2 Indonesia

Kunto Laksito

I. Introduction

Indonesia is a country located in South East Asia, which is known as the largest archipelago complex in the world. It is also one of the most populous and the largest Moslem population country in the world. The name of Indonesia is originated from Greek words indos and nesos, which mean India and islands respectively, and the combined words mean the islands near India. The formal name is The Republic of Indonesia, because its government system is a unitary republic.

In the ancient periods, Indonesia was hosted by some large empires, Srivijaya, centered in southern part of Sumatra island between 7th and 14th century, Majapahit, centered in eastern part of Java island between 13rd and 15th century, and Mataram, centered in central part of Java island between 15th and 16th century. In the 17th century, the Dutch started its colony in Indonesia and for 300 hundred years Indonesia was one of the Dutch's richest colonies.

On August 17th, 1945, Indonesian independence leaders Soekarno and Mohammad Hatta proclaimed Indonesian independence, three days after the end of Japanese occupation when the Japanese surrendered to Allied Forces during the World War II.

Geography, Climate, and Geology

Indonesia is located between two continents, Asia and Australia, and two oceans, Indian and Pacific. As an archipelago complex country, it has more than 17 thousand islands, which about 6 thousand of them are inhabited. There are five main islands of the archipelago, Sumatra, Borneo (or Kalimantan in Bahasa Indonesia language), Java (Jawa), Celebes (Sulawesi), and New Guinea (Papua), and two group islands, the Moluccas (Maluku) and the Lesser Sunda (Nusa Tenggara). The capital city is Jakarta, located on the west part of the Java island. Indonesia's total land areas are 1,826,440 sq km and have land boundaries with Malaysia, by 1,782 km, East Papua New Guinea, by 820 km, and East Timor, by 200 km.

Its geographical location has strategic impacts in economy, social, and politics. In economy, the location has made seas in Indonesia as hubs for sea transportation since ancient periods. The ancient empires have societies of advanced civilization, with overseas trading bringing the hinterland into distance markets and civilizations such as Middle East and India in the west and China Empire in the east. Now, Indonesian seas had became more important than in the ancient periods, since the new continent Australia also uses them as its hubs for sea transportation. By the interactions with distant civilizations, since the ancient periods, Indonesia's people have been affected by those civilizations through religions and cultures. Buddha, Hindu, and Islam, are the main religions and cultures that are brought by ancient overseas traders who often became migrants. Those religions and cultures became the foundation of empires in the ancient periods, Buddhism in Srivijaya, Hinduism in Majapahit, and Islamism in Mataram. During the Cold War period, Indonesia was in between the western block with Australia which is the closest western country in the south, and the eastern block with China which was one of the largest communist countries in the north.

Astronomically, Indonesia is located between 6°08' north and 11°15' south latitude, and from 94°45' to 141°05' east longitude. Together with its geographical location, Indonesia's astronomical location cause Indonesia's climate to be hot tropical and humid, and only has two seasons, dry and rainy. Dry season is between the months of April and September when dry winds blow from the southeast, arid continent of Australia. Rainy season is between the months of October and March when wet winds blow from the northeast, the South China Sea. Indonesia's average annual rainfall is 1,821 mm. Average daily temperatures in Jakarta are 25.8C in January and 26.3C in July.

Geologically, Indonesia is located on intersections between two rings of fire and two plateau continent. Indonesia's geological location causes earthquakes and volcano eruptions often happened. However, the soil is fertile with rich volcanic minerals thus agriculture has been the main source of living for the most people in rural.

A massive earthquake in southeastern Asia with the epicenter on the west side of the Sumatra island on December 26th, 2004 gave rise to tsunamis in the Indian Ocean, which has so far left hundreds of thousands of people dead across the region. Estimates suggest that the total death toll has topped 200,000 with 174,000 dead in Indonesia alone.

On May 27, 2006, a strong earthquake struck a densely populated area of the Indonesian island of Java. The earthquake, measuring 6.3 on the Richter scale, affected Java's south coast most acutely but the worst devastation was in the town of Bantul, just south of Indonesia's ancient royal capital city of Yogyakarta. By May 29, 2006, the death toll surpassed 5,000, with more than 10,000 injured and approximately 200,000 believed to have been displaced.

Demography, Culture, and Human Development

Indonesia's estimated population was more than 246 million in 2006, which is diverse by races, ethnic groups, religions, and languages. The majority of the people are consisted of Malay race who live on the western part (the four main islands) and the other are Polynesia race on the eastern part (the New Guinea island, the Moluccas and the Lesser Sunda islands). Java is the most populous island with more than 114 million inhabitants. Indonesia's largest cities by their population in year 2006 are Jakarta, with 8.6 million inhabitants, Surabaya, with 2.4 million inhabitants, and Medan, with 1.8 million inhabitants. There are minority races whose ancestors weren't originated from Indonesia, such as Chinese, Indian, and Arab. Different ethnic groups have different languages, such as Javanese, which is 45 percent of total population, has its own Java language, and Sundanese, 14 percent of total population, has its own Sundanese language, etc. However, there is only one official language Bahasa Indonesia, which has diverse dialects such as Javanese and Sundanese. Islam is the largest religion in Indonesia which is held by 88 percent of the people, followed by Protestant by 6 percent, Roman Catholic by 3 percent, Hindu by 2 percent, Buddha by 1 percent, and others by 1 percent.

Compulsory education is 9 years, the children must attend the education freely from elementary to junior high school. Although it is compulsory, the number of eligible children who enrolled to elementary school is still only 92 percent and to junior high school is still only 44 percent. The population aged 15 and over who can read and write are 84.1 percent of female population and 92.9 percent of male population.

In recent estimates, Indonesian people health life expectancy at birth of 68.9 years – 66.5 for men and 71.5 years for women. Indonesia's infant mortality rate is 38.1 death per 1,000 live births. The population age structure is typical of developing countries, age 0-14 years is 29.1 percent, age 15-64 years is 65.7 percent, and age 65-over years is 5.2 percent

A notable measure of human development is the Human Development Index, formulated by the United Nations Development Program. In year 2003, Indonesia's position is at 109th place in the medium human development category, out of 177 countries and territories.

Political History and Conditions

As a unitary republic, Indonesian governmental system is presidential and based on separation of powers into executive, legislative, and judicial power. On August 18th, 1945, the Constitution of 1945 was established. In 1950, a new temporary constitution providing for a parliamentary system of Government was established. A failure by the constituent assembly to develop a new fixed constitution further weakened the parliamentary system with an already divided parliament among various political parties. As a result, President Sukarno met little opposition in 1959 when he revived the Constitution of 1945 providing for broad presidential powers.

From 1959 to 1965, Indonesia was under the authoritarian regime of President Sukarno. During this period, Indonesia's relations with the Asian communist countries were close, and domestically, the Indonesian government was close with the Indonesian Communist Party. The September 30th, 1965 revolt by the Indonesian Communist Party caused Indonesia became unstable. Violence was rampant, and tens of thousands of alleged communists in rural areas were killed by rightist gangs. Because of the revolt, the

Communist Party was banned in Indonesia. In March 1967, the Provisional People's Consultative Assembly put Sukarno under house arrest until his death in 1970 and named the general acting president. In 1968, the People's Consultative Assembly formally selected Suharto to a full five-year term as president. He was re-elected for the next six terms in 1973, 1978, 1983, 1988, 1993 and 1998.

After coming to power, President Suharto reversed many of Sukarno's policies and initiated a "New Order" in the country. With economic rehabilitation as its priority, Indonesia's New Order secured a rescheduling of foreign debts and attracted aid through an intergovernmental group of donor countries.

The complex regulations governing economic activities were simplified, and a new foreign investment law in 1967 provided a framework for new private capital investment. In addition to economic development under new economic policies, Indonesia enjoyed political stability during the Suharto administration, which was supported by military power. Although stable, the political condition was controlled by the government by limiting the freedom of press, political parties, and labor unions. During the six terms, Golongan Karya was the only ruling party, while two other parties are only the minorities.

In mid-1997, economic crisis swept across Asian countries, and Indonesia was also affected by the crisis. Economic hardship and popular resentment to the government's corruption brought Indonesia into turmoil. The country saw student demonstrations as well as public unrest. As a consequence, President Suharto was forced to resign May 21, 1998, when he handed over power to Vice President Habibie.

President Habibie promised to hold new elections, and a special session of the People's Consultative Assembly was held in November 1998, setting the date of parliamentary elections at June 1999. On June 7, 1999, Indonesia held elections for the national, provincial and subprovincial parliaments, with 48 parties participating and competing in the elections. The elections were deemed to be the first "mostly free and fair" elections since 1955. Then, on Oct. 20, 1999, the People's Consultative Assembly chose Abdurrahman Wahid of the National Awakening Party as president, and he named a cabinet six days later. By November 1999, Megawati Sukarnoputri from the PDI-P was made vice president, indeed, initiating a coalition government.

On July 22, 2001, the Indonesian parliament voted overwhelmingly to dismiss Abdurrahman Wahid from office by launching a fast-tracking impeachment proceeding. Within minutes of the vote to force him out, the parliament swore in Megawati Sukarnoputri as the fifth president of the Republic of Indonesia. A few days after Megawati Sukarnoputri took office, the Indonesian parliament voted Hamzah Haz as the new vice president.

The general elections in April 2004, Indonesia's two biggest political parties appeared to be in a two-way race to the finish. In the runoff vote, the General Election Commission officially announced that Yudhoyono garnered 69.27 million votes, or 60.62 percent of the total, counted ballots from the Sept. 20 runoff in all 32 provinces, while incumbent president Megawati Sukarnoputri acquired 44. 99 million votes, or 39.38 percent. The new president was to be sworn in by the highest lawmaking body on October 20th. A new cabinet was later formed.

II. Overview of Macroeconomic Activity and Fiscal Position

Indonesia had been known as a country with rich natural resources and depended its economy on them. The rich natural resources are not only from the mining sector such as oils and minerals, but also from agricultural sectors such as coconut oil and natural rubber. Before 1980's, exports consisted mainly of primary commodities including natural rubber, coconut oil and copra, tin, and crude oil. Indonesia was the only asian country which joins the OPEC (Oganization of Petroleum Exporting Countries). Indonesia's golden period in enjoying the mining sector was between 1970's to early 1980's when the oil price was booming. During the oil price booming Indonesia's export boosted. After the golden period was over, manufacturing sector started to take over as the biggest contributor to Indonesia's export.

That shift to no longer rely on the mining but rather to manufacturing sector was a result of Indonesian government's decision to reform tax system and investment policy in early 1980's. The reform successfully invited foreign direct investments in manufacturing sector. In late 1980's the government decided to deregulate the banking sector to support the rapid growth of manufacturing sector. Together with the deregulation, the government also introduced incentive to further attract foreign direct investments. From 1987 to 1998, Indonesia's average annual growth was 7 percent. In that period, the service started to rise and gave significant contribution to Indonesia's GDP. However, in 1998 when the Asian financial crises started to hit Indonesian economy, Indonesian currency the Rupiah collapsed thus the GDP declined sharply and registered a negative growth of 13.7 percent in 1998.

Today, Indonesia is no longer an oil net exporter, but rather an importer. Increase of oil price in recent years has been causing the government politically in difficult positions. On one side, the government no longer has the ability to provide oil subsidy, while on the other side increase of oil price will increase prices of goods and the most vulnerable victims are the poor.

In recent years, service sectors have been expanding fast and accounts for about 55 percent of GDP.

Indonesia's macroeconomic indicators before and after the crisis show that the economic structure has undergone far reaching changes. On the sectoral level, the structural change in the 1970-1997 period was marked by the rapid ascent of secondary sectors (including manufacturing), followed by growth in tertiary sectors. During the same period, the primary sector share (agriculture and mining) underwent corresponding decline. Investment and exports were the major components in aggregate demand, as indicated by their sizeable share of GDP composition.

The structural transformation that began in the 1970's came to an abrupt end with the economic crisis in 1997 and 1998. Concerning sectoral composition in the aftermath of the crisis, secondary sectors and especially manufacturing became largely stagnant. At the same time, the share of the primary sectors, mainly agriculture, continued to decline. The gloomy trend in the secondary sectors was also reflected in aggregate demand. Investment and exports, the former dominant engines of economic growth, were displaced by the expanding role of consumption. This resulted in a widening share of public consumption, while the share of investment in the GDP diminished further. The flagging performance of the secondary sectors was also reflected in the labor market, with stagnant and even declining employment levels in the formal sector.

II.1 Macroeconomic Activity

II.1.1 International Environment

(1) Current Account

Compared to previous years, the balance of payments performance in 2006 was markedly improved with a surplus of US$15.0 billion. A key contributor to this was the increased current account surplus, which reached US$9.6 billion (2.6% of GDP). During 2006, the current account posted an increased surplus compared to the previous year. The substantial rise in the surplus resulted from export growth at 18.1% (yoy) that contrasted with slowed import growth (c&f) at only 5.1% (yoy).

(2) Trade of Balance

Indonesia's mainstay exports were dominated by natural resource-based products and accounted for about 30% of total exports. Exports of leading commodities, mainly copper, wood products, paper, coal, crude palm oil and rubber, underwent strong growth driven by rising external demand and continued high international commodity prices. However, oil production did not rise in response to the opportunity created by the 20% increase in the average Indonesian oil price; instead, oil export volume declined.

Table 1: Indonesian Balance of Payment

Million of US $

	Description	2004	2005	2006
I.	Current Account	1,564	278	9,628
	A. Goods, (net) (Balance of Trade)	20,152	17,534	29,718
	1. Export, fob	70,767	86,995	102,728
	2. Import, fob	-50,615	-69,462	-73,010
	B. Services (net)	-8,811	-9,122	-11,237
	C. Income (net)	-10,917	-12,927	-13,718
	D. Current Transfer (net)	1,139	4,793	4,865
II.	Capital and Financial Transaction	1,852	345	2,451
	A. Capital Transaction	…	333	304
	B. Financial Transaction	1,852	12	2,148
	1. Direct Investment	-1,512	5,271	4,096
	2. Portfolio Investment (net)	4,409	4,190	3,806
	3. Other Investment	-1,045	-9,449	-5,755
III.	Total (I+II)	3,415	623	12,079
IV.	Errors and Omission	-3,106	-179	2,956
V.	Overall Balances	309	444	15,035
VI.	Monetary Movement[1]	-309	-444	-15,305
	a. Change in International Movement	674	663	-7,428
	b. IMF	-983	-1,107	-7,608
	Withdrawal	0	0	0
	Payment	-983	-1,107	-7,608
Notes:				
	Foreign Assets (IFRCL)	36,320	34,724	42,586
	Equivalent on Imports and Payments on Government Foreign Debt	5.5	4.3	4.5
	Current/GDP (%)	0.6	0.1	2.6

1) (-) surplus : (+) deficit

(3) Export

The export growth was driven principally by non oil gas exports. The value of total exports rose 18.1% to $102.7 billion in 2006. Non oil-gas exports grew briskly with an increase in exports volume, especially natural resource commodities. Meanwhile, oil exports was still unperformed due to limited exploration activities despite the fact of soaring oil price. Increased oil-gas investment in the last three years did not contribute significantly in raising production to offset the diminishing of oil production. As a result, oil export volume tended to fall in 2005 as well as in 2006.

Table 2: Exports

Description	2005	2006	2006*	
	Change (%)		Value (Million of US$)	Share (%)
Non Oil and Gas Export	22.5	20.7	80,578	78.4
Agriculture	18.1	20.7	3,465	3.4
Mining	72.8	41.8	11,361	11.1
Industry	17.8	17.7	65,752	64.0
Oil and Gas Export	24.3	9.4	22,150	21.6
Total	22.9	18.1	102,728	100.0

Non oil-gas exports in agricultural, mining and industrial sector grew strongly. During 2006, the total value of non oil-gas exports experienced quite a significant jump of 20.7% to $80.6 billion. This growth stemmed from both higher prices and higher volumes. Higher prices were reflected in export price index of non oil-gas commodities which overall rose by around 28.4%2. Meanwhile, volume increase was mainly noticed in mining and agricultural products, at 44.0% and 39.5% respectively.

