserves upon exit for the IMF Program. The greater concern is that exit from the IMF Program might cause capital outflows in line with declining confidence of market agents and the international community towards the Indonesian economy.

2. Outbreak of the Crisis

The monetary and economic crisis that started in 1997 is basically a crisis confidence. That is, confidence in Indonesia' economic future, confidence in exchange rate stability, and confidence in legal certainty. The government has released a detail program setting outs it economy policy objective for the remainder of 2003 and 2004. A key motivation for issuing the document was to bridge the potential "credibility gap" that could emerge following Indonesia's graduation from the IMF-supported program. The document, which sets out both broad policy objectives and specific reform measures focuses on three key areas as follow:

- Macroeconomic stability:

Over the medium term, the program aims to further fiscal consolidation (targeting budget balance by 2005-2006), reduce inflation, maintain exchange rate stability, and ensure a sufficient level of foreign reserves. Ongoing effort to improve tax policy, to modernize tax and custom administration, enhance expenditure efficiency, and address remaining weaknesses in the fiscal decentralization framework are to be continued.

- Financial Sector Restructuring:

The principal objective is to strengthen the financial sector net by clarifying Bank Indonesia's lender of last resort function, improving supervision and regulation, and establishing deposit guarantee agency and financial services authority. Also, addressing remaining deficiencies in the anti-money laundering framework and strengthening governance in state-owned enterprises are also key objectives.

- Investment, Export, and Employment:

Improving the investment climate and promoting export are identified as key instruments for bolstering growth, generating employment and reducing poverty. Legal certainty for business is to be increased by amending the bankruptcy law and harmonizing regional and national regulations. Other reform include rehabilitating infrastructure, streamlining trade and investment regulations, establishing a fair labor policy framework, improving the provision of public services, and enhancing internal security.

3. Economic Restructuring

a. Fiscal Reform

1) Fiscal Policy

Fiscal policy will remain tight in 2004 given that the government is targeting a deficit of less than 1% of GDP. Although this again appears optimistic, a significantly stronger economy will lead to higher revenue growth and we forecast a reduction in the deficit to 1.8% of GDP in 2004.

In 2003, target for budget deficit is 1.8 percent of GDP, as approved by Parliament in November. In January 2003, government adopted a package of tax measures to further stimulate economic activity, which comprised a reduction in luxury taxes on consumer goods, interim relief from the VAT for businesses, and an elimination of income taxes for minimum wage workers.

The strategy to mobilize non-oil tax revenues centers on a continuation of tax administration reforms initiated in 2002. In this connection, the initial operations of the Large Tax Payer Offices (LTOs), now under way since last September, have been promising. Directorate General of Taxes (DGT) will expand operations of the LTO in Jakarta to more taxpayers while we evaluate an expansion to other regions at a future date. The new electronic payment system will be extended nationwide in 2003. In addition, DGT plan to expand the coverage of corporate tax audits, intensify the collection of arrears, enhance control of non-filing taxpayers, and take steps to increase the taxpayer population. The governance framework of Directorate General of Taxation (DGT) will also be strengthened and extended to all tax offices nationwide in 2003.

2) Tax Amnesty

The government has cancelled its plan to introduce a tax amnesty in fiscal year 2002. The reason is that the government is not ready administratively speaking, and the circumstances are not supportive. "After conducting a thorough study on the issue, it was concluded that well-thought out preparations would be required for the implementation of a tax amnesty. The government is of the opinion that careful and in-depth preparations will be required before such a tax amnesty can be put into effect," said Minister of Finance. Boediono denied that the postponement of the plan was due to the fact that the government had deemed that a tax amnesty plan would be difficult to put into effect during 2001 for a number of reasons, including administrative problems and the unfavorable circumstances prevailing at the moment.

3). Financing and Debt Management

Public debt management strategy aims to lower the budget's debt service costs, and to minimize refinancing risk by improving the maturity profile of our debt. The Government Debt Securities Law has been enacted, and an inter-dealer market has been established to provide transparent price discovery for market players.

The regulatory framework and developing the market infrastructure needed to enhance the liquidity of the secondary market for government securities. Moreover, the structure of debt has been significantly improved by the re-profiling of government recapitalization bonds held by state banks, and the debt stock has been reduced by using asset recoveries to redeem bonds.

4). Decentralization

The procedures governing the issuance of regional regulations have the potential to conflict with the national interest. The development of an effective regional budget reporting system also remains a priority. During the first half of year 2003, the government issues generally accepted government accounting standards to ensure uniform reporting standards across regions. Existing regulations on local government financial management will be modified in line with these standards. New government accounting systems are being developed to support the implementation of the forthcoming standards, and will be introduced on a gradual basis over the course of the year. A ministerial decree has been issued extending the existing moratorium on local government borrowing (except through the center) until end-2003.

