3 Indonesia

Ery Heriawan and Farilla Darmadi

I. Introduction

The name Indonesia was derived from "indos nesos", meaning islands near India. It is generally believed that the earliest inhabitants of the Indonesian archipelago originated in India or Burma. Fossils of Java Man (homo erectus were found in east Java in 1890. Later migrants came from southern China and Indochina, and they began populating the archipelago around 3000 BC. Powerful groups such as the Buddhist Srivijaya empire and the Hindu Mataram kingdom appeared in Java and Sumatra towards the end of the 7th century. The last important kingdom to remain Hindu was the Majapahit, which was founded in the 13th century. The subsequent spread of Islam into the archipelago in the 14th century forced the Majapahits to retreat to Bali in the 15th century. Indonesia proclaimed its independence on August 17, 1945 from Netherlands. The capital city of Indonesia is Jakarta which is also the most populated city in Indonesia.

A. Geography and Population

Indonesia is an archipelago in Southeast Asia consisting of 17,508 islands (6,000 inhabited) and straddling the equator, spread in an area between the Asian continent and Australia, and between the Pacific and the Indian oceans, with 93,000 sq km of water and 1,826,440 sq km of land area. It is is located between 6°08' north and 11° 15' south latitude, and from 94°45' to 141°05' east longitude. Because of the position around the equator, the climate is tropical, hot and humid; more moderate climate in highlands. Little variation in temperature because of almost uniformly warm waters that are part of the archipelago. Indonesia has only two seasons, dry season and rainy season. The dry season (June to September) is influenced by the Australia continental air masses. The rainy season (December to March) is influenced by the Asia Continental and Pacific Ocean air masses passing over oceans.

The largest islands are Sumatra, Java (the most populous), Bali, Kalimantan (Indonesia's part of Borneo), Sulawesi (Celebes), the Nusa Tenggara islands, the Moluccas Islands, and Irian Jaya (also called West Papua), the western part of New Guinea. Its neighbour to the north is Malaysia and to the east is Papua New Guinea.

The islands are inhabited by many tribes with diverse culture and languages. There are 365 ethnic and tribal groups. The principal ones are Acehnese, Bataks, Minangkabaus (Sumatra); Javanese, Sundanese (Java); Balinese (Bali); Sasaks (Lombok); and Dani (Irian Jaya). Although it has so many diversity, there is a national language spoken throughout the country, namely Bahasa Indonesia. It is thus appropriate, that the country's motto is Bhinneka Tunggal Ika, which means: Unity in Diversity. Our state philosophy is Pancasila or the Five Principles.

The population of Indonesia is 219.898.300 (Statistic Indonesia, August 2005) and most of them remained in the Java Island. About 107 million live on Java Island and 7,505,057 of them live in Jakarta, the capital city of Indonesia (DKI Jakarta Province, Local Government Office September 2005), so there is an unbalanced situation in population distribution. The population growth is about 1.5% yearly.

Most of Indonesian people are Moslems (88%), the others are Protestant (5%), Roman Catholic (3%), Hindu (2%), Buddhist (1%), other (1%).

B. Natural Resources

Indonesia is a blessed country which has abundant natural resources such as petroleum, tin, natural gas, nickel, timber, bauxite, copper, fertile soils, coal, gold, silver. Not to mention also Timber, rattan, fisheries, and other biological resources have made major contribution to the national economy.

For so many years, Indonesia relies heavily on these natural resources especially from Oil and Gas. They became the main source of national income to finance development expenditures. The result is that the natural resource base is increasingly degraded by a combination of forest fires.

C. Politics

Government system in Indonesia is Unitary Republic based on separation of powers into executive, legislative, and judicial power. The governmental system has been described as "presidential with parliamentary characteristics". Constitution of 1945 is in force.

Following the Indonesian 1998 Revolution and the resignation of President Soeharto, several political reforms were established. Among them are term limits of up to two of five years term for the president and vice president, and measures to institute checks and balance. The highest state institution is the People's Consultative Assembly (MPR), whose functions include electing the president and vice president, establishing broad guidelines of state policy, and amending the constitution.

General election in June 1999 produces the first freely elected national, provincial and regional parliaments in over 40 years. In October 1999 the MPR elected a compromise candidate Abdurahman Wahid, as the fourth president and Megawati Soekarnoputri as the vice president. Megawati's PDIP party had won the largest share of the vote (34%) in the general election, while Golkar the dominant party during Soeharto era came in second (22%).