By export destination, there was no change in the top five destination countries for Indonesia's exports. Most Indonesian products were exported to five major countries, namely Japan (15.2%), US (13.2%), Singapore (9.8%), China (7.0%), and Malaysia (4.8%). These five destinations accounted for 50.0% of total non- oil-gas exports, relatively unchanged from the previous year.

Main export products to the Japanese market were metal ores and coal accounting for 4.2% and 1.7% of total non-oil-gas exports. For the US market, exports were mainly garments and crude rubber accounting for 4.3% and 1.4%. To the Singapore market, machinery and metal products were the main export products which accounted for 1.6% and 0.9%. Meanwhile, Indonesia's main export product to China was CPO accounting for 1.2%, while to Malaysia metal products accounted for 0.5%.

Table 3: Major Non-Oil/Gas Export Commodities Share by Country of Destination

United States		**Japan**		**China**		**Singapore**		**Malaysia**	
Garments	4.30 %	Metal Ores and Metal By-Products	4.19 %	Fixed Vegetable Oils and Fats	1.19 %	Electrical Machinery and Apparatus	1.57 %	Nonferrous Metals	0.54 %
Crude Rubber	1.38 %	Coal, Coke and Briquettes	1.65 %	Crude Rubber	0.83 %	Nonferrous Metals	0.94 %	Fixed Vegetable Oils and Fats	0.51 %
Fish, Crust	0.84 %	Rubber	1.13 %	Organic Chemicals	0.74 %	Office Machinery and Automatic Data Processing	0.88 %	Coal, Coke and Briquettes	0.36 %
Apparatus	0.70 %	Electrical Machinery and Apparatus	0.98 %	Pulp and Paper	0.69 %	Telecommunications And Rep. App	0.78 %	Coffee, Tea, Cocoa Spices	0.36 %

In 2006, oil-gas exports rose by 9.4% to $22.2 billion. The increase in oil-gas exports was in line with the rising oil price to as high as $77 per barrel in July 2006. By contribution toward oil-gas exports, exports of oil reached $10.5 billion while exports of gas reached $11.6 billion. The momentum of high oil prices in 2006 could not be utilized optimally through higher oil export volume.

In fact, the volume of oil exports actually declined by 9.5% in connection with the diminishing productivity of existing oil wells, while investment activity and new exploration has not contributed to higher production yet.

(4) Import

Growth in the value of imports (c&f) slowed by 5.1% to $79.4 billion during 2006. Adjustments to fuel prices at the end of 2005 helped to reduce fuel consumption which, in turn, reduced the volume of oil imports. Meanwhile non oil-gas imports grew by 7.1% to $62.3 billion. By component, the slowing imports growth in 2006 was mainly caused by slowing growth in imports of raw materials and capital goods. Meanwhile, imports of consumption goods experienced a large increase of 17.1%. This is an indication of the higher penetration of finished goods from overseas.

Table 4: Imports (c&f)

Description	2005	2006	2006*	
	Change (%)		Value (Million of US$)	Share (%)
Non Oil and Gas Export	36.0	7.1	62,254	78.4
Consumer Goods	25.2	17.1	4,878	6.1
Raw Materials	36.9	6.5	45,282	57.0
Capital Goods	36.6	6.0	12,094	15.2
Oil and Gas Import	44.1	-1.5	17,158	21.6
Total	37.8	5.1	79,412	100.0

Although the share of consumption goods toward total imports was still relatively small, it showed an increase. During 2006, the share of imports of consumption goods toward total non oil-gas imports increased to 6.1%, from around 3% in 2000. The strengthen rupiah exchange rate also encouraged this increase.

By country of origin, the share of imports from the five major countries of origin shifted slightly. Imports from Singapore, which in the last two years rose from on average (1999-2004) by 7.3% to 16.6% (on average 2005-2006), surpassed that from Japan which was initially the biggest contributor to Indonesia's imports. The increase of Singapore imports share was partly due to more accurate statistics, such as the recording of imports by bounded zone - especially Batam and its surrounding areas. China was still in third place and tended to increase. Unlike China, the share of imports from the US showed a tendency to decline. Meanwhile, the share of Indonesia's imports from Thailand showed a slight decline. Overall, the share of imports from these five countries reached 55.6%, down from 58.3% in 2005.

The types of goods imported from these countries varied from one country to the other. A large proportion of the imports from Japan were motorcycles and iron & steel with shares of 2.0% and 1.8% from total non-oil-gas imports. Imports from the US were dominated by other transportation and industrial machinery with shares of around 0.7% each. From China, iron and steel products, along with woven had shares of 1.3% and 0.9%. Meanwhile, from Thailand motorcycles had a share of 1.9%, and from Singapore electrical equipment and office equipment had shares of 2.8% and 1.8%. Many of those import products were the output of manufacturing industry and used in the domestic production industry.

Table 5: Major Non-Oil/Gas Import Commodities Share by Country of Origin

Japan		China		United States		Singapore		Thailand	
Motor Vehicles for Public Roads	1.99%	Iron and Steel	1.33 %	Other Transportation	0.71 %	Electrical Machines Tools, and Fittings	2.81 %	Motor Vehicles for Public Roads	1.89 %
Iron and Steel	1.81%	Yarn, Fabrics Textile and Product	0.88 %	Industrial Machinery and Fittings	0.67 %	Office Appliances And Fittings	1.75 %	Organic Chemicals	0.60 %
Electrical Machines, Tools, and Fittings	1.51%	Electrical Machines, Tools, and Fittings	0.82 %	Textile Fiber and Residue	0.48 %	Organic Chemicals and Automatic Data Processing	1.54 %	Industrial Machinery And Fittings	0.54 %
Industrial Machinery and Fittings	1.36%	Industrial Machinery and Fittings	0.67 %	Specialized Industrial Machinery	0.45 %	Telecommunications and Rep. App	1.38 %	Plastic Materials	0.33 %

Corresponding to lower fuel consumption, oil imports in 2006 revealed a tendency to turn down. Lower fuel consumption was a result of slowing economic activities along with the impact of substantial hikes in fuel prices in October 2005. During 2006, the value of oil-gas imports continued to fall, although international oil price had risen quite a lot in the first half of 2006. Overall, the value of oil-gas imports in 2006 dropped by 1.5% to $17.2 billion.

(5) Services

In 2006, the total deficit rose by 16.4% to $20.1 billion. The deficit in services in 2006 rose by 23.2% to $11.2 billion primarily due to freight cost in relation to imports activity and the increase in transportation costs. For travel services, this was especially due to the flow of Indonesian tourists going overseas- including Haj and Umroh. From the revenue side, services faced a decline, including foreign exchange revenue from foreign tourists, due to unfavorable local tourism climate. Realization of foreign tourist arrivals fell by 2.6% to 4.9 million people. This descent mainly from concerns in the wake of the second Bali bombing in the final quarter of 2005, natural disasters in a number of regions, and the bird flu epidemic. Meanwhile, the deficit in incomes rose by 6.1% to $13.7 billion, mainly due to the transfer of profits from FDI and reinvested earnings.

Actually, there was no outflow in the reinvested earning since it was also documented as inflow on financial account. The source of the increase in the deficit also originated from portfolio interest payments and dividends which noted a bigger deficit of $ 2.7 billion from $1.7 billion.

Current transfer posted a surplus, mainly coming from workers remittances. Current transfer during 2006 had a surplus of $4.9 billion. Inflows from workers remittances reached $5.6 billion or up around

5.4% compared to 2005. It triggered by improvements of Indonesian overseas workers data based on the survey conducted by Bank Indonesia and the Manpower and Transmigration Department. With these improvements there was an upward revision in the number of Indonesian overseas workers to 4.3 million people. By country, worker remittances from Saudi Arabia and Malaysia still gave the biggest contribution. Meanwhile, the source of other transfers included the channeling of grants relating to the international community's commitment to rebuild Nanggroe Aceh Darussalam (NAD) and Nias following the devastating tsunami in 2005.

(6) The Capital and Financial Account

In the capital and financial account, foreign portfolio investment continued at a strong pace, charting a surplus of US$3.8 billion. These portfolio capital inflows were invested on the stock market and in government securities and SBIs, following the improvement in perceptions of the economic outlook and encouraged by prudent macroeconomic policy and high yields on rupiah placements. Foreign direct investment, however, recorded a US$4.1 billion surplus, down from the preceding year. Overall, the capital and financial account generated a surplus of US$2.5 billion.

With such encouraging balance of payments performance, the government was able to accelerate repayments of the IMF outstanding debts. The remaining debts of $7.6 billion which would have matured up to 2010 were actually settled while still keeping sufficient foreign exchange reserves.

The country's foreign exchange reserves stood at $42.6 billion at the end of 2006 or equivalent to 4.5 months of imports and government foreign debt repayments. In turn, performance of the balance of payments had positive impact on external vulnerability indicators and supporting macroeconomic fundamentals including stability of rupiah exchange rate.

Table 6: Indicators of External Vulnerability

Description	1996	1997	2004	2005	2006*
Current Account/GDP	-3.4	-2.3	0.6	0.1	2.6
Exports of Goods and Services	25.7	29.1	34.3	37.4	33.3
Non-oil and Gas Exports/GDP	16.7	19.7	21.4	23.1	21.8
Foreign Debt Interest/GDP	2.7	3.0	2.2	1.0	1.3
Debt Service Ratio[1)]	35.9	44.5	27.1	17.3	24.5
Capital and Finance Flow/GDP	4.8	1.1	0.7	0.1	0.7
Foreign Debts/Exports of Goods and Services	188.7	207.3	157.1	123.3	102.0
Foreign debt/GDP	48.5	60.3	53.9	45.1	33.9
International Reserves/Debt Service[2)]	91.2	73.4	153.6	185.6	141.4
International Reserves/Foreign Debt	17.4	15.7	26.5	26.6	34.0
International/Imports and Gov't Foreign Debt Payments (months)[3)]	5	5.5	5.7	4.3	4.5
Foreign Debt (billions $)	110,171	136,088	137,024	130,652	125,240
International Reserves (billion $)[4)]	19,215	21,418	36,320	34,724	42,586

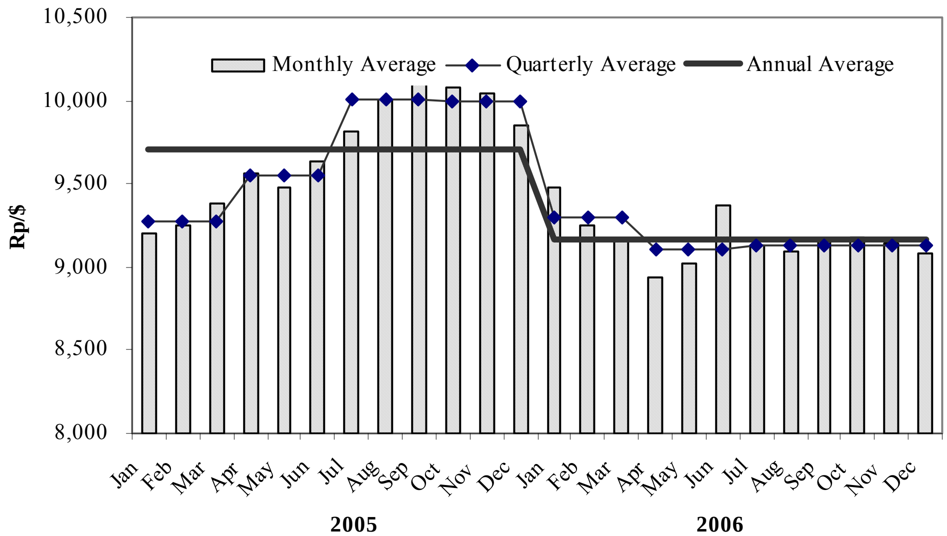
1) Debt Service ratio (DSR) increased in 2006 due to IMF debt repayment $ 7.6 billion
2) Foreign Debt repayment including principal and interest
3) In 1996 and 1997, the international reserves divisor did not include payments on government foreign debt
4) In 1996, the concept of official reserves was used. In 1997-1999 based on Gross Foreign Assets concept, and beginning in 2000, the International Reserves and Foreign Currency Liquidity (IRFCL) concept

(7) Exchange Rate and Exchange System

The rupiah appreciated against the dollar by 9.3%; from Rp9,831 per dollar at the end of 2005 to Rp8,995 at the end of 2006. As an average, the rupiah gained 6.0% from Rp9,713 per dollar to Rp9,167. In addition, the exchange rate in 2006 stabilized over the previous year; reflected by less volatility, more specifically 4.2% in 2005compared to 3.9% in 2006. Exchange rate stability was buttressed by conducive global economic conditions and better macroeconomic fundamentals complemented by consistent monetary policy to achieve established inflation targets and prudent fiscal policy.

From January to early May 2006, the rupiah strengthened against the dollar to Rp8,772 per dollar; representing appreciation of 11.3% over year end 2005. The strong rupiah was attributable to buoyant supply in the foreign exchange market compared to the demand (excess supply). The significant surge in foreign currency supply was primarily due to inflows of foreign capital into the domestic financial market. For the same period, foreign currency demand waned on account of weak imports in line with a downturn in economic activity as a result of fuel price hikes in October 2005. The rupiah weakened in the mid of May 2006 to Rp9,288 per dollar, fueled by growing expectations of a Federal Reserve interest rate hike above initial estimates. This encouraged foreign investors to withdraw their portfolio investment from Indonesia. However, depreciative pressure on the rupiah quickly dispersed, supported by market confidence in prudent macroeconomic management and diminishing expectation of Fed Fund Rate hike. Towards the end of 2006, the exchange rate remained relatively stable at around Rp8,995 per dollar.

Figure 1: Average Rupiah Exchange Rate



Source: Bank of Indonesia

(8) Foreign Direct Investment

Capital flows in the form of FDI in 2006 recorded a surplus of $4.1 billion or down from $5.3 billion in 2005. This decline was due to higher Indonesia FDI overseas and lower capital inflows. Although FDI inflows were less than the previous year, but FDI into the oil-gas sector rose by 6.5% to $7.3 billion. The high international oil price provided the main incentive for foreign oil companies to boost their efforts in the oil-gas sector. The additional incentive of cost recovery provided by the government for the development of less productive fields also boosted investment.

Foreign Direct Investment in the non oil-gas sector documented insignificant surplus. Net FDI reached $5.9 billion in 2006. Business sectors which were attractive were manufacturing sector, (electricity, gas, and water sector), and (trade, hotels, and restaurants sector). In addition, loan disbursement by foreign companies from their parent companies abroad and reinvested earning for expansion also showed an escalation. The relatively low levels of FDI inflows in the non oil-gas sector reflected that improvements in the investment climate were not yet optimal.

Table 7: Direct Investment Transaction

(Million of $)

Description	2004	2005	2006
FDI (net)	-1,512	5,271	4,096
Abroad (net)	-3,408	-3,065	-3,418
In Indonesia (net)	1,896	8,336	7,514
Non-Oil and Gas	1,923	7,282	5,916
Oil and Gas	-27	1,054	2,620

(9) Borrowing from Abroad

The foreign debts indicator showed an improvement with total foreign debts of $125.2 billion at the end of 2006 or down from $130.7 billion in the previous year. The decline in foreign debts was mainly due to a decline in the government's foreign debts in the wake of the IMF debt repayment. Meanwhile, debts from the private sector showed a slight increase to $49.2 billion from $48.6 billion in the previous year. With an improvement in the foreign debts indicator and improvements in a number of macro indicators, both ratio of debts to exports and debts to GDP declined to 102% and 33.9% respectively. These indicators provided confirmation of the improvements from critical levels as stated by the World Bank (World Bank threshold).

Meanwhile, the debt service ratio (DSR) rose to 24.5%. Nonetheless, the increase was more due to the acceleration of IMF debt repayments. If debt repayments to the IMF had been carried out as scheduled then the DSR would be around 19% or already below the critical level of 20%.