5). Fiscal Transparency and Public Sector Governance

Improving fiscal transparency and public sector governance remain priorities in 2003. All remaining funds not previously consolidated should be brought under the control of the central government by June 2003. The State Audit Agency (BPKP) will continue its routine audits of government agencies with a view to identifying any additional non-consolidated funds. The main findings of the audit of the Reforestation Fund completed last year have been submitted to Parliament, and corrective action plans adopted. The primary actions are to integrate its bank accounts into the Treasury and bring their use under the control of the Ministry of Finance. Necessary corrective action plans will be developed by the government in consultation with Parliament.

The legal framework for public sector financial management is in the process of being updated. The recently approved law on state finances, which covers all state funds in all state institutions, and the draft laws on state treasury and state audit, aims to improve accountability and transparency in government financial management.

The government will also take steps to strengthen the framework for auditing military and other foundations receiving state funds or financing state activities. The government is preparing amendments to the Foundations Law, to be presented to Parliament in its next session, to clarify the legal basis for the BPK to undertake such audits.

6). Bank Divestment and Restructuring

The government remains committed to selling the remaining IBRA banks by the time IBRA winds down in early 2004. The government strengthen state bank governance center on steps to improve oversight and accountability. First, the capacity of the Ministry of State-Owned Enterprises to monitor state bank performance and additional staffing resources are being provided to the Ministry for this purpose. Second, additional independent, qualified commissioners will be appointed, with a view to ensuring that each state bank has four to five commissioners by mid-year. Third, new annual performance contracts will be prepared, which will contain benchmarks developed from their annual business plans. And finally, the external audit mechanism of state banks will be strengthened in the first half of the year, through the development of follow-on external audit corrective action plans.

7). Indonesian Bank Restructuring Agency (IBRA)

The strategy remains to maximize recoveries from IBRA's remaining assets, in advance of its scheduled winding-down. In this regard, IBRA has announced a detailed plan for asset recovery, with quarterly targets, to meet its annual asset recovery target of Rp26 trillion. To ensure transparency, the Oversight Committee (OC) is reviewing the proposed asset sales mechanisms, and will provide any recommendations regarding their strengthening to IBRA. As set out in Presidential Instruction No. 8 signed on December 30, 2002, the government remains committed to taking strong legal and other enforcement actions against former bank shareholders who fail to meet their obligations under their settlement agreements. IBRA is finalizing its plans for the winding down of its operations. Administrative preparations are well advanced and a strategy for the resolution of any assets that may remain unsold at the end of IBRA's mandate will be finalized and published by September 2003. The strategy will ensure that adequate recoveries will be maintained, on the basis of full transparency and accountability, after IBRA is closed.

8). Privatization

The government remains committed to its privatization program, which is critical for improving economic performance and strengthening the public finances. The divestment plan for 2003, which builds on the progress generated in 2002, is designed to achieve the budget target of Rp8 trillion. The plan has been approved by the Privatization Committee chaired by the Coordinating Minister for Economic Affairs.

9). Corporate Restructuring

With the Jakarta Initiative Task Force's (JITF) mandate set to expire on December 31, 2003, the strategic objective now is to process the remaining 40 cases in its docket (total debt of $10.1 billion), through either mediated resolution or dismissal. In 2002, the JITF met its targets for debt restructurings, and by end-December the cumulative total for JITF-mediated debt reaching the MOU stage amounted to $18.9 billion, representing the debt of 86 companies.

10). Policies to Improve the Investment Climate

While significant progress has been made under the program to restore macroeconomic stability and advance the structural reform agenda, investment-the engine of long-term growth and employment generation-remains weak. A number of the policies described above will contribute to an improvement in the investment climate. These include improvements to the decentralization framework, strengthened tax and customs administration, improved public sector governance, and maintenance of a liberal trade regime. In addition, establishing certainty for investors with respect to the application of commercial and bankruptcy laws, and improving the industrial relations framework are also important for improving the investment climate.

11). Legal and Judicial Reform

The emphasis in 2003 will be on the further development of the Commercial Court, which has jurisdiction over bankruptcy and intellectual property rights cases. A number of steps have already been taken to strengthen the administration and procedures of the Court, and to enhance the transparency of the Court's decisions. The Blueprint formulated in 2001 for the development of the Commercial Court has been keys to this effort and an updated version would be issued in May 2003. With respect to other judicial reforms, the government intends to work closely with the Supreme Court and other concerned parties to facilitate the establishment of a Judicial Commission, an initiative central to strengthening the governance and administration of the judiciary. The Supreme Court is currently finalizing its proposals in this area, and the law establishing the Commission is expected to be adopted by end-2003. Steps will also be taken to ensure that the Anti-Corruption Commission (ACC) is fully operational by no later than December 2003, as required by the Anti-Corruption law.