In April the second parliamentary election since the downfall of Soeharto and the first under the new constitutional framework took place. In an orderly and relatively transparent poll the electorate voted for members of the 550-seat House of Peoples' Representatives (DPR) and for 128 members of the new Regional Representatives Assembly (DPD).

The April general election was followed in July 2004 by the country's first ever direct presidential election. With no outright winner emerging, the two leading candidates—the incumbent, Ms Megawati, and a retired army officer, Susilo Bambang Yudhoyono—went forward to a run-off in September 2004. Mr Yudhoyono won a landslide victory, gaining 61% of the vote, as a result of a campaign focusing on job creation, economic growth and fighting corruption. He was inaugurated on October 20th, and announced his cabinet a day later. The new cabinet was set in the multiparty tradition, but included a heavier weighting of non-partisan technocrats. It was criticized for the number of "old faces" it contained, despite Mr Yudhoyono's promises of reform. However, without the support of at least some members of the larger parties, such as Golkar, Mr Yudhoyono would have found himself unable to legislate.

II. Overview of Macroeconomic Activity and Fiscal Position

The Year 2005 marked the first year of a new era for the Indonesia economy to achieve high and sustainable growth following the launching of the Medium-Term National Development Plan (MNDP) of 2004-2009. The MNDP sets out targets among others: achieving average economic growth of 6.6% in the next five years, reducing the incidence of poverty to 8.2% and lowering the rate of unemployment to 5.1% by 2009. Monetary conditions were generally quite stable following the pursuit of policy to achieve the inflation target, while keeping the momentum of economic growth. The main challenges confronting the Indonesian economy was to maintain stability and among heightening global uncertainties and to accelerate economic growth so as to reduce unemployment and alleviate poverty. The policies were directed to maintain macroeconomic stability and step up economic growth. Monetary policy continued to be geared toward achieving medium term inflation target. Fiscal policy was to implement consolidation and also lower the ratios of fiscal deficit and public debt to GDP while providing stimulus for economic growth.

Overall Indonesia economic performance had further improved in 2004; this condition was supported by conducive world economic conditions. Economic activity recorded the highest growth (5.1%) in the post economic crisis period. This growth was accompanied by more balance expansion as reflected in improved investment, in the non-construction sector and exports while consumption remain relatively stable. The manufacturing and trade, hotel and restaurant sectors were the main contributors to economic growth.

Reflecting accelerating economic growth, public welfare improved meaningfully, as indicated by higher per capita income and a decline in the incidence of poverty. Real per capita income rose by 3.8% from Rp7.4 million in 2003 to Rp7.7 million in 2004. Among the factors contributing to this increase was government policy to raise provincial minimum wages by 1.0-29.0% in 2004. Meanwhile, the number of population living below the poverty line dropped to 36.1 million (16.7%) from 37.3 million (17.4%) in 2003. By composition, most of the poor lived in rural areas, arriving at 24.8 million people (20.1 % of total rural population); poor people living in urban areas totaled 11.3 million people (12.1 % of total urban population). The raise in economic growth has yet given a significant impact on improving unemployment condition. In 2004, the unemployment rate was 9.4%, changed a little from 9.5% last year. This stagnant unemployment condition was partly due to regulatory problems in the real sector. This situation of fewer available jobs relative to the number of job seekers was suspected to stem from production sector activity that was inadequate for creating work opportunities.

Table 1 Selected Macroeconomic Indicators

Current Account/GDP		**2002**	**2003**	**2004**
Gross Domestic Product		**4.4**	**4.9**	**5.1**
Inflation		10.03	5.06	6.4
Average Exchange Rate (Rp/$)		9,318	8,572	8,940
Interest rate (1month)		12.93	8.31	7.43
Current Account / GDP		**3.90**	**3.40**	**1.10**
GDP by Expenditure	Consumption	4.70	4.60	4.60
	Gross Fixed Capital Formation	4.70	1.00	15.70
	Export of Goods & Services	-1.20	8.20	8.50
	Imports of Goods & Services	-4.30	2.70	25.00
GDP by Sector	Agriculture	3.20	4.30	4.10
	Manufacturing	5.30	5.30	6.20
	Construction	5.50	6.70	8.20
	Trade, Hotel and Restaurants	3.90	5.30	5.80
	Transportation and Communication	8.40	11.60	12.70
	Finance, Leasing & Service Companies	6.40	7.00	7.70
	Services	3.80	3.90	4.90
Unemployment Rate		**9.10**	**9.50**	**9.40**
Poverty Rate		**18.20**	**17.40**	**16.70**
Real GDP per Capita (thousand Rp)		**7,136.00**	**7,391.00**	**7,673.00**
Real GDP per Capita ($)		**761.80**	**861.40**	**857.90**
Monetary Aggregate	M2 growth end of period	4.72	8.12	8.14
	M1 growth end of period	7.99	16.60	13.41
	Base Money Growth - end of period (test date)	5.97	14.25	10.20
Interest Rate (%)	Inter Bank Money Market (overnight)	12.42	8.12	8.14
	Time Deposits (1 month)	12.81	6.62	6.43
	Working Capital Credit	18.25	15.07	13.41
Investment Credit		17.82	15.68	14.05
Balance of Payments	Debt Service Ratio (DSR) (%)	33.10	34.10	29.50
	Foreign Reserves Equivalent to Months -Of Non-Oil/Gas Imports	6.60	7.10	5.60