Table 8: Indonesia Foreign Debt Position

(Million of $)

Notes	2004	2005	2006			
			Mar	Jun	Sep	Dec
Government	80,734	75,406	76,192	72,879	70.636	66,021
Private	52,929	48,601	49,551	49,192	48,118	49,188
a. Financial Institutions	8,211	6,371	6,483	6,340	5,943	5,644
-Bank	3,906	4,042	4,110	3,870	3,643	3,889
-Non-Bank	4,306	2,329	2,374	2,470	2,301	1,755
b. Non-Financial Institutions	44,718	42,229	43,068	42,852	42,174	43,544
Securities	3,361	6,646	8,884	7,863	8,775	10,031
-Government	1,991	4,666	7,208	5,960	6,846	8,087
-Bank	4	15	18	37	34	30
-Non-Financial Institutions	1,367	1,965	1,658	1,866	1,895	1,914
Total	137,024	130,652	134,627	129,934	127,529	125,240

II.1.2 Domestic Environment

The Indonesian economy grew modestly 5.5% in 2006, down slightly from 5.7% in 2005. The economic performance in 2006 was marked by deceleration in private consumption and investment, and higher growth in net exports.

Table 9: GDP Growth and GDP Components Distribution on Demand Side

Year	2003	2004	2005	2006				2006
				I	II	III	IV	
Total Consumption	4.6	4.9	4.3	3.8	5.6	2.8	3.5	3.9
Private Consumption	3.9	5.0	4.0	2.9	3.0	3.0	3.8	3.2
Government Consumption	10.0	4.0	6.6	11.5	28.8	1.7	2.2	9.6
Investmen[t1]	0.6	14.7	10.8	1.1	1.1	1.3	8.2	2.9
Domestic Demand	**6.0**	**5.4**	**5.3**	**1.9**	**3.2**	**1.9**	**6.0**	**3.3**
Net Export	**18.6**	**-19.5**	**13.6**	**54.7**	**3.0**	**0.1**	**-4.6**	**15.6**
Exports of Goods and Services	5.9	13.5	16.4	11.6	11.3	8.2	6.1	9.2
Imports of Goods and Services	1.6	26.7	17.1	2.8	7.5	10.1	9.7	7.6
GDP	**4.7**	**5.0**	**5.7**	**5.0**	**5.0**	**5.9**	**6.1**	**5.5**
Distribution of GDP (%)								
Total Consumption	68.4	68.2	67.3	65.3	66.4	64.5	69.0	66.3
Private Consumption	60.7	60.6	59.6	58.7	58.3	57.2	59.3	58.3
Government Consumption	7.7	7.6	7.7	6.7	8.1	7.4	9.7	8.0
Investment	19.6	21.4	22.5	21.3	21.9	21.9	22.6	21.9
Exports of Goods and Services	38.0	41.1	45.2	46.0	46.4	46.6	48.3	46.8
Imports of Goods and Services	27.2	32.8	36.3	35.2	37.5	38.2	37.2	37.0

1 Gross Fixed Capital Formation

Source: BPS-Statistics Indonesia

(1) Consumption

Growth in private consumption was only 3.2% in 2006, down from 4.0% in 2005, as a result of the decline in public purchasing power following the fuel price hike in October 2005. The deceleration in consumption growth was strongly influenced by declining non-food consumption, reflected in falling sales of consumer items such as passenger vehicles, motorcycles and electronics goods. In contrast, government consumption climbed significantly at 9.6% for 2006 overall, up from 6.6% in the previous year. Disaggregated by component, government consumption increased mainly in personnel expenditures, other expenditures, General Allocation Funds (DAU) and Profit Sharing Funds (DBH). Increased government consumption was also recorded for direct cash transfers aimed at halting the decline in public purchasing power.

(2) Investment

Investment in 2006 was only a slim 2.9% growth in domestic fixed capital formation, far below the 10.8% in 2005 and the 14.7% in 2004. Disaggregated by structure of formation, investment growth was down from decline in non-construction investment, while construction investment maintained steady growth throughout the year. The investment made a relatively small contribution to economic growth by 0.7%, down sharply from 2.3% in 2005. As a share of GDP, gross fixed capital formation in 2006 was 24%, up slightly from 2005.

(3) Net Exports

Growth of exports in 2006 was 9.2%, ahead of the 7.6% growth in imports. During 2006, net exports contributed a positive 1.4% to GDP growth, up from 1.1% in 2005. Robust export growth was closely linked to expanding world demand and high commodity prices for primary products. Leading in export growth were mining and agricultural products. Exports of natural resource-based downstream products, such as palm oil, similarly recorded steady growth in line with rising external demand. In contrast, import growth declined for 2006 overall as a result of weakening domestic demand.

Table 10: GP Growth and GDP Components Distribution on Supply Side

Year	2003	2004	2005	2006				2006
				I	II	III	IV	
Growth (%)								
Agriculture	3.2	2.8	2.7	6.4	1.5	2.2	1.8	3.0
Mining and Quarrying	-1.4	-4.5	3.1	2.7	4.0	1.6	0.7	2.2
Manufacturing	5.3	6.4	4.6	2.9	3.7	5.9	5.9	4.6
Electric, Gas, and Water	4.9	5.3	6.3	5.1	4.5	5.8	8.1	5.9
Construction	6.1	7.5	7.4	7.4	8.7	9.3	10.4	9.0
Trade, Hotels, and Restaurants	5.4	5.7	8.4	4.4	5.5	7.5	7.0	6.1
Transportations and Communication	12.2	13.4	13.0	11.5	13.3	13.6	15.9	13.6
Finance, Rent, and Service	7.2	7.7	6.8	5.7	5.3	4.7	6.8	5.6
Services	4.4	5.4	5.0	5.8	6.1	6.8	6.0	6.2
GDP	**4.7**	**5.0**	**5.7**	**5.0**	**5.0**	**5.9**	**6.1**	**5.5**
Distribution of GDP								
Agriculture	15.2	15.0	14.5	14.9	14.6	14.9	12.2	14.1
Mining and Quarrying	10.7	9.7	9.4	9.1	9.1	8.9	9.4	9.1
Manufacturing	28.0	28.4	28.1	27.8	27.7	27.6	28.3	27.8
Electric, Gas, and Water	0.7	0.7	0.7	0.7	0.	0.7	0.7	0.7
Construction	5.7	5.8	5.9	6.0	6.1	6.0	6.3	6.1
Trade, Hotels, and Restaurants	16.2	16.4	16.8	16.6	16.8	17.0	17.2	16.9
Transportations and Communication	5.4	5.8	6.3	6.5	6.6	6.7	7.1	6.7
Finance, Rent, and Service	8.9	9.1	9.2	9.2	9.2	9.1	9.4	9.2
Services	9.2	9.2	9.2	9.3	9.2	9.1	9.4	9.2

Source: BPS-Statistics Indonesia

Disaggregated by sector, positive growth was recorded across all sectors in the economy. Services continued to grow faster than agriculture and industry, and contributed 3.0 percentage points of the total 5.5% GDP growth. In the agricultural sector, growth mounted from 2.7% in 2005 to 3.0% in 2006. Leading in growth were the transportation and communications and the construction sectors at 13.6% and 9.0%, although these sectors represent only a small contribution to GDP formation. Growth was down mainly in the transportation, machinery and tools manufacturing category, impacted by weak domestic demand and limited support from bank financing. In the foods, beverages and tobacco industries, growth climbed significantly from the year before. During 2006, the manufacturing sector, which accounts for the largest share of GDP formation, recorded 4.6% growth.

(4) Inflation

CPI inflation in 2006 gradually eased from 17.11% in December 2005, fell to 6.60% at the end of 2006, below the Government-established target of 8.0%±1%. Similarly, core inflation at end-2006 came to 6.03%, down from 9.75% at end-2005. Easing inflationary pressure was also seen in the monthly inflation rate, especially inflation coming from the transportation, communications and financial services components. During 2006, inflation was seen in every month with the highest inflation occurring in January and December (1.36% and 1.20% respectively) triggered by surging rice prices. Although high at the beginning of the year, monthly inflation in 2006 was lower than in 2005 overall.

Table 11: Contribution of Core Inflation

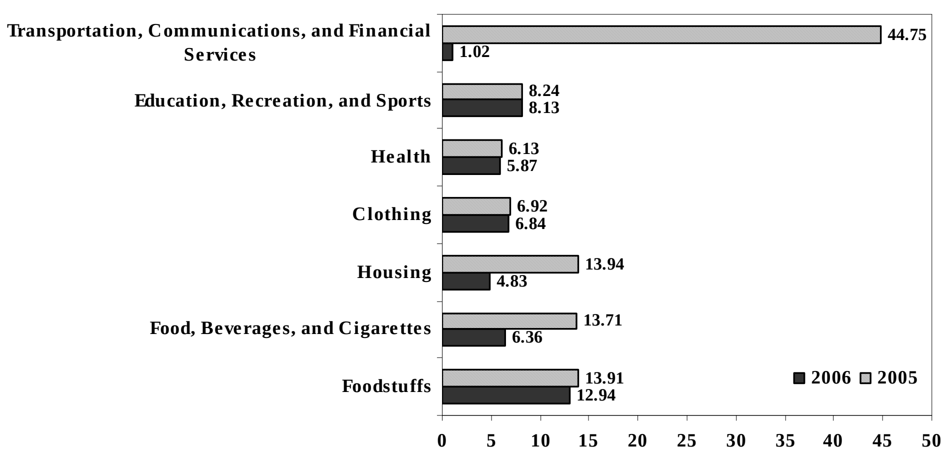
Percent (yoy)

	Core		Volatile Foods		Administered Prices		CPI
	Inflation	Contribution	Inflation	Contribution	Inflation	Contribution	Inflation
2002	7.0	4.2	9.7	2.3	22.1	3.5	10.1
2003	6.9	4.1	-2.4	-0.6	9.1	1.6	5.1
2004	6.7	4.0	6.5	1.3	5.4	1.1	6.4
2005	9.8	6.1	15.5	2.8	41.7	8.1	17.1
2006	6.0	3.0	15.3	3.1	1.8	0.5	6.6

Seen from each component, the most significant fall in the inflation rate was in the transportation and communications component and the financial services component. They were accompanied by a decline in inflation in the housing, water, electricity, gas and fuels along with the prepared foodstuffs, drinks, cigarettes and tobacco components. Meanwhile, the group of goods which experienced the highest inflation rate was the foodstuffs component.

Figure 2: CPI Inflation by Category of Goods

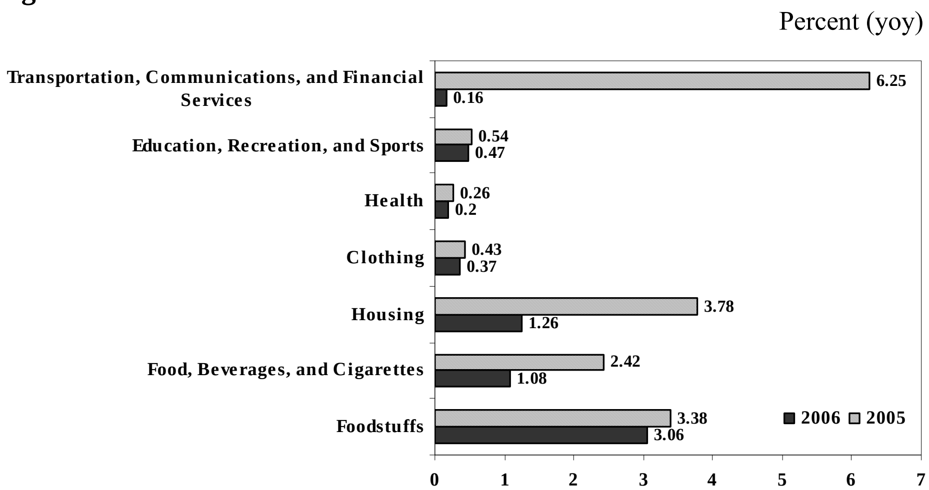
Percent (yoy)



Source: BPS-Statistics Indonesia

CPI Inflation in 2006 was primarily driven by the foodstuffs component. Inflation from the foodstuffs component that reached 3.05% primarily originated from higher prices of basic needs grouped in the sub-group rice, spices, and meat. The long dry season was the main factor which affected prices in the rice and spices sub-group. Inflation was next highest in the housing, water, electricity, gas and fuels, along with the prepared foodstuffs, drinks, cigarettes and tobacco components at 1.28% and 0.99%, respectively.

Figure 3: Contribution to CPI



Source: BPS-Statistics Indonesia

Overall, the decline in CPI inflation during 2006 was attributable to developments in both fundamentals and non-fundamentals. Analysed by fundamentals, lower CPI inflation resulted from improving inflation expectations, stable exchange rate and low inflationary pressure from the output gap. In regard to non-fundamentals, reduced inflationary pressure in the CPI came from minimum increases in administered prices and improvement in volatile foods inflation, even though still relatively high.

Inflation fuelled by administered prices fell sharply during the year. At the end of 2006, inflation from administered prices reached 1.84% (yoy), down from 41.71% in 2005. Key to this was the decision to delay the increase in electricity billing rates and to keep increases in other administered prices to a minimum. Inflationary pressure in the administered prices category came only from hikes in cigarette retail prices and water billing rates.

Annual inflation in the volatile foods category reached 15.27% (yoy), slightly below the 15.51% (yoy) recorded in 2005. During 2006, the Government took active steps to suppress the second round impact of the fuel price hike in October 2005 on volatile foods by ensuring adequate supply and distribution of these commodities.

(5) Money Supply

Lack of full recovery in domestic demand and perceptions of lack of improvement in the investment climate contributed to a steady rise in excess liquidity on the money market during 2006, particularly from banks. In nominal term, annual growth rates of M1 and M2 accelerated, with M1 grew by 28.1%, much higher than growth in 2005 (11.1%). M2 grew by 14.9%, down from 16.4% in 2005. Real M1 continued to accelerate, far exceeding its average position over the last two years. Meanwhile, real M2 started to post positive growth in October. Excess money market liquidity combined with poor acceleration in loan disbursement was reflected in low and declining money multipliers as evident in the persistently weak M1 and M2 money multipliers in relation to developments over the past two years. Inadequate use of economic liquidity was also visible in the rising trend in M2 velocity. At end-2006, M2 was recorded at Rp 1,382 trillion, having expanded Rp 178.9 trillion during the year. This M2 expansion resulted mainly from increased quasimoney (savings and time deposits).

Analysed by influencing factors, the rise in M2 was dominated by credit expansion for business and households. The upward trend in lending was recorded for credit in both rupiahs and foreign currency, in line with the stable exchange rate during 2006. During the last quarter of the year, M2 growth was driven mainly by increased lending for working capital and consumption. At the same time, net claims on government reflected the extent of the monetary implications of fiscal policy. Net foreign assets expanded faster than that of the previous year due to increased net foreign assets held by banks mostly in call money placements on foreign money markets. In a similar vein, the higher net foreign assets also reflected mounting volume of capital inflows into the domestic financial system.