12). Labor Policies

Establishing a sound framework for labor relations is central to generating employment, improving the welfare and skills of workers, and providing a stable environment for business. Following the major reform of the rights of association and union activity in 2000, modernization of complementary labor legislation relating to industrial relations has become a priority. The devolution of minimum wage setting to the regions, it has become increasingly important to provide standards to guide the minimum wage setting process to ensure that it is in accordance with the national interest.

13). Bank Intermediation

Bank intermediation has not fully restored. On one hand, this has limited financing for production and investment, while on the other hand, there is excess liquidity in the banking sector which has the potential to exert pressure on the exchange rate inflation, and reduce the effectiveness of monetary policy.

b. Structural Reforms

1). Financial Sector

A core objective of economic strategy in 2003 is to further advance the process of bank restructuring and to restore a strong, private sector-led banking system essential for establishing efficient credit flows and reviving investment. Accordingly, the 2003 program includes further significant progress in the bank divestment program, and improving the governance of state banks.

2). Balance of Payments and External Policies

The external current account recorded another sizeable surplus in 2002, estimated at $7.2 billion (4.2 percent of GDP), facilitating a further build-up in international reserves. The surplus, however, is expected to narrow in 2003, as imports rebound and tourism receipts recover only gradually in the aftermath of the Bali incident. The capital account is also expected to remain in deficit. Even still, gross international reserves are targeted to rise by $0.6 billion, sufficient to maintain import coverage at current levels and to increase the coverage of short-term debt. The government remains committed to a liberal and open trade regime, and will continue to honor its WTO and AFTA commitments.

V. Conclusion: Where We Stand and Where We Go?

Government has begun to lay a solid foundation for Indonesia's economic recovery from the crisis. While the Bali attacks pose a significant concern for the outlook, Indonesia stands a good chance of weathering the incident with only a modest impact. However, without further progress on critical reforms as outlined above, there is a risk that growth over the medium term will not reach the pace needed to generate enough jobs and reduce poverty in a meaningful way.

The pre-election environment in 2003 poses greater challenges for the Government as it seeks to implement its reform program. The economic team will need to work even harder to convince the public of the merits of its program. With such a show of commitment, the Government's economic program for 2003 would deserve the continued strong support of the international community.

The Government should considering its strategy for 2004 and beyond, following the expiration of the current Fund arrangement. Indonesia should complete its recovery from the 1997-98 crises as soon as possible, thereby no longer needing to seek recourse to exceptional financial support from the international community. But this will require that Indonesia redouble its effort in the implementation of the reform agenda.

A number of steps would need to be taken as part of an IMF exit strategy at the end of 2003. The first important step for the Indonesian government is a full awareness that the government should enhance its ability to create a coherent policy framework and implement it consistently. In this regard, an important, early step would be to fully implement all policy commitments in the LOI for the rest of 2003 in a timely, consistent manner.

As a second step, the Indonesian Government must work hard to explore alternative financing sources to compensate for the loss of further debt rescheduling from the Paris Club and a likely decline in bilateral and multilateral program loans after exiting the IMF Program. Possible options include: increased tax revenues through a broader tax base; efficient spending through a shift from generalized price subsidies to targeted subsidies; re-profiling of government bonds; and issuance of securities in the domestic market, especially for refinancing maturing bonds. These are all possible alternatives that should be explored further. Another possibility is foreign bilateral debt rescheduling outside the Paris Club. The third step that should be implemented by the Government is to promote the development of a domestic market for Government bonds. This could be a valuable source of financing for the budget, and development of this market would help attract inflows of foreign portfolio investment. Such inflows would offset the outflows in the balance of payments resulting from the debt service payments to the IMF and the loss of Paris Club rescheduling. The fourth important step by the Government is to build a strong, deep political commitment to recovery from the crisis and for its leaders to capably coordinate the exit from the IMF Program. The experiences of **South Korea** and **Thailand** provide Indonesia with a lesson on the importance of these two ingredients. Also, stable political and security conditions played a sizable role in the success of those two countries' exit from IMF Programs.

Based up on the Parliament's decision Number VI/MPR/2002, the Government is to terminate the IMF program by the end of 2003. In response to that, the Government and Bank Indonesia have prepared a comprehensive economic program covering:

1. Macroeconomic stabilization
2. Financial sector restructuring and reformation
3. Promotion of investment, exports and employment.

The program is aimed at overcoming development constraints and at facing future challenges. It also aimed at preventing any recurrence of the 1997 financial and banking crisis. The program is expected to promote Indonesia's credibility both internally and abroad.

In light of the challenging economic environment, the following main policy priorities should be identified for achieving macroeconomic stability and promoting growth:

- Making decisive progress towards fiscal sustainability and a reduction of Indonesia's large public debt burden;
- Implementing a monetary policy aimed at bringing inflation back to single digits;
- Making headway in restructuring and privatizing assets held by the public sector;
- Strengthening efforts to reduce vulnerabilities in the banking system and restore a functioning credit mechanism; and
- Accelerating efforts to improve the investment climate through governance and legal reforms.

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