Source: Bank of Indonesia Annual Report 2004

The exchange rate was broadly stable as reflected in low volatility. Foreign currency demand for debt service and import expanded, but this was generally adequately satisfied by foreign currency supply coming from foreign capital inflows and exports. On average the exchange rate weakened by 3.9% reaching Rp8.940. Meanwhile inline with sustain exchange rate stability; inflation expectation was relatively stable, which kept core inflation in the range of 6-7%. CPI inflation was relatively contained within the target range set by Bank of Indonesia of 5.5% $\pm$1%.

The government fiscal operations had an expansionary impact on economic growth. The absence of a policy to adjust domestic fuel prices in the face of high world oil prices has put pressure on state expenditure, especially subsidies. On the side of revenues, oil and gas revenues were lower than expected due to a contraction in national oil production. Through these developments, the 2004 fiscal deficit was 1.4% of GDP, slightly wider than the original budget target of 1.2% and the revised budget target of 1.3%, but it was better than 2003 deficit of 2%.

Despite the progress achieved in 2004, a number of problems remain. Economic growth of 5.1 % was insufficient to address unemployment problem. Efforts to accelerate economic growth so far had been hampered by the existing problems relating to investment climate, especially in light of emerging constraints in production capacity and inadequate infrastructure in addition to weakening economic competitiveness. Moreover, restructuring in banking and corporate sectors has yet been completed, which could impede the recovery of business confidence and financing to the real sector.

II.1 Macroeconomic Activity

A. International Environment

1) Trade Balance

The favorable world economy improved Indonesia"s balance of payments performance in 2004. It was reflected in the current account which remained in surplus, but narrower than it did in 2003. Exports increased strongly, in line with rising world trade volumes and commodity prices, which was more than offset by significant increases in imports and net services. Meanwhile, the capital account shifted into a surplus, largely due to heightened investor confidence in prospects for the Indonesian economy and to benefit from the rising capital flows to developing countries, particularly into Asia. The private capital account posted quite a large surplus, which was partly offset by a sizable deficit on the official capital account due to increasing foreign debt repayments after the end of the Paris Club rescheduling. With both the current and capital accounts in surplus, the overall balance of payments also recorded a surplus, raising official foreign currency reserves to $36.3 billion, equivalent to 5.6 months of imports and government foreign debt service.

Indonesia Trade surplus on the Balance of Trade narrowed by 13.6% in 2004 to reached $21.2 billion. The trade surplus for gas widened 22.8% to $9.1 billion, stemming from increases in export prices and volumes. However, for the first time in decades the balance on oil account recorded a deficit, after experienced a surplus years before. Indonesia"s trade surplus in the non-oil/ gas sector mostly originated among ASEAN trading partners (particularly Singapore, Malaysia, and Philippines), followed by the US and Japan.

Total exports in reporting year grew by 12.0%, reaching $71.8 billion. This pickup mainly originated in exports of primary goods-based manufactures, as well as oil & gas and mining commodities. This increase was in line with improved global prices and high world demand. By export destination, the share of non-oil/gas exports to five major countries reached 51.5% in 2004, up from 49.9% in 2003. The destination countries were the US (14.9%), Japan (14.8%), Singapore (10.7%), China (6.1%), Malaysia (5.1%).