Table 12: Changes in Money Supply and its Affecting Factors

Billions of Rupiah

Items	2003	2004	2005	2006	2006 I	II	III	IV
Money Supply								
M2	71,784	77,836	169,687	178,859	-8,148	58,938	37,391	90,678
M1	31,860	30,019	28,087	79,168	-4,612	36,122	20,490	27,168
Currency	13,856	14,723	15,051	26,693	-11,691	11,398	5,946	21,040
Demand deposits[1)]	18,004	15,296	13,036	52,475	7,079	24,724	14,544	6,128
Quasi Money	39,924	47,817	141,600	99,691	-3,536	22,816	16,901	63,510
Affecting factors								
Net foreign assets	21,124	-8,173	49,436	100,182	34,887	-2,513	55,608	12,200
Net claims on central government	-31,338	18,134	882	7,587	-42,627	11,730	20,478	18,006
Net claims on IBRA								
Claims on business sector	77,532	148,976	123,039	517,860	-7,964	28,477	30,764	466,584
Claims on official entities/state enterprises	1,198	2,832	1,140	10,887	-2,502	4,189	2,112	7,088
Claims on private enterprises/individuals	76,334	146,144	121,899	506,973	-5,462	24,288	28,652	459,496
Net other items	-4,466	-81,974	-3,672	-27,139	-6,219	48,721	21,123	6,678

1) Consists of time and saving deposits in rupiah and foreign currencies, and demand deposits in foreign currency held by residents

(6) Employment

Figure 4: Labor Force, Working, and Unemployment

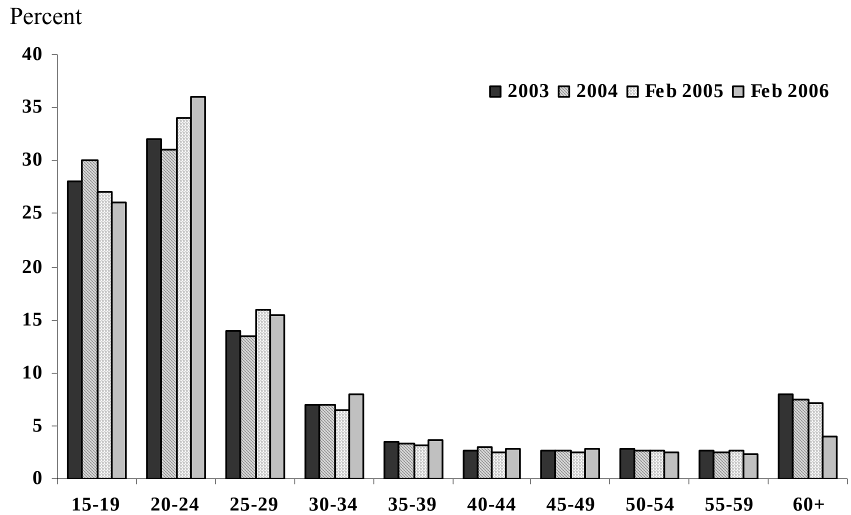
Source: BPS-Statistics Indonesia

The structure of economic expansion, not balanced by significant growth in production capacity, constrained the capacity for growth to bring about reduction in unemployment. Open unemployment fell slightly from 11.2% in 2005 to 10.3% (Figure 4). However, at this level unemployment was still considerably higher than the pre-crisis average of 5.5%. Disaggregated by age group, most of Indonesia's unemployed were younger and more productive workers aged 15-24 years (Figure 5). The high proportion of unemployed in this age group indicates that the labour market is not yet optimal to absorb school leavers entering the workforce. This was also consistent with the predominance of job seekers with junior and senior high school education, who represented more than 60% of total unemployed (Figure 5). The lack of significant reduction in unemployment is primarily driven by the workforce absorption of individual economic sectors. Sectors able to absorb large numbers of workers, such as agriculture and manufacturing industry, have not seen strong growth.

In 2006, workforce absorption in the two sectors recorded negative 2.8% and 0.5% growth, well below the positive 1.7% and 8.0% expansion in 2005 (Table 12). At the same time, high growth in transport and communications, construction and services failed to make much dent in unemployment because of the capital and technology-intensive nature of these sectors.

Nevertheless, these developments in workforce absorption have not had much effect on workforce composition. The workforce remains concentrated in the agriculture, trade and industry sectors at 42.0%, 17.8% and 12.5%.

Figure 5: Unemployment Based on Age Composition



Source: BPS-Statistics Indonesia

Table 13: Growth of Labor Force Absorption Pre & Post Crisis (Per 1% GDP)

Sector	Growth 1 Year (%)			Pre-Post Crisis Per 1% GDP	
	2004	2005	2006	1991-1996	2000-2005
Agriculture	-5.7	1.7	-2.8	-343,636	-563,452
Mining	41.2	-12.6	15	16,920	137,751
Manufacturing	-3.7	8	-0.5	52,372	19.965
Electricity	52.1	-15.7	6.7	597	-200
Construction	12	0.6	3	24,449	-69,772
Trade	10.8	-6.3	7.3	50,354	26,151
Transportation/Communication	11	3.1	0.1	29,941	16,828
Finance	-13.9	1.5	9.5	2,984	5,969
Services	6.9	-1.8	10	101,931	-33,286
Total	**1**	**0.3**	**1.6**	**222,979**	**191,731**

Source: BPS-Statistics Indonesia

II.2 Fiscal Position

Table 14: Summary of Government Finance and Operation

Description	Realization in 2005			Budget 2006		Revised Budget 2006		Realization in 2006		
	Tril of Rp.	% of GDP	% of Budget	Tril of Rp.	% of GDP	Tril of Rp.	% of GDP	Tril of Rp.	% of GDP	% of Budget
A. Total Revenues and Grants	495.2	18.1	91.7	625.2	20.6	659.1	21.1	637.8	19.1	96.8
I. Domestic Revenues	493.3	18.1	92.7	621.6	20.4	654.9	21.0	635.9	19.1	97.1
1. Tax Revenues	347.0	12.7	98.6	416.3	13.7	425.1	13.6	409.1	12.3	96.2
2. Non-Tax Revenues	146.9	5.4	81.3	205.3	6.8	229.8	7.4	226.9	6.8	98.7
II. Grants	1.3	0.0	17.5	3.6	0.1	4.2	0.1	1.9	0.1	43.9
B. Total Expenditures	509.6	18.7	90.2	647.7	21.3	699.1	22.4	670.6	20.1	95.9
I. Central Government Expenditures	361.2	13.2	87.7	427.6	14.1	478.2	15.3	444.2	13.3	92.9
a. Personnel Expenditures	54.3	2.0	88.7	79.9	2.6	79.1	2.5	72.9	2.2	92.2
b. Good Expenditures	29.2	1.1	69.0	55.2	1.8	56.0	1.8	47.1	1.4	84.1
c. Interest Payment	65.2	2.4	106.9	76.6	2.5	82.5	2.6	79.0	2.4	95.8
d. Subsidies	120.8	4.4	101.4	79.5	2.6	107.6	3.5	107.4	3.2	99.8
e. Capital Expenditures	32.9	1.2	60.1	63.0	2.1	69.8	2.2	58.9	1.8	84.5
f. Grants Expenditures	0.0	0.0	0.0	0.0	0.0					
g. Social Assistance	24.9	0.9	83.2	36.9	1.2	41.0	1.3	43.4	1.3	105.8
h. Other Expenditures	34.0	1.2	78.3	36.5	1.2	42.3	1.4	35.5	1.1	84.0
III. Regional Budget Expenditure	150.5	5.5	98.1	220.1	7.2	220.8	7.1	226.4	6.8	102.5
III. Suspen	(2.0)									
C. Primary Balance	50.8	1.9		54.2	1.8	42.5	1.4	46.2	1.4	
D. Budget Surplus/(Deficit)	(14.4)	(0.5)	57.8	(22.4)	(0.7)	(40.0)	(1.3)	(32.8)	(1.0)	82.0
E. Financing	11.2	0.4		22.4	0.7	40.0	1.3	33.0	1.0	
I. Domestic Financing	21.5	0.8		50.9	1.7	55.3	1.8	52.3	1.6	
1. Domestic Bank Financing	(2.5)	(0.1)	(57.0)	23.0	0.8	17.9	0.6	15.2	0.5	85.0
2. Domestic Non-Bank Financing	23.9	0.9	93.9	27.9	0.9	37.4	1.2	37.1	1.1	99.2
a. Privatization (nett)	0	0.0	0.0	1.0	0.0	1.0	0.0	0.4	0.0	40.0
b. Asset Sales Banking Restructuring Program	6.6	0.2	128.7	2.4	0.1	2.6	0.1	2.7	0.1	104.1
c. Government Bond Sales, nett	22.6	0.8	102.2	24.9	0.8	35.8	1.1	36.0	1.1	100.6
d. Infrastructure Funds	(5.2)	(0.2)	99.9	(0.4)	(0.0)	(2.0)	(0.1)	(2.0)	(0.1)	100.0
II. Foreign Financing (nett)	10.3	(0.4)	211.8	(28.5)	(0.9)	(15.3)	(0.5)	(19.3)	(0.6)	126.5
1. Gross Drawing	268	1.0	75.5	35.1	1.2	37.6	1.2	33.4	1.0	89.0
2. Amortization	37.1	(1.4)	91.9	(63.6)	(2.1)	(52.8)	(1.7)	(52.7)	(1.6)	99.8
Assumption:										
Economic Growth		5.68			6.20		5.8		5.48	
Inflation (%)		17.11			8.00		8.0		6.6	
Average exchange Rrate (Rp./$)		9705			9900		9300		9063	
Average 3-month SBI Rate (%)		9.09			9.50		12.0		11.7	
International Oil Prices ($/barrel)		51.81			57		64		63.8	
Indonesian Oil Lifting (million of barrel /day)		0.999			1.05		1.00 0		0.95 9	

Source: Ministry of Finance

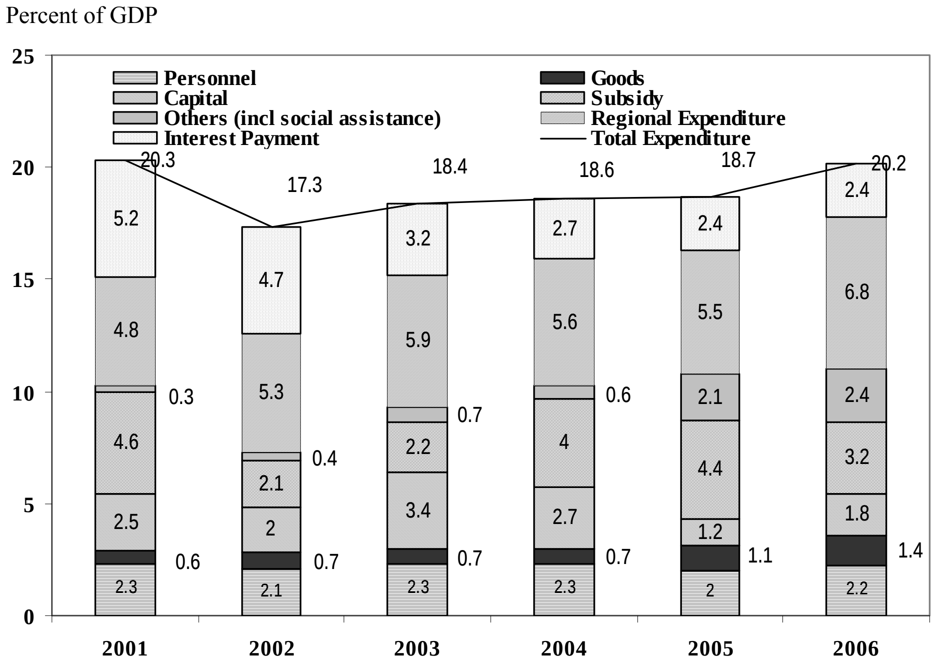
II.2.1 Government Expenditure

Total expenditure in 2006 increased 32%, which was higher than that in 2005 only 19%. The increase was almost in all components of total expenditures, except in fuel subsidy. The expenditure in 2006 was 20.1% of GDP, composed by central government expenditures that was 13.3% of GDP and regional expenditures that was 6.8% of GDP. The central government expenditures in capital expenditures increased 79%, goods expenditures 61%, and personnel expenditures 34%. The regional expenditures increased 50%, especially Special Allocation Fund aiming at the development of infrastructure. The increase in social assistance was in Direct Cash Transfer and electricity subsidy.

Most of total expenditures in 2006 (34%) was allocated to regional expenditures that was 6.8% of GDP. The second largest of the expenditure (28%) were the subsidy and payment of debt interest that were 5.6%

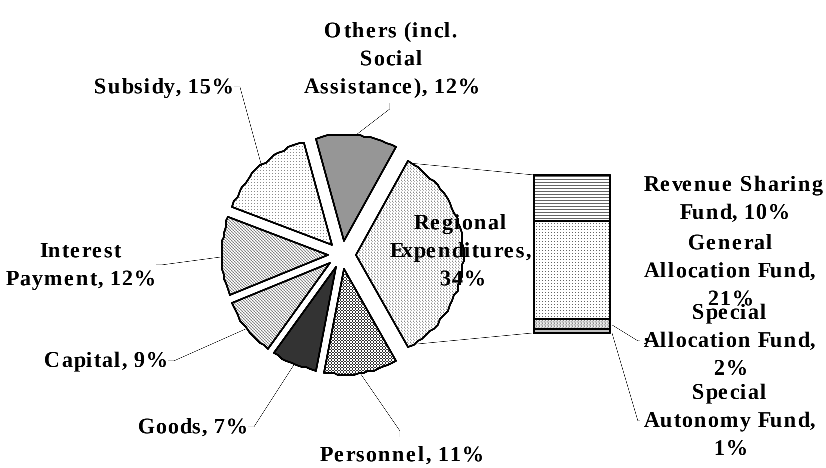
of GDP. Capital and goods expenditures were still the smallest portion (only 9% and 7%) of total expenditure which were about 1%-2% of GDP.

Figure 6: Development of Total Expenditure Component



Source: Ministry of Finance

Figure 7: Total Expenditure 2006 Composition



Source: Ministry of Finance

The realization of total expenditures 2006 achieved 96% from the Revised State Budget 2006, higher than 2005 that was only 90% of the Second Revised State Budget 2005. Nevertheless, several expenditures were still below target, such as personnel expenditures (92%), material expenditures (84%) and capital expenditures (84.5%). However, the absorption of personnel, material, capital and other expenditures in

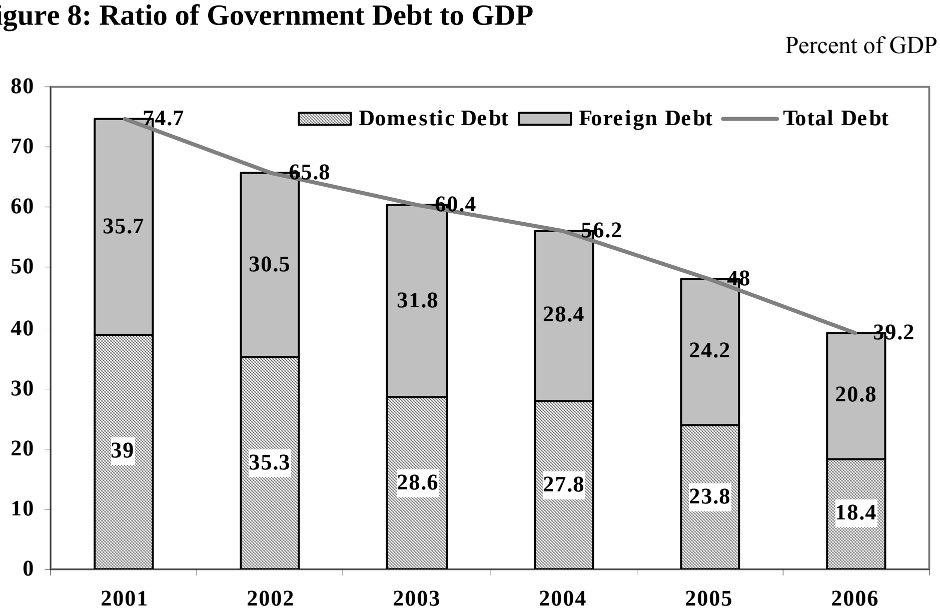
2005 respectively were only 89%, 69%, 60% and 78% of Second Revised State Budget 2005. On the other hand, some other expenditures had relatively achieved the target of Revised State Budget 2006.

From total expenditures reaching 20.1% of GDP, the biggest portion was in the form of consumption (around 40%), followed by transfer (around 34%) and investment (23%). This proportion has relatively been unchanged since 2002. With this development, government consumption reached 8% of GDP, investment reached 5% of GDP and transfer payment reached 7% of GDP. Government consumption and investment had increased compared to the performance of 2005 reaching respectively 7% and 3% while transfer payment was relatively unchanged. In overall, the highest increase of government contribution was made through investment activities especially through the raise in capital expenditure reaching 84.5% of Revised State Budget of 2006. This achievement was better than the one obtained in 2005 reaching only 60% of the Second Revised State Budget 2005.