Table 2 Balance of Payment

(Million of $)

Description	2002	2003	2004
A. Current Account	**7,822**	**8,106**	**2,878**
I. Goods Account	**23,513**	**24,562**	**21,231**
- Export f.o.b	59,165	64,109	71,785
- Import f.o.b	-35,652	-39,546	-50,554
II. Services (net)	**-15,691**	**-16,456**	**-18,353**
B. Capital Account	-1,102	-949	2,236
- Public Sector	-190	-833	-1,911
- Private Sector	-912	-116	4,148
Direct Investment	145	-597	1,043
Portfolio Investment	1,222	2,251	2,793
Others Investment	-2,279	-1,770	311
C. Total (A+B)	**6,720**	**7,157**	**5,114**
D. Errors and Omission	-1,692	-3,502	-4,805
E. Financing	**-5,028**	**-3,654**	**-309**
Changes in Reserves Assets	-4,023	-4,257	-24
From Transaction	-	-	674
IMF	-1,006	603	-983
Notes:			
1 Reserves Assets (IRFCL)	**32,039**	**36,296**	**36,320**
In Month of Imports and Official			
Debt Repayment	**6.6**	**7.1**	**5.6**
2 Current Account/GDP (%)	3.9	3.4	1.1

Source: Bank of Indonesia Annual Report 2004

Table 3 Trade Balance

(Millions of $)

Item	2002	2003	2004
Total Trade Balance	**23,513**	**24,564**	**21,231**
Non-oil and Gas	**17,317**	**17,152**	**14,738**
Export f.o.b	46,307	48,875	54,127
Import f.o.b	-28,990	-31,723	-39,389
Oil	**204**	**38**	**-2,562**
Export f.o.b	6,548	7,469	8,390
Import f.o.b	-6,344	-7,431	-10,953
Gas	**5,992**	**7,373**	**9,055**
Export f.o.b	6,310	7,765	9,267
Import f.o.b	-319	-392	-213

Source: Central Bureau of Statistic of Ministry of Republic of Indonesia

Meanwhile according to region, exports to countries in Asia (outside ASEAN) had the highest share of 39%, followed by exports to ASEAN with 22.1% share, and the American region with 17.6% share. The largest non-oil/gas exports to main destination countries were CPO (13.1%), coal (9.7%), natural rubber (5.9%), copper ores (5%), as well as office equipment and data processing machines (4.8%).

Table 4 Developments of Exports

Items	2003	2004	2004	
	Changes (%)		Value (Million $)	Share (%)
Non Oil and Gas Export	**5.5**	**10.7**	**54,127**	**75.4**
Agriculture	4.2	-6.5	2,572	3.6
Mining	7.7	9.2	4,525	6.3
Manufacturing	5.4	12	47,029	65.5
Oil and Gas Export	**18.5**	**15.9**	**17,658**	**24.6**
Total	**8.4**	**12**	**71,785**	**100**

Source: Central Bureau of Statistic of Ministry of Republic of Indonesia

Non-oil/gas exports rose by 10.7% to $54.1 billion. The increase was mainly accounted for by primary goods-based non-oil/gas products, which recorded quite a high growth rate, particularly palm oil, rubber products, metal products and paper products.

Table 5 Selected Non-oil/Gas Export Commodities

Items	2003	2004	2004	
	Changes (%)		Value (Million $)	Share (%)
Textile & Textile Products	1.9	5.8	7,715	14.3
- Garment	3.8	6.7	4,423	8.2
Electrical Appliances	15.4	5.9	3,392	6.3
Palm Oil	17.2	31.7	3,319	6.1
Wood Product	-2.9	-2.1	3,178	5.9
Rubber Product	33.8	36.1	2,920	5.4
Coal	13.4	37	2,815	5.2
Paper	-4.4	7.8	2,223	4.1
Metal Product	44.5	84.7	1,639	3
Shrimp	7.4	-5.4	878	1.6
Nickel	18.6	77.9	110	0.2

Source: Central Bureau of Statistic of Ministry of Republic of Indonesia

2) Current Account Balance

The current account in 2004 posted a surplus of $2.9 billion (1.1 % of GDP). Despite acceleration in exports, this current account surplus was narrower than it was in 2003, as a result of high import growth stemming from the expansion in domestic demand. This high import activity also widened the deficit on the services account. Increases in commodity prices, high world trade volume and a stable Rupiah encouraged Indonesia's exports.

Table 6 Developments of Imports

Items	2003	2004	2004	
	Changes (%)		Value c&f (Million $)	Share (%)
Non Oil and Gas Import	8.6	26.5	42,665	77.9
Consumption Goods	-16.5	34.9	3,130	5.7
Primary Raw Materials	**10**	**21.6**	**31,214**	**57**
Capital Goods	**15.8**	**44.6**	**8,321**	**15.2**
Oil and Gas Imports	17.4	42.7	12,136	22.1
Total	**10.3**	**29.7**	**54,801**	**100**

Source: Central Bureau of Statistic of Ministry of Republic of Indonesia

This was particularly the case for exports of oil/gas and some primary goods, like mining commodities, whereas the agricultural goods category (which mostly comprises raw materials) declined. At the same time, the acceleration in domestic economic activity caused a significant increase in imports, notably of raw materials and capital goods. Expansion in domestic economic activity led to accelerated fuel consumption, triggering a pickup in the volume of oil imports. Accelerating imports and higher oil prices caused transportation costs to jump, accordingly widened the deficit on the services account. This was partly offset by a rise in receipts of services, originating in foreign tourist visits and income repatriation from Indonesian workers abroad.

Table 7 Selected Non-oil/Gas Import Commodities

Items	2003	2004	2004	
	Changes (%)		Value C&F (Million $)	Share (%)
Raw materials (processed), for industry	6.8	26.6	18,867	44.2
Capital good (except transport equipment)	18.6	30.4	6,803	15.9
Parts and accessories for capital goods	11.6	20.2	3,733	8.7
Parts and accessories for transport Equipment	24.2	9.3	3,191	7.5
Raw materials (primary), for industry	5.7	19.2	2,624	6.1
Transport equipment for industry	-32.9	244.4	1,150	2.7
Food and beverages (primary), mainly for house hold	-16.8	7.6	868	2
Non-durable consumption goods	-26.3	37.8	650	1.5
Food and beverages (processed), mainly for house hold	-33.3	47.4	477	1.1
Semi-durable consumption goods	-14.4	28.9	378	0.9

Source: Central Bureau of Statistic of Ministry of Republic of Indonesia

The value of total imports (c & f basis) in overall rose by 29.7% to $54.8 billion.. This sharp growth occurred in oil and gas, as well as non-oil/ gas components, in accordance to the expansion of domestic demand. In addition, international commodity price hikes, especially for oil, were added to import costs.

In terms of value, non-oil/gas imports grew by 26.5% to $42.7 billion. Almost all major categories of non-oil/gas import increase, namely consumer goods, raw materials, and capital goods. Imports of consumer goods soared by 34.9% to $3.1 billion. Most sub-categories imports expanded, particularly food and beverages, transportation equipment and vehicles, as well as non-durable consumer goods. The expansion in consumer goods stemmed from price hikes; while volume contracted.

In 2004, imports of raw materials and capital goods grew 21.6% and 44.6% to $31.2 billion and $8.3 billion, respectively. The rise of capital goods imports, which has been continuing since end-2003 (both for replacement and additional capacity), has boosted production capacity in, for example, the paper and printing, chemical products and plastic good industries. Meanwhile, the rise of raw materials imports has mostly occurred in the manufacturing sector. This development reflected the supply side response to strong domestic demand, thereby reducing domestic price pressures.

3) Exchange Rate and Exchange System

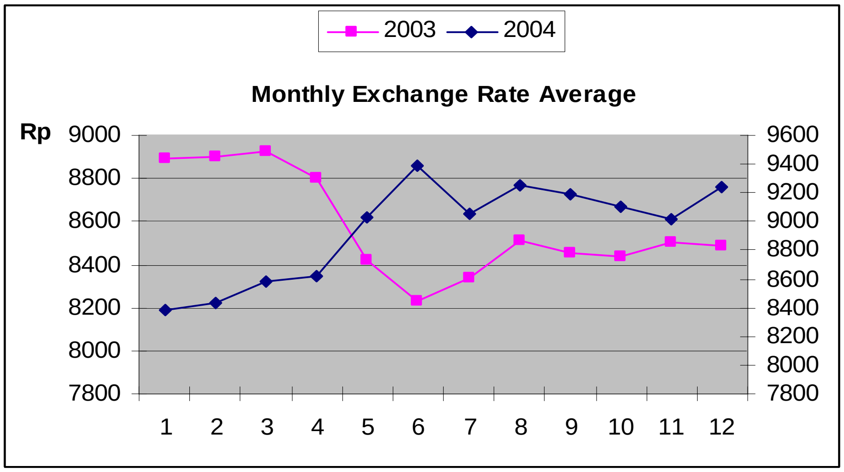
During 2004, the Rupiah exchange rate was relatively stable, despite some downward pressure at midyear, triggered by several international and domestic factors. Considering the importance of exchange rate stability in strengthening macroeconomic stability and in maintaining the economic recovery, Bank of Indonesia launched the Rupiah Stabilization Policy Package in June 2004. The combination of an improving macro economy, more conducive socio-political conditions and policy actions has supported Rupiah exchange rate stability, notably during the second half of the year.