The composition of capital expenditures were around 30% for both equipment/machinery and infrastructure (roads, irrigation, network), around 20% for buildings, and the rest was for land and other physical assets. Meanwhile, the increase in government consumption was supported by the raise in basic salary of civil employees, 13th month salary, and the increase of general allocation fund and revenue sharing fund allocation. The improvement in the absorption of materials and other expenditures also gave contribution to this increase each reaching 84% of the target. The performance of those expenditures was better than ones in 2005 which respectively reached 69% and 78% of the target. The increase of transfer payment especially came from social assistance and direct cash transfer which were far higher than 2005. The increase of government investment was made by the policies in revenue side and expenditures side which raised government saving to finance partly government investment.

II.2.2 Public Borrowing

Figure 8: Ratio of Government Debt to GDP



Source: Ministry of Finance

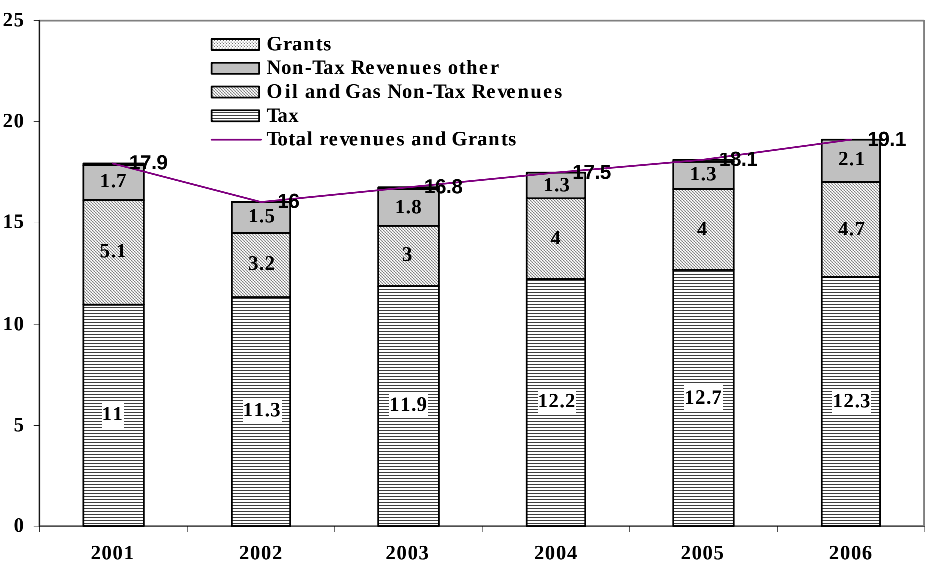
To finance budget deficit, the Government succeeded in collecting fund from government bond issuance amounting to Rp 32.8 trillion. The largest fund collected by the Government was from the issuance of government bond (nett) and the use of its accounts at the central bank representing respectively Rp 36 trillion and Rp 15.2 trillion. For 2006, the objective was achieved through bond issuance in domestic market and in foreign currency as well as the selling of Obligasi Negara Ritel and debt switching of government bond. The net revenues obtained from bond issuance was Rp36 trillion after the payment of matured bond amounting Rp23.6 trillion, which was relatively in accordance with the target. Meanwhile, the disbursement of foreign debt was below budget, around Rp 33.4 trillion, or 89% of the target. With the amortization of foreign debt amounting to Rp 52.7 trillion, the nett of foreign debt financing was higher than initially targeted, reaching negative Rp 19.3 trillion. Apart for deficit financing, the bond issuance was also used for infrastructure financing through Public-Private-Partnership (PPP) program amounting to Rp 2 trillion. With this deficit financing strategy, Government debt outstanding in 2006 reached around 40% of GDP consisting of domestic loan amounting to 20.8% of GDP (53%) and foreign debt amounting to 18.4% of GDP (47%). Due to this development, the ratio of government debt was still in declining trend and was lower than the ratio in 2005 reaching 48% of GDP.

II.2.3 Government Revenue

The growth of total revenues and grants rose from 23% in 2005 to 29% in 2006, largely supported by the growth of non-tax revenues reaching 55%, while tax-revenues increased by 18%. Consequently, the ratio of total revenues and grants towards GDP reached 19.1% consisting of tax revenue amounting to 12.3% of GDP, non-tax revenue amounting to 6.8% of GDP, and grants reaching 0.1% of GDP. On the other hand, the portion of tax revenues in total revenues and grants declined from 70% in 2005 to 64% in 2006. The realization of grants was higher than that of 2005. This is due to the fact that the realization of grants also depends on the commitment and willingness of grant provider. The major part of the grant was used for rehabilitation and reconstruction program of Aceh-Nias.

Figure 9: Development of Total Revenues and Grant Component

Percent of GDP

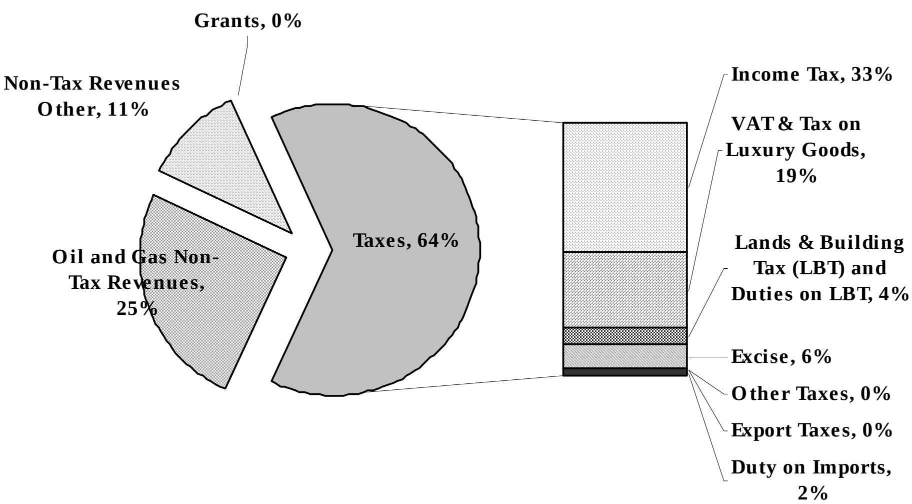


Source: Ministry of Finance

Better tax performance in 2006 was reflected from the tax ratio around 12.0% of GDP and the increasing number of tax payers from 19.8 millions in 2005 to 20.8 millions in 2006. In nominal terms, there was an increase in almost all of tax components except for Import Duties and Duty on Land and Building Acquisition. This condition was mainly related to the policy of tariff harmonization in international trade and slow growth of land and building transactions. The increase of excise was also benefited from the hike of taxable goods such as cigarettes and beverages containing ethyl alcohol. Moreover, the policy implementation on increase of Retail Selling Price (HJE) by 10% starting April 1st, 2006 for all kinds of tobacco had also affected tax revenues. Due to the hike in crude oil prices, tax revenues from oil and gas increased along with coupled with the raise in oil and gas revenues.

The other factor boosting the increase of tax was the increasing of transactions using stamp duty. Basically, several measures in taxation were aimed at providing fiscal stimulus. These included the increase of non-taxable income by 10% from Rp 12 millions to Rp 13.2 millions for each individual taxpayer as well as other tax facilities such as ones in Income Tax, Value Added Tax, and Tax on Luxury Goods. Added to this, in International Trade Tax, the policy of lowering import duty was associated with tariff harmonization on particular products which decreased periodically. Meanwhile, the policy for reducing the volume of dutiable imported goods was related with various policies in international trade such as trade arrangements on specific products as well as policies on Free Trade Agreement such as AFTA, FTA, ASEAN-China, Japan, South Korea and India.

Figure 10: Total Revenues and Grant 2006 Composition



Source: Ministry of Finance

Table 15: The composition of tax revenue by types of taxes

(in billions of Rupiah)

Fiscal Year	Domestic Tax					International Tax		Total Tax Revenue (A)	Total Domestic Revenue (B)	% A/B
	Income Tax	VAT	Land & Building Tax	Excises	Other Tax	Import Duties	Export Tax			
2001	94,576.	55,957.0	6.662,9	17,394.	1,383.	9,025.8	541.2	185.540,9	300.599,5	61.7
2002			7,827.7						298.527,5	70.3
2003			10,905.3		1,654.	10,884.6	229.7	242,048.2	340.928,3	71.0
2004	134,903	87,567.3	14,680.0	29,172.	1,832.	12,444.2	297.6	280,897.6	403.104,6	69.6
2005	180,252	102,670.	17,036.7	32,244.	2,198.	16,590.5	979.9	351,973.6	493.919,4	71.2
2006	210,713	128,307.	21,008.0	36,519.	2,772.	16,572.6	418.9	416,313.2	654.882,4	63.5
2007	261.698	161.044,	26.656,9	42.034,	3.157,	14.417,6	452,8	509.462,0	720.389,0	70.7

Source: Ministry of Finance

The increase of non tax revenue in 2006 was mainly driven by oil and gas revenues, profit of State Owned Enterprises (SOE) as well as other non tax revenues. The soaring crude oil price from US$51,8 per barrel in 2005 to US$63,8 per barrel in 2006 had driven oil and gas revenues inspite of the strengthening of rupiah from Rp 9705/dollar in 2005 to Rp 9063/dollar in 2006. The realization of total revenue and grants 2006 reached 97% of the Revised State Budget 2006 especially due to the development on tax revenues and revenues from oil and gas sector. Tax revenues reached 96.2% of the Revised State Budget

2006, lower than the last five years development which represented 99% of the Revised State Budget 2006. This condition is attributable to the slowing economic activities in automotive and chemical industries as well as the decreasing of imports volume on consumer products thus affecting several types of taxes. Meanwhile, the realization of oil and gas revenues reached 98.9% of the Revised State Budget 2006 as the impact of lower oil lifting realization and stronger Rupiah compared to initially estimated. The oil lifting realization continued to decline from the beginning of the year until finally reaching an average of 0.959 million barrel per day, lower than 1 million barrel per day as initially assumed in the Revised State Budget 2006. Meanwhile, the rupiah exchange rate during the period of 2006 reached Rp 9063/dollar, stronger than Rp 9300/dollar as forecasted in the Revised State Budget 2006.

III. Tax Structure: Institutions and the Reality

III.1 Historical Background

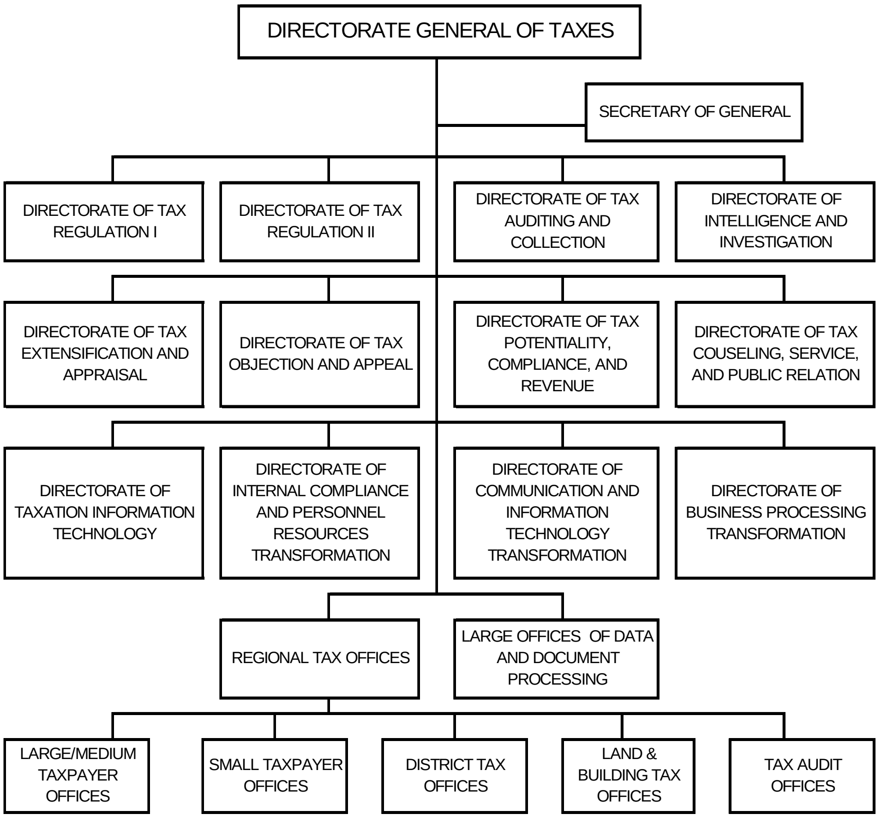
Indonesia taxation history can be divided into two periods, before and after Indonesian independence in 1945. The first Indonesian income tax that applied to all individual income tax earners, regardless of ethnicity, and all companies in colonial Indonesia was introduced by the enactment of Income Tax Ordinance in 1920. After Indonesian independence in 1945, Indonesian taxation had administrated by some different bodies under the Ministry of Finance. In 1976, those bodies are merged and formed a new organization namely Directorate General of Taxes.

Before 1983, Indonesian tax laws were still comprised of various overlapping laws since the colonial period. The year 1983 was the first fundamental Indonesian tax reform, when Indonesian tax laws were simplified to be only five tax laws: (1) General Provisions and Taxation Procedures; (2) Income Tax; (3) VAT and Sales Tax on Luxury Goods; (4) Stamp Duty; and (5) Land and Building Tax. The 1983 reform also the introduction of self assessment system in Indonesian Taxation.

III.2 Current Tax Administration

Directorate General of Taxes (DGT) has responsibility in formulating the policy, collecting, and administering taxation in national scale. DGT's head office is located in Jakarta. In conducting its operation, DGT is supported by 1 Secretariat of DGT, 12 Directorate, 1 General Office of Data and Document Processing, 31 Regional Offices, 190 Tax Offices (including Tax Offices that runs Modern Administration System, there are 2 Large Tax Payers Offices, 10 Specialized Tax Payers Offices, 6 Medium Tax Payers Offices, and 15 Small Tax Payers Offices), 146 Land Building Tax Offices, 55 Tax Audits Offices, and 237 Tax Counseling Offices. DGT has more than 29,000 personals, with various educational backgrounds from high school graduates to PhDs.

Figure 11: Current Tax Administration Chart



III.3 Current Tax System

Indonesian taxation also can be divided into taxation by the central government and taxation by local government. Central government taxation administered by Directorate General of Taxes is the only body that authorizes income tax, VAT, stamp duty, and land and building tax. Local government taxation doesn't have authority to collect taxes that already levied by the central government, and only administers few taxes such as auto vehicles tax, hotels and restaurant tax, outdoor advertising tax.

Tax collection in Indonesia is under the self assessment system; tax payers calculate their tax amount and pay the amount to the state treasury by themselves before fill in tax returns. To secure the payments, tax payers pay at banks or post offices. Nowadays, tax payers even may pay at ATMs, internet, and other convenient modes.

III.3.1 Personal Income Tax

(1) Tax Residence

Taxable subjects can be either Indonesian tax residents or non-residents. Tax residents are subject to tax on world wide income, while non residents are only subject to tax on Indonesia source income.

An individual is regarded as tax resident if he/she:

- is domiciled in Indonesia;
- is present in Indonesia for more than 183 days within 12 months of period;
- is present in Indonesia within the fiscal year and intends to reside in Indonesia.

Resident individuals are subject to general tax rates (Article 17 Income Tax Law) and withholding tax rates (Article 21, 22, 23 and 4 (2)). Non resident individuals are subject to a 20 % withholding tax (Article 26, subject to treaty provisions).

(2) Income Subject to Tax

Taxable income is defined as any increase in economic prosperity received or accrued by a taxpayer, whether originating from within or outside Indonesia, that may be used for consumption or to increase the recipient's wealth in whatever name and form. It includes any remuneration in connection with work or services, business profits (with no distinction between operating and capital income), dividends, interest, rent, royalties and other income related to the use of property.

Certain income is exempt from tax, such as dividends earned by a domestic corporation from another domestic corporation, provided that the dividend is from the retained earnings, the shareholding of the recipient is at least 25%, and the recipient maintains other active business. Fiscal exit tax (Rp. 1 million per exit from Indonesia by plane and Rp. 0.5 million by ship) is a form of prepayment of an individual's income tax.

(3) Tax Rates

Resident individual income is subject to income tax at the following general tax rates (Article 17 Income Tax Law):

Table 16 : General Tax Rate for Individual

Taxable Income (Rp)	Tax Rate (%)	Cumulative Amount (Rp)
On the first 25,000,000	5	1,250,000
On the next 25,000,000	10	3,750,000
On the next 50,000,000	15	11,250,000
On the next 100,000,000	25	36,250,000
Over 200,000,000	35	-

(4) Threshold (Personal Exemption)

Table 17: Annual non-taxable income for individuals

Exemption for	(Rp)
Taxpayer	13,200,000
Spouse	1,200,000
Each Dependent (maximum of 3)	1,200,000
Occupational Expenses	1,296,000
Pension Expenses	432,000
Employee contribution for old age security savings	2% of gross income amount

(5) Computation of Taxable Income

- Taxable income is determined by subtracting allowable deductions and exemptions, and carryover of losses from current year revenue. Certain expenses, such as employee benefits in kind and donations, are generally not tax deductible for the employer.
- Carryover of losses is allowed for up to five years.
- The tax due is determined by multiplying the taxable income with the tax rates.
- The tax amount payable is determined by deducting the tax due with tax credits and taxes withheld.

(6) Fringe Benefits

Benefits in kinds (BIKs), e.g. car, education, home leave, and reimbursement, of an employee's Indonesian tax liability provided by the employer, are typically not assessable in the hands of employee. The same principle applies to BIKs required to perform a job, such as protective clothing, uniforms, transportation costs to and from the place of work and accommodation for ship crews and the like, and the cost of providing BIKs in remote areas.

III.3.2 Corporate Income Tax

Taxpayers for income tax purpose are individual, undivided inheritance as unit in lieu of the beneficiaries, corporation, and permanent establishment. Taxable income of a resident taxpayer in a taxable year shall be income reduced by allowable deductions.

Income is defined as any increase in economic capability received or accrued by a taxpayer, originating from Indonesian as well as from offshore, in whatever name or form, that can be used to consume or to increase the wealth of the taxpayer

Table 18: Applicable tax rates for entities other than individuals

Taxable Income Brackets	Tax Rate
Rp. 50 million or less	10%
Over Rp. 50 million – Rp. 100 million	15%
Over Rp. 100 million	30%

Deductions allowed in calculating taxable income are defined as:

- expenses to earn, to collect and to secure income, including cost of materials, costs in connection with employment or services including wages, salaries, honoraria, bonuses, gratuities and remuneration in the from of money, interest, rents, royalties, travel expenses, waste processing expenses, insurance premiums, administrative expenses and taxes other than income tax;
- depreciation of tangible asset and amortization or rights and other expenditures, which have useful life or more than 1 (one) year;
- contribution to a pension fund approved by the Minister of Finance;
- losses incurred from the sale or transfer of properties owned and used in business or used for the purpose of earning, collecting and securing income;
- losses from foreign exchange;
- costs related to research and development carried out in Indonesia;
- scholarships, apprenticeships and training expenses;
- debts which are actually uncollectible with certain requirements.

(1) Depreciation

For calculating tax, it is allowed to depreciate cost of purchasing, erecting, expanding, improving, or replacing tangible assets, except land that is held for earning, collecting, and securing of income that has a useful life or more than one year. For building category, straight line method is applied, and for other tangible assets double declining balance method may be applied.

Table 19: The Percentage of Depreciation for Each Group of Assets

Group of Tangible Assets	Useful Life (years)	Depreciation Rate	
		Straight Line Method	Double Declining Balance Method
I. Non Building Category			
Group 1	4	25%	50%
Group 2	8	12.5%	25%
Group 3	16	6.25%	12.5%
Group 4	20	5%	10%
II. Building Category			
Permanent	20	5%	-
Non-Permanent	10	10%	-

Group I

- Furniture and wooden/rattan appliance, including table, chair, seat, cupboard, and similar which is not part of the building
- Office machine, such as typewriter, calculator, duplicator, photocopy machine, accounting/bookkeeping machine, computer, printer, scanner and the similar
- Other appliance, such as amplifier, tape/cassette, video recorder, television and the similar

- Motorcycle, bicycle and the pedicab
- Special tools for the relevant industry/service
- Kitchen appliance for cooking, food and beverages
- Dies, jigs and mould

Group II
- Furniture and metal ware, including table, chair, seat, cupboard and the similar, which is not part of the building. Air regulator, such as AC, fan and the similar
- Vehicle, bus, truck, speed boat and the similar
- Container and the similar

Group III for chemical industry
- Machine/equipment for processing/producing products of chemical industry and other industries connected with the chemical industry (inorganic chemical essences, organic and inorganic compound and precious metal, radioactive element, isotope, organic chemical essences, pharmaceutical products, fertilizer, varnish, bleaching agent, dyeing agent, paint, eteric oil and perfume resinoids, beautifying and make-up medicines, soap, detergent, albumminal essence, glue, alloy piroforis, pyrotechnic product, matches, photographic and cinematographic product.
- Machines for processing/producing other industrial product (artificial dammar, plastic material, cellulose ester, synthetic rubber, artificial rubber, tanned leather and skin).

For other industry:
Mining excludes oil and gas:
- Machine used in the mining sector, including machines processing mineral product

Spinning, weaving and bleaching:
- Machines processing/producing textile products (e.g. cotton, silk, manmade fiber, wool and other animal fur fabrics, jute, carpet and fur fabrics, tile)
- Machines for yarn preparation, bleaching, dyeing, printing, finishing, texturing, packaging and the similar

Timber:
- Machines processing/producing wooden products, Articles of jute, grass and other mat
- Timber sawing machine and equipment

Machinery Industry:
Machines producing/yielding medium and heavy machines (automotive and ship machine)
Transport and communication:
- Passenger ships, cargo ships, ships specially designed to carry certain goods (e.g wheat, stones and mineral) including cool storage ship, tanker, fishing ship and the similar, weighing up to 1,000DWT
- Ship specially designed to pull or push signaling ship, fire extingushing ship, dredging ship, floating tap and similar, weighing up to 1,000 DWT
- Floating dockyard
- Sailing vessel with or without engine, weighing above 250 DWT
- Aircraft and helicopters of all kinds

Telecommunication:
- Instruments of navigation radio, radar and long distance controller

(2) Installment

Table 20: Example of Monthly Installment Calculation

(a) Taxable Income of Previous Year	1,000,000
(b) Loss Carry Forward	(200,000)
(c) Taxable Income = (a) – (b)	800.000
(d) Tax due = Tax Rate x (c)	80.000
(e) Previous Years Tax Credit	(2,000)
(f) Tax to be installed = (e) – (d)	78,000
(g) Installment per month = (f) / 12	6,500

Although, the ultimate corporate income tax amount for taxable year should be calculated based on annual income of that year, taxpayers are required to pay monthly installment (Article 25) during the year, the amount of which is based on the preceding year's annual tax return. Taxpayers under certain circumstances may request an adjustment of the installment of the Article 25. According to the decree of Director General Of Taxes number Kep-537/PJ./2000, taxpayers who can prove that the potential tax due for a taxable year would be less than 75% of taxable income of the previous year (basis for calculating Article 25 installment) may request for a reduction of the installment, at the earliest three months after a taxable year began.

III.3.3 Withholding Taxes

Indonesian income tax is collected mainly through a system of withholding taxes. These withholding taxes are commonly referred to by the relevant article of the income tax law.

- Article 21 - withhold tax on salaries and other payments to individuals (after deductions and exemptions), including payments to non-employee individuals (e.g., fees payable to individual consultants and service providers).
- Article 22 - withhold tax on imports of goods (by 2.5 % and 7.5 % tax rate), sales of goods to the government and certain state-owned companies (by 1.5 % tax rate), sales/purchases of transaction of steel, automotives, cigarettes, cement, and paper products (by 0.3 %, 0.45 %, 0.1 % final, 0.25 %, and 0.1 % tax rate, respectively).
- Article 4 (2) - withhold final tax from gross payments of transfers of title of land and/or building (5 % tax rate), rentals of land and/or building (10 % tax rate), interest on time or saving deposits (20 % tax rate), interest on bonds sold on Indonesian stock exchanges (20 % tax rate), sales of shares on Indonesia stock exchanges (0.1 % tax rate), income on prize from lotteries (25 % tax rate), and fees for the services of small construction companies (2 % and 4 % tax rate).
- Article 23 - withhold tax (generally by 15 % tax rate) from gross payment of dividends, interest (including premiums, discounts, and loan-guarantee fees), royalties, prizes and awards (by 25 % tax rate), and from estimated net income on rents (other than land and/or building), fees for technical, management, or other services.
- Article 26 – withhold final tax (generally by 20 % tax rate) from gross payment of dividends, interest (including premiums, discounts, and loan-guarantee fees), royalties, prizes and awards, rents, fees for services, work and activities, and pensions and other periodic payments.

III.3.4 Value Added Taxes

According to Article 4 the Law Number 18 of the year of 2000, VAT is the tax imposed on:

- a supply of Taxable Goods by a Taxable Person for VAT purposes within the Custom Area of Indonesia;
- importation of Taxable Goods;

- rendering of Taxable Service by a Taxable Person for VAT purposes in the Customs Area of Indonesia;
- utilization of intangible Taxable Goods obtained from outside the Customs Area of Indonesia within the Customs Area;
- utilization of Taxable Service obtained from outside the Customs Area of Indonesia within the Customs Area; or
- exportation of Taxable Goods by a Taxable Person for VAT purposes.

Taxable Person for VAT purposes is a firm which supplies Taxable Goods and or renders Taxable Service according to the VAT Law, excluding small firms with a turnover not exceeding a limit determined by the Minister of Finance Decree. However, small firms may choose to be confirmed as Taxable Person for VAT purposes. Firm is an individual or an entity, which in the course of business or work, produced goods, imports goods, export goods, engages in trading activities, utilizes intangible goods obtained from outside the Customs Area, provides business service, or utilizes service obtained from outside the Customs Area. Entity is a group of individual and or capital as a union, whether or not conducting business activity, including a limited company, partnership, a state owned enterprise or company owned by a regional government in whatever name and form, “firma”, “kongsi”’ “cooperative”, permanent establishment, foundation or such kind of organisations, institute and other business form.

(1) Taxable-Nontaxable Goods and Services

Supply of Taxable Goods is any business activity of supply taxable goods which are subject to tax according to the law. Taxable Goods are goods, which according to their nature and legal status are movable, or immovable, and intangible assets, which are subject to VAT. Types of good which are not subject to VAT are:

- Products of mining and drilling, taken directly from the source;
- Daily necessities needed by public;
- Food and beverages served in hotel, restaurant, and similar places;
- Money, gold, and valuable documents.

Taxable Service are any service activity under a contractual agreement or legal arrangement which makes available for use goods, facilities or rights, including services provided on order or request, for which the material is provided by the customer, which are subject to tax according to the VAT law. Types or services which are not subject to VAT are:

- healthcare;
- social welfare;
- postal delivery;
- banking, insurance and financial leasing;
- religion;
- education;
- culture and entertainment which has been imposed by entertainment tax;
- broadcasting, excluding advertising;
- shipping and inland public transportation;
- manpower;
- hotels;
- rendering of service by the government in efforts to run the governance in general.

(2) VAT Base

Tax base for VAT is the sales price or consideration or import value or export value, or such other value as may be determined by the Minister of Finance Decree, to be used as the basis for calculating tax payable.

(3) Sales Tax on Luxury Goods

Sales Tax on Luxury Goods shall be imposed on:

- a supply of Taxable Goods categorized as Luxuries by a firm, which produces the goods within the Customs Area in the course of business or work;
- the importation of Taxable Goods categorized as Luxuries.

Sales tax on Luxury Goods shall be imposed only once, either at the time of supply of the Taxable Goods categorized as Luxuries by the firm producing them, or at the time of import.

(4) VAT Registration

Taxpayer should register at its place of residence, domicile or business activities or such other place as may be determined by the Director General of Taxes, where tax shall be payable.

The Director General of Taxes, upon written request, may determine one place or more as the place or place where tax shall be payable.

Small firms with a turnover not exceeding a limit determined by the Minister of Finance Decree are exempted from the obligation to register their business for VAT purpose. Small firms may choose to be confirmed as a Taxable Person for VAT purposes even though their turnover does not exceed the limit describe in the Ministerial decree. Once the small firms choose to be confirmed as a Taxable Person for VAT purposes, all the obligation of Taxable Person should be fulfilled. The confirmation as a Taxable Person for VAT purposes may be cancelled upon a written request.

According to DGT decree number KEP-334/PJ/2002 taxpayer may request one more places to be tax payable place for VAT purpose. If a VAT centralization (i.e. choosing one place) is desired, an application should be submitted not later than three months before the commencing of the centralization.

Value Added Tax and Sales Tax on Luxury Goods paid on the supply of Taxable Goods, which are subsequently returned, may be deducted from Value Added Tax and Sales Tax on Luxury Goods in the Taxable Period in which the aforesaid Taxable Goods are returned, according to procedures determined by the Minister of Finance.

(5) VAT Return Filing

VAT return should be filed on monthly basis. Due date for filing return is 20th day after the Taxable Period ended (i.e. a month). There is no annual VAT return. Failure to comply with the filing deadline will be subject to an administrative sanction of Rp 50,000.

(6) Calculation for VAT and Sales Tax on Luxury Goods

The tax rates for VAT and Sales Tax on Luxury Goods are as follows:

- The Value Added Tax rate is 10% (ten percent).
- The Value Added Tax rate on the export of Taxable Goods is 0% (zero percent)
- The rates of Sales Tax on Luxury Goods are between 10% (ten percent) and 75% (seventy five percent) depending on types of goods.
- On the export of Taxable Goods categorized as Luxuries, the Sales Tax on Luxury Goods is 0% (zero percent)

The mechanisms to calculate VAT are as follows:

- Value A□ded tax payable shall be calculated by multiplying the tax rate by the Tax Base.
- Input tax in one Taxable Period is credited against Output Tax for the same Taxable Period.
- In case there is no Output Tax has in one Taxable Period, input tax may still be credited.
- In case within a specific Taxable Period, Output Tax is greater than input tax, the difference is Value Added tax, which should be paid by Taxable Person for VAT purposes.
- In case within a specific Taxable Period, creditable Input Tax exceeds Output Tax, the difference is surplus tax, which may be refunded or credited in the next Taxable Period.

- In case within a specific Taxable Period, a Taxable Person for VAT purposes conducts both taxable and non-taxable supply, insofar as the part of taxable supply can be identified exactly from the bookkeeping, the amount of creditable input tax shall be the input tax related to the taxable supply.
- In case within a specific Taxable Period, a Taxable Person for VAT purposes conducts both taxable and non-taxable supply and insofar as the amount of input tax related to the taxable supply can not be identified exactly from the bookkeeping, the amount of input tax which may be credited against taxable supply shall be calculated by using guidelines for crediting input tax determined by the Minister of Finance Decree.
- The amount of input tax which may be credited by a Taxable Person for VAT purposes who pays Income Tax by using deemed profit governed by law number 7 of 1983 on Income Tax as amended by law number 17 of 2000, may be calculated by using guidelines for crediting input Tax determined by the Minister of Finance.

  Input tax may not be credited for costs incurred for:
- the acquisition of Taxable Goods or Taxable Services before firm is registered as Taxable Person for VAT purposes;
- the acquisition of Taxable Goods or Taxable Services which do not have direct connection with a firm's business activities;
- the acquisition and maintenance of motor vehicles, cars, jeeps, station wagons, vans, and "combi" vehicles, except the vehicles used as merchandised or hired goods;
- the utilization of intangible Taxable Goods or Taxable Service from outside the Customs Area prior to confirmation as a Taxable Person for VAT purposes;
- the acquisition of Taxable Goods or Taxable Services of which proof of tax is in form of a simple tax invoice:
- the acquisition of Taxable Goods or Taxable Services of which tax invoice fails to meet the provision referred to in paragraph (5) or Article 13 of the VAT law;
- the utilization of intangible Taxable Goods or Taxable Service from outside the Customs Area for which tax invoice fails to meet the provisions referred to in paragraph (6) of Article 13 of the VAT Law;
- the acquisition of Taxable Goods or Taxable Services of which input tax is collected under the issuance of a assessment;
- the acquisition of Taxable Goods or Taxable Services of which input tax is not reported in the Value Added tax return, which is found when the return is audited by the tax office;

Creditable input tax that has not been credited against output tax for the same taxable period, may be credited in subsequent taxable period, not later than the third month following the end of the Taxable Period concerned, provided it has not been charged as a cost and has not been tax audited.

The mechanisms of Sales Tax on Luxury Goods are as follows:

- Sales Tax on Luxury Goods payable shall be calculated by multiplying the tax rate by the tax Base;
- Sales Tax on Luxury Goods, which is paid on the acquisition, or importation of Taxable Goods categorized as Luxuries, may not be credited against either Value Added Tax or Sales tax on Luxury Goods withheld according to the Law.
- A Taxable Person for VAT purposes who exports Taxable Goods categorized as Luxuries may request refund on the Sales Tax on Luxury Goods paid on the acquisition of the exported Taxable Goods concerned.

(7) VAT Payment

Tax shall be payable at the time of:

- supply of Taxable Goods;
- import of Taxable Goods;

- rendering of Taxable Services;
- utilization of intangible Taxable Goods obtained from outside the Customs Area;
- utilization of Taxable Services obtained from outside the Customs Area; or Export of Taxable Goods.

If payment is received before supply or Taxable Goods, rendering of Taxable Services, the utilization of intangible Taxable Goods or the utilization of Taxable Services obtained from outside the Customs Area, tax shall be payable at the time of payment.

The VAT payable at the place of:

- For a Taxable Person for VAT purposes which conduct supply, tax is payable at its place of residence, domicile or business activities or such other place as may be determined by the Director General of Taxes Decree.
- On a written request by a Taxable Person for VAT purposes, the Director General of Taxes may determine one place or more as the places or places where tax should be payable.
- In case of imports, tax shall be payable at the point of entry of the Taxable Goods and shall be withheld through the Directorate General of Customs and Excise.
- For an individual or an entity who uses intangible Taxable Goods and or Taxable Services within the Customs Area which are obtained from outside the Custom Area, tax shall be payable at the place of residence, domicile or business activities of the individual the entity.

VAT should be paid not later than 15th day after a Taxable Period (i.e. month) ended. The method of payment is similar with income tax, i.e. you can pay either manually or on line with E-payment system. Late payment of VAT will be subject to an administrative penalty in the form of 2% (two percent) interest monthly, calculated from the due date of payment up to the date of payment where fraction of the month is treated as a 1 (one) full month shall be imposed.

(8) VAT Invoice

A Taxable Person for VAT purposes is obliged to issue a VAT invoice for each supply of Taxable Goods and for rendering of Taxable Services. A Taxable Person for VAT purposes may issue a single VAT invoice consisting of all supplies to the same buyer of Taxable Goods or recipient of Taxable Services during one calendar month. If payment is received before the supply of Taxable Goods the rendering of Taxable Services, the VAT invoice should be issue at the time of payment. The time of issuance, format, size, availability and procedures for submission and correction of a VAT invoice shall be determined by the Director General of Taxes.

A VAT invoice should include information concerning the supply of Taxable Goods or the rendering of Taxable Services, which at least consist of the following:

- The name, address, and taxpayer identification number of the Taxable Person for VAT purposes supplying the Taxable Goods or rendering the Taxable Services.
- The name, address, and taxpayer identification number of the buyer of the Taxable Goods or recipient of the Taxable Services;
- The type of goods or services, total sales price or consideration, and amount of discount;
- The Value Added tax charged;
- The sales tax on Luxury Goods charged;
- The code, serial number and date of issuance of the VAT invoice; and
- The name, position, and signature of person authorized to sign the VAT invoice.

An individual or an entity not registered as a Taxable Person for VAT purposes is prohibited from issuing a VAT invoice. If a VAT invoice has been issued, the individual or entity should deposit the tax amount written in the VAT invoice to the state treasury.

VAT need not be charged in part or in full, either temporarily or permanently, in respect of:

- activities in specified zones or specified places within the Customs Area;

- the supply of specified Taxable Goods or rendering of specified Taxable Services; import of specified Taxable Goods;
- the utilization within the Customs Area of specified intangible Taxable Goods obtained from outside the Customs Area;
- the utilization within the Customs Area of specified Taxable Services obtained from outside
- the Customs Area;

Input VAT paid on the acquisition of Taxable Goods and or Taxable Services in connection with the supply for which output VAT is not charged due to the above-mentioned conditions, may still be credited. Input VAT paid on the acquisition of Taxable Goods and or Taxable Services in connection with the supply, which is exempt from the imposition of output VAT, may not be credited.

(9) VAT Refund

Before the refund is given, tax office will conduct a tax examination for VAT. According to circular number 1/PJ.7/2002, under normal circumstances, a tax examination should finish not later than 4 weeks if the tax audit is conducted by tax office, and 2 months if the tax examination is conducted by tax examination office starting from the receipt date of formal letter from the tax office. The length of a tax examination period may be extended for 2 weeks to 4 months depending on the complexity of the audit.

III.3.5 Stamp Duty

The documentation subject to stamp duty is describe as follows:

- Agreement or other letters which is made for the purposes of documentation of the fact, action, or civil nature;
- Notarial deeds including their copies;
- The official land registry (PPAT deeds) including the copies;
- A letter describe the money more than Rp. 1,000,000 (one million rupiah) which stipulates the following:
  - the evidence of receiving money;
  - the statement of account in a bank;
- Financial instruments such as money order, promissory note, IOU, and check with a nominal value exceeding Rp. 1,000,000 (one million rupiah);

The stamp duty dates are as follows:

- The due date for document made by one party is the time when the document is delivered;
- The due date for document made by more than one party, is the time when the document is complete;
- The due date for document drawn up overseas is time when the document is used in Indonesia.

Stamp duty can be paid by use of stamp; use of stamped paper; use of stamping machine; and further stamp. For the document with the nominal amount not exceeding Rp. 250,000 is not subject to stamp duty. For check, bank notes, stock with the nominal value not more than Rp. 1,000,000 and the document with the nominal value more than Rp. 250,000 but not exceeding Rp. 1,000,000, the tariff is Rp. 3,000. For stock with the nominal value more than Rp. 1,000,000 and the document with the nominal value exceeding Rp. 1,000,000, the tariff is Rp. 6,000.

III.3.6 Land and Building Tax

(1) Land and Building Tax

According to the Land and Building Tax Law, the definition of land is the earth surface and earth body to be found underneath; and the definition of building is any technical construction planted into or attached to the earth and/or water permanently. The Taxable Person for Land and Building tax is an individual or an entity who owns a right over the land and/or obtains benefits from it, and/or owns, control and/or obtains benefit from a building.

The base of Land and Building Tax is sales value, which is defined as the average price obtained from an arm's length sale and purchase transaction. Should there not be any such transaction, the taxable sales value is determined by a comparison of price with another object of the same kind, or the new acquisition value, or a substitute taxable sales value.

Land and Building Tax should be paid at the latest 6 months after the date of receipt of the tax notice by a taxpayer.

(2) Acquisition Duty of Land and Building

The acquisition of right on land and or building is subject to acquisition Duty of Right on Land and Building payable by the buyer. Taxable object shall be an acquisition right on land and or building.

The definition of acquisition of right on land and or building includes transfer of right due to: buying; bartering; granting; bequeathed granting; inheritance; contribution to company or other legal entity; separation or right causing transfer of right; buyer determination in auction; judge order which has a definite court verdict; merger; consolidation; business expansion; gift and

conferral of new right due to: continuation of releasing of right; other. The definition of right on land includes: ownership right; right to cultivate; right to build; right to utilize; ownership right on apartment; and development right.

The rate of the acquisition duty of right on land and building is 5%.

III.3.7 Tax Incentives

Special treatments are granted to taxpayers who invest capital in certain sectors and or in certain regions, regardless they are domestic corporation (domestic capital or foreign capital) or foreign corporations. The incentives for investment have benefit of 6 (six) years, so that, the Taxpayer have the rights to deduct 5% (five percent) of the real investment against the net income in every year. This provision can also be used to cover the possibility of agreements with another country or countries in the field of trade, investment and other areas. The special treatments may be granted are:

- Up to 30% (thirty percent) investment allowance;
- Accelerated depreciation and amortization;
- Loss carried forward can be extended after 5 (five) years but shall not exceed 10 (ten) years; and
- Ten percent tax on dividends referred to in Article 26 (tax for non-resident tax payer), unless the tax rate under the relevant tax treaty is lower (only for non-resident taxpayers).

Tax incentives that are offered in Government Regulation No. 1/2007 on Income Tax Facilities for Investment, comprised of following certain industries:

- Food Seasoning Industries
- Textile Industries
- Pharmacy Materials Industries
- Rubber Goods for Industry Purposes Industries
- Laboratories and Porcelain Electrical/Technical Equipment Industries
- Iron and Steel Making, Steel Rolling Industries
- Basic Non-iron Metals Industries
- Machines and Their Equipment Industries
- Electric Motor, Generator, and Transformator Industries
- Electronics and Telematics Industries
- Ground Transport Equipment Industries
- Boat and Ship Making and Repairing Industries
- Basic Non-Iron Metal Making Industries

Tax incentives that are offered in Government Regulation No. 1/2007 on Income Tax Facilities for Investment, comprised of following certain regions:

Table 21:

Industry	Region
Fish and Other Sea Biotic Canning Industries	Maluku, Sulawesi, Papua
Coconut Oil and Corn Flour Industries	Sulawesi
Sugar Industries	Other than Java Island
Cotton Fiber Industries	Sulawesi, Nusatenggara
Paper Based Packaging and Box Industries	Other than Java Island
Plastic Based Packaging Industries	Other than Java Island
Cement Industries	Papua, Maluku, Sulawesi, Nusatenggara
Wood, Rattan/Bamboo Based Furniture Industries	Other than Java Island
Sea Fish Catching and Processing Industries	All Indian Ocean Border
Sea Crustacea Catching and Processing Industries	All Indian Ocean Border

Most of above regions are located in the eastern part of Indonesia which are less developed areas.

Tax Incentives also offered for the development of the East Indonesia. According to the Government Regulation No. 147/2000, the following tax facilities are available to the granted taxpayers:

- VAT and sales tax on luxury goods are not collected on certain transactions;
- A reduction in net income of up to 30% of the amount invested, prorated at 5% for 6 years, provided that the assets invested are not transferred within 6 years;
- Acceleration of fiscal depreciation;
- Extension of tax loss carry-forwards up to 10 years;
- A reduction of withholding tax on dividends paid to non-residents to 10%;
- Exemption from prepaid income tax (Article 22) on the importation of capital goods and other equipment directly related to production activities;
- Postponement of import duties on capital goods and equipment and goods and materials for processing; and
- Exemption from import duties for 4 years on machinery and certain spare parts.

Currently there are approximately 25 areas designated as Integrated Economic Development Area.

The capital allowance, which is the ultimate benefit of the incentives, is only granted for six (6) years. However, after six (6) years, the incentive recipient still can extend its carry loss forward if:

- The new investment is within industry area or bonded zone area;
- Employs at least 500 Indonesian nationals for at least five (5) years;
- The new investment requires economic and social infrastructure investment amounted at least ten billion rupiah (Rp. 10,000,000,000);
- Expenses in research and development in Indonesia for product development or production efficiency at least five percent (5%) of the investment within five (5) years;
- Uses raw material or domestic component product at least seventy percent (70%) since the fourth (4th) year.

III.3.8 Tax Examination

According to the General Provision and Tax Procedures the purposes of tax examination are to assess tax compliance and other objectives may necessary for complying with the provisions of the tax laws. Tax examination is compulsory examination, thus a taxpayer cannot refuse tax examination for all kinds of reason. During the examination, a taxpayer also cannot refuse to disclose book keeping, recording, and documents for all kinds of reason. If a taxpayer refuses to be examined or presents false book keeping, records, and documents, he or she may be penalized between six months to six years imprisonment and/or twice to four times of tax dues. If a taxpayer refuses to disclose book keeping, records, and documents, the income tax can be officially calculated.

To assess compliance, tax examination can be conducted in case of:

- Tax return in an overpayment position (without necessarily followed by a request for tax refund)
- Annual tax return claims a tax loss
- Tax return is not submitted within the prescribed time
- Tax return meets criteria of selection
- There is an indication of non-compliance e.g. tax evasion, criminal tax offense

Tax examination can also be conducted for other objectives, such as: issuance of TIN officially; termination of TIN; confirmation or annulment of Taxable Person for Value Added Tax (VAT) Purposes Identification Number; taxpayer requests for objection; data gathering for determining Estimated Net Income; data matching; determining taxpayer who is located in a remote area; and determining one or more of VAT return filing basis.

Criteria of selection are based on: risk analysis that considers comparison of gross profit to sales in each line of business, frequency of tax examination, using of external data; and computerized selection system.

Before the examination result being decided, the examiner provides the taxpayer with a written notification of the examination findings containing suggested corrections and the taxpayer has to respond the notification in writing within 7 (seven) days. In certain cases, at the examiner's discretion, the time limit can be extended up to 21 (twenty one) days. After the time limit, the examiner and the taxpayer have a final discussion about the examination findings (closing conference). The result of final discussion is summarized in a "closing conference" document, and the taxpayer has to state "Agree" or "Disagree" to each suggested correction. The examiner can cancel or reduce one or more of suggested corrections if the taxpayer can provide a reasonable argument. The examiner and taxpayer have to sign the closing conference document. Based on the closing conference document, the legal products of examination are issued: the Tax Assessment Letters and the Tax Collection Letter. The Tax Collection Letter is used to collect tax administrative sanctions (because the Tax Assessment Letter does not cover the sanctions).

III.3.9 Tax Sanctions

Tax penalties can be on fixed amount or percentage of payment amount. Fixed amount penalties are imposed for non-filing and late-filing, while percentage of payment amount penalties are imposed for late or underpayment. The latest amendment of the General Provision and Tax Procedures (Law No. 28) will change some the penalties. There are also a term of "interest" that must be paid by a taxpayer whom allowed to make installment or postponement of tax payment or to extend the filing of the tax return. Severe imprisonment sanctions also imposed for criminal tax offenses.

(1) Non-filing and Late-filing Penalties

If a tax return is not filed within the time limit or within the extended filing time limit, a fine of Rp. 50,000 shall be imposed for Monthly Tax Return and Rp. 100,000 for an Annual Tax Return. (Article 7 paragraph (1) Law No. 16/2000 –the General Provisions and Tax Procedures).

Started from January 1st, 2008, according to the latest amendment of the General Provisions and Tax Procedures (Law No. 28/2007), above penalties will be increased except only for Personal Income Tax annual return. The fine for VAT monthly/periodically tax return will be Rp. 500,000, while for other monthly/periodically tax return will be Rp. 100,000. The fine for annual corporate income tax return will be Rp. 1,000,000. Incomplete tax return will not be received by the tax office. As a consequence, the taxpayer will be considered as not filing the return and it will also be subject to above penalty.

(2) Late or Underpayment Penalties

If payment of tax is undertaken after the due date for payment, the taxpayer shall be subject to a penalty of 2% interest monthly, calculated from the due date of payment up to the date of payment. Part of a month is treated as a full month.

In case a Taxpayer voluntarily amends a filed tax return which result in an increase of the tax payable, the Taxpayer shall also be subject to an administrative penalty of 2% (two percent) interest per month on the underpaid tax, calculating from the original due date for filing the Tax Return up to the date of payment of the underpaid tax arising from the correction of the Tax Return.

When the tax payable, based on Tax Underpayment Assessment, or Additional Tax Underpayment Assessment, and the increased amount of tax payable based on a Tax Correction Notice, Decision Letter on objection/appeal, is underpaid or unpaid on the due date, there shall be a penalty of 2% per month for the period maximum of 24 (twenty four) months, from the due date of payment through the date of actual payment of the amount stated in the Tax Collection Letter. Part of a month is deemed as a full month. The amount of tax underpaid in a Notice of Tax Underpayment Assessment above mentioned shall be increased by 50% or 100% under certain condition.

(3) Interests on Installment or Postponement

Where a taxpayer is allowed an installment or postponement, interest of 2% per month is applied. Part of a month is deemed as a full month.

(4) Interest on Underpayment

Where a taxpayer is allowed to extend the filing of the tax return and the estimated tax calculation turns out to be less than the actual tax due, interest of 2% per month is applied to the underpayment, calculated from the initial filing deadline of the tax return up to the date.

(5) VAT Penalties

A penalty of 2% of the tax imposition base (DPP) is applied in the following circumstances:

- A qualified taxpayer has not registered as a Taxable Person for Value Added Tax ("PKP").
- A taxpayer issues VAT invoices without being confirmed as a Taxable Person for Value Added Tax.
- A Taxable Person for Value Added Tax does not issue VAT invoices or issues incorrect, late, or incomplete VAT invoices.
- If a tax overpayment is incorrectly used as an offset or the 0% rate was incorrectly applied, a 100% penalty will be imposed in addition to the tax itself.

(6) Criminal Offense Sanctions

If a taxpayer because of negligence fails to file a tax return or files an incorrect or incomplete tax return or attaches incorrect information, which may cause losses to the state revenue, shall be punished by imprisonment for a period not exceeding of 1 year and/or shall be fined an amount not exceeding 2 times the amount of unpaid or underpaid tax. (Article 38 Law No. 16/2000).

If a taxpayer intentionally: fails to register, misuses or uses without authority a Tax Identification Number or a Taxable Firm Registration Number; or fails to file a tax return; or files a tax return and/or the information provided is false or incomplete; or refuses to be audited or shows an account, record or other document that is false or forged to appear as if it were true; or fails to keep books of accounts or record, or does not show or provide the accounts, records or other documents; or fails to deposit tax already withheld or collected, thus causing losses to the state revenues, shall be punished by imprisonment for a period not exceeding 6 year and shall be fined an amount not exceeding 4 times the amount of unpaid or underpaid tax.

If a Taxable Person for VAT in the course of claiming a tax refund or a tax loss carried forward, attempts to commit a criminal tax offense by misusing or using without authority a Tax Identification Number or a Taxable Firm Registration Number, or files a tax return and/or information which is false or incomplete, shall be fined an amount not exceeding 4 times the amount of the refund and/or the loss carried forward claimed by the taxpayer. (Article 39 Law No. 16/2000)

Whosoever is obliged to provide information or evidence as requested, but deliberately fails to do so, or provide information or evidence that is false, shall be punished by imprisonment for a period not exceeding 1 year and shall be fined an amount not exceeding Rp. 10,000,000 (ten million rupiah). (Article 41A Law No. 16/2000).

Whosoever deliberately obstructs or complicates a criminal investigation in the field of taxation shall be punished by imprisonment for a period not exceeding 3 years and shall be fined an amount not exceeding Rp. 10,000,000 (ten million rupiah). (Article 41B Law No. 16/2000).

The stipulation as mentioned in Article 38 and Article 39 shall also apply to a representative, authorized person or officer from the taxpayer, who initiates, joins, suggests or helps a crime in taxation. The stipulation as mentioned in Article 41A and 41B shall apply to anybody who initiates, suggests or helps a crime in taxation. (Article 43 Law No. 16/2000).

III.3.10 Tax Dispute

(1) Objection process

A taxpayer may file an objection against any tax assessment with the DGT or any withholding tax by a third party, within 3 months of the date of issuance of the assessment or of the date of the withholding tax. The Objection must be written and state the tax due, the tax being withheld, or the loss amount according to the taxpayer's calculation and provide the reason of his/her disagreement. Under the Law No. 16/2000, filing an objection does not postpone the due date for payment of a tax underpayment assessment, or the collection process of such tax underpayment by the DGT. After the amendment of the law, the Law No. 28/2007 stipulates that a taxpayer shall only to pay the underpayment at amount that the taxpayer had agreed during the final discussion on examination result before he/she files an objection on a tax assessment letter. The period of payment of the amount that had not been paid by a taxpayer who files an objection is suspended up to one month after the publication date of an objection decision letter. However, the amended law stipulates that if the taxpayer's objection is refused or partly agreed, the taxpayer is fined at 50% of tax amount based on objection decision less the tax that had been paid before filing the objection. If a taxpayer appeals, the 50% fine is not imposed.

The tax office should make their decision on the objection within 12 months after receiving the objection; if the DGT fails to issue a decision within this period the taxpayer's objection will be assumed to be accepted and granted.

(2) Appeal process

A taxpayer may appeal to the Tax Court against the DGT's decision on a taxpayer's objection within 3 months of receiving the DGT decision. Under the law No. 16/2000, in order to undertake the appeal, the taxpayer should pay at least 50% of the tax underpayment assessment before lodging the appeal. After the amendment of the law, the Law No. 28/2007 stipulates that the period of payment of the amount that had not been paid by a taxpayer who files an appeal is suspended up to one month after the publication date of an appeal decision letter. However, the amended law stipulates that if the taxpayer's appeal is refused or partly agreed, the taxpayer is fined at 100% of tax amount based on appeal decision less the tax that had been paid before filing the objection.

The Tax Court will conduct hearings on the appeal and issue a verdict within 12 months of the appeal being lodged.

(3) Reconsideration Request

Either the taxpayer or the DGT can further challenge a decision of the Tax Court through an appeal, by filing a request for reconsideration with the Supreme Court. This application is subject to certain conditions and is not automatically available. The reconsideration request should be submitted within 3 months of qualifying to file the request.

Filing a reconsideration request does not postpone the execution of the Tax Court decision. The Supreme Court should investigate the case and present its decision within 6 months of the filing of the reconsideration request.

IV. Country Specific Fiscal Issues

It was ten years ago when the Asian crisis hit Indonesia by the most severe effect among other Asian countries. There was only small warning before the crisis. The government budget was in good shape. If it was compared to Thailand and Malaysia, the current accounts deficit was relatively smaller. However, the crisis leaded to 80% of currency depreciation and 70% of inflation, the worst among other Asian countries. The fact showed that the disguised budget was characterized by high reliance on oil revenue while tax revenue was relatively low. The other facts were high dependency on foreign sources, expanding credit and oil subsidies, and public corruption. Those issues were covered by high sustained economic growth thus no one had suspected the crisis to be occurred.

At the peak of the crisis, the central government debt to GDP ratio was about 100% in 1999. At that time, the government budget was in a very severe condition because of large burden from interest payment and subsidies. To get out from the crisis, the government set its macroeconomic policies to address fiscal consolidation. Some of the policies were rescheduling external debts, re-profiling debt stocks, divesting banks, and reducing subsidies. According to the Indonesia Public Expenditure Review 2007 (IPER 2007) by the Worldbank, there are three factors had contributed in reducing the debt since the crisis: the principal and interest rescheduling through the Paris club agreement, appreciation of the currency since the crisis, and increase in non-oil and gas tax revenues. The fiscal deficit was 5% of GDP at the peak of the crisis. The fiscal consolidation has succeeded in reducing the deficit to be 3.7% in 2001 and 1% in 2006.

The success of the fiscal consolidation has brought Indonesia to the momentum to move on its path towards development, poverty reduction and provision of basic services. The Worldbank (IPER 2007) and IMF (IMF Country Report 2007) suggest that the Indonesian government policy requires the creation of fiscal space to increase spending on health, education, and infrastructure. To achieve those objectives, some measures can be done through raise revenues and reallocation of expenditures.

Increasing Spending in Infrastructures and Social Indicators

Low investment in infrastructure is regarded as a key bottleneck to foster economic growth. Due to weak project preparation and implementation, and also significant delays in budget process, actual spending in infrastructure has fallen well below the budgeted amounts. Total private and public annual infrastructure investments are about 2–3 percent of GDP, fell from 6 percent of the level before the crisis. The low investment led to deterioration of Indonesia's infrastructure indicators, such as electrification ratio, sanitation access, clean water access, and road network, to be the lowest among regional countries. Therefore to fill the large infrastructures needs, participation from the private sector is required. Unfortunately, the government attempts to improve the investment climate and forging partnerships with the private sector have not yet fruited. None of the 91 projects identified in the 2005 infrastructure summit have been finalized because of uncertainties surrounding the legal system and weak project preparation.

Table 22 shows, compares to other ASEAN countries, Indonesia has large share of near poor, and lowest levels on the education and health indicators. Despite the increase of education and health expenditures, the amounts are still less spent as a percentage of GDP compare to regional countries (Table 23).

Table 22: Some social indicators: Indonesia and comparator countries

Countries	Poverty: (less than 1 US$/day, headcount ratio)	Poverty: (less than 2 US$/day, headcount ratio)	Primary Education (Gross %)	Secondary Enrollment	Under 5 child mortality per 1000	Maternal mortality ratio per 100k live
Indonesia	8.5	49	82	52.9	46	307
Malaysia	…	…	91	70	12	41
Philippines	15	43	97	84	34	200
Thailand	2	32	Na	77	21	44
Vietnam	2	26	101	74	23	130
E AsiaPacific	…	34	99	69	37	117
Lower Middle Income	…	…	98	72	40	153

Source: IMF Country Report 2007

Table 23: Total Public Expenditures in percent of GDP, 2004

Countries	Health	Education
Indonesia	0.9	2.8
Thailand	3.3	4.6
Malaysia	3.8	8.1
Philippines	3.2	3.1
Vietnam	5.4	…
India	4.8	…

Source: IMF Country Report 2007

Raising Tax Revenues

Indonesia tax system has many good characteristics such as sophisticated VAT and income tax, low reliance on import duties, and a balance proportion of income tax and VAT revenues. However the tax to GDP ratio is still the lowest among other ASEAN countries. Some of the impediments of the low ratio are the tax administration itself and relatively high reliance on oil and gas revenues.

The main problem of the tax administration is its weakness on tax law enforcement. The weakness is shown by a low number of income tax return that claims profit, a low number of registered taxpayers, and a high number of uncollected tax arrears.

Some programs had been done to improve the tax administration such as by modernizing tax offices and revamping audit procedures. The main task of both programs is to reduce corruption, by reallocating the taxpayer's fund that was used to bribe the tax officer to be tax revenue.

The IMF Country Report 2007 suggests options to generate additional yields of at least 1% of GDP on annual basis. The options are by limiting VAT exemptions, adjusting property tax rates, and introducing a fringe benefits tax.

In order to promote business climate, there are demands to improve Indonesian tax system which might reduce the tax revenues. After the amendment of the General Tax Provisions and Procedures in 2007, the amendment of the Income Tax and VAT Law will follow and change the tax structure. The changes include: (i) reduction of the PIT rate from 35 percent to 33 percent in 2008 and to 30 percent by 2010; (ii) reduction in the number of brackets for the PIT from 5 to 4; (ii) change in the corporate income tax rate from 3 brackets to a single rate of 30 percent; and (iii) reduction of the CIT rate from 30 percent to 28 percent in 2008 and 25 percent in 2010. The IMF Country Report 2007 estimates those changes are likely to be as tax cuts that will reduce revenue by about 0.6 to 0.8% of GDP by 2010.

Reallocating Expenditures

Since 2001, the structure of government budget had changed because of decentralization. When the budget will spend more on transfers to regions, the fiscal policy by the central government will be less flexible. In 2000, the transfer to region was 19 percent of total expenditure, and in later years it had increased to be 24 percent in 2001, 31 percent in 2002, and budgeted to almost 34 percent in 2007. Because of the transfer, the central government spending in routine and development expenditure has been declining. For both the central government and local governments, spending in personnel expenditures was still very high at 54 percent and 61 percent of total central government and local governments expenditure, respectively, in 2005. The central government development expenditure was still very low at 14 percent in 2006, while the local government development expenditure was at 40 percent. Therefore, since the decentralization, the local governments have bigger role in development.

Despite the reduction in oil subsidies in 2005, the total subsidies remain high at close to US$ 10 billion. Oil and electricity subsidies are still being considered to have wrong targets that more benefit the rich. Continuing oil subsidy reduction will be easier if the international price declined. However, in 2007 world oil price has reached more than US$ 90 per barrel, thus it is difficult to continue the subsidy reduction.

The budget spending on government apparatus is still at 15 percent, which is comparatively high to other countries. Therefore, civil service reform is required through such as modifying the compensation package and developing clear job description and service standards (IMF Country Report 2007).

V. Conclusion: Where We Stand and Where to Go

The Indonesian government mission since the independence in 1945 has been to achieve the welfare for all Indonesian people. Since the independence until now economic development have been progressing thus the development had successfully bring majority of Indonesian people out of poverty. However the poverty problem has not yet totally solved, especially for some Indonesian people who lived in remote areas since the development had not much affected those areas. Not only in remote areas, but also in urban areas poverty becomes problem because poor people from undeveloped rural areas came to find better living.

Now Indonesian economy had came back to its track for development, after having a crisis ten years ago. Sound macroeconomic policies by the Government, especially by the Ministry of Finance, who had kept its policy on fiscal consolidation, had brought healthy budget with lower debt ratio. Other important policies by the central bank, the Bank of Indonesia, such as by made a prudent tuning of interest rate and exchange rate had caused business runs confidently.

One starting point of development is by utilizing the fiscal space that the government has from reducing oil subsidies. One benefit of the fiscal space that has already been utilized is for education sector. Now teachers, especially elementary school and junior high school teacher, can enjoy better remuneration thus they can focus on improving their teaching methods rather than looking for side job. However, for health sector there has not been significant improvement because it is more complicated than education sector. Improvement in health sector entails quite high cost of medical supplies and equipment, beside the lack number of paramedics. Health sector also requires people to understand the importance of sanitation which is difficult to be understood for uneducated people. One example failure in health sector is the prevention of the spreading of avian flu. Almost like the financial crisis, the avian flu was started in another Asian country but it most affected Indonesian people, even until now. Both education and health are preconditions for a country to be ready for take-off stage. Without both preconditions being achieved, any physical development might be not benefited to all people thus will lead to inequality.

The allocation of the fiscal space is not necessary only for education and health sector, but also for the development of infrastructure. Compare to its neighboring countries Indonesia lags in competition in attracting foreign investors. After the crisis, many investors flew their capitals out of the country because of security reason. After the security problem has been solved, Indonesia political situation is more stable than the neighboring countries such as Thailand. However, it is difficult to invite investors because the problem is more about competitiveness in attracting those investors. All countries in the region have been giving very attractive measures to promote business climate, such as tax incentives, establishment of special economic zone, convenience in starting business, and even low cost of labor and transportation. Unfortunately Indonesia has the lowest rank of competitiveness in the region. Therefore, it had lost opportunities when many businesses around the world are looking for the most efficient place to produce goods. Therefore it is very important for the government to increase Indonesia's competitiveness by carrying out those attractive measures.

To reduce the cost of transportation, investment in roads and harbors is required thus larger amount of fiscal space is needed. Increase in tax revenue would satisfy that need by improving the tax administration that has begun since the establishment of large taxpayers unit. The improvement of tax system also has begun since the latest amendment of the general tax provisions and regulations.

Under the deeper economic integration among countries because of the globalization, the Indonesian government challenge is getting more tasks especially in preventing another financial crisis. Symptoms of global imbalances such as the soaring world oil price and the risk of bubble capital market and maladjusted currency level, must be taken care of carefully. The global imbalances can direct or indirectly affect Indonesia people welfare even which often worse to the poor people.

After the crisis, the government had changed four times but none of them are viewed to be successfully brought better economic condition. In 2009, Indonesia will have an election when most of the people really hope that the election will result of a government who will bring welfare. The process of election itself will be monitored both from domestic and international bodies to ensure its fairness and legality. Some of the latest elections had been proved to be not clean because some corruption practices were uncovered. At least in the incoming election the monitoring process will be strengthened to realize the desired fair election.

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