The Rupiah Stabilization Policy Package, particularly in response to growing depreciation pressures. The Rupiah exchange rate is vulnerable to depreciation pressures because much of the supply of foreign currency currently originates in short-term capital inflows from offshore banks, which are potentially very volatile. Offshore banks as the main suppliers of foreign currency are evidenced by the excess supply faced by domestic banks in their transactions with offshore players.

This policy package was important, considering the potential adverse impact on macroeconomic stability and sustainability of the economic recovery, if the Rupiah continued to slide. The policy package covered policies (i) to control excess Rupiah liquidity, and (ii) to enhance bank prudential regulations. The policy to control excess liquidity was implemented through more absorptive open market operations (OMOs); by stabilizing interest rates, and adjusting minimum reserve requirements in line with positions of third-party funds at individual banks.

Short-term capital is generally recognized as easily reversible and highly susceptible to shifts in non fundamental factors, like short-term expectations.

Figure 1 Average Exchange Rate Monthly 2003-2004



Source: Bank of Indonesia Annual Report

4) Foreign Direct Investment

Foreign capital inflows in the form of foreign direct investment reached $3.9 billion in 2004, up from $3.2 billion last year. In details, those inflows comprised loans and participations totaling $2.6 billion and $1.3 billion, respectively. These amounts were mainly used by existing companies for business expansions.

Table 8 Foreign Capital Investment Realizations

(million $)

Sectors	2002	2003	2004
Industry	892	642	923
Agriculture	171	689	840
Financial Institution	652	900	272
Mining	205	317	197
Others	873	616	1619
Total	2,793	3,164	3,851

Source: Central Bureau of Statistic of Ministry of Republic of Indonesia

By country of origin, larger foreign direct investment inflows mostly came from Holland, the US and Malaysia, while those from Japan has declined in the last two years. By sector, foreign direct investment was generally flowing into the industrial and agricultural sectors. Taking into account outflows of direct investment, which remain quite large, net foreign direct investment posted a surplus of around $1 billion, compared with a deficit of around $600 million in 2003.

Table 9 Foreign Capital Investment Realization

(million $)

Countries	2002	2003	2004
Netherlands	214	44	994
United States	186	899	642
Malaysia	69	205	487
South Korea	256	197	433
Singapore	407	877	426
Japan	760	264	281
Australia	169	190	243
United Kingdom	59	37	40
Others	673	452	303
Total	2,793	3,165	3,849

Source: Central Bureau of Statistic of Ministry of Republic of Indonesia

Regarding portfolio investment, net inflows widened to $2.8 billion from $2.3 billion in 2003. This pickup mainly originated in purchases of shares by foreign investors, who made net purchases of around $2.1 billion, helping to boost the Jakarta Composite Index above the 1,000 level. One important factor for foreign investors was the privatization program undertaken through a public offering on the bourse floor. In the mean time, net foreign purchases of government bonds and SBIs (Bank of Indonesia Certificate) were also important, at around $1.3 billion. Meanwhile, loan disbursements by non-foreign capital investment companies increased sharply from around $6 billion to some $9 billion. These loan disbursements were undertaken mostly by non-financial institutions, whose businesses were in the electricity, textiles and petrochemical sectors.

5) Borrowing from Abroad

The official capital account posted a higher deficit than it did in 2003, due to a surge in government debt repayments. Although the official capital account overall experienced a deficit, disbursements of government loans rose to $3.3 billion compared to $1.8 billion last year.

This increase came from disbursements of both program loans amounting to $1.5 billion from $210 million and project loans amounting to $1.8 billion from $1.6 billion last year. This shift into deficit stemmed from developments on the outflows side of the official capital account. Repayments on foreign debts of the government rose sharply with the end of the Paris Club debt-rescheduling program at end-2003. In the reporting period, government foreign debt repayments reached $5.2 billion, far higher than $2.6 billion in 2003.

Table 10 Developments of External Vulnerability Indicators

(%)

Items	2002	2003	2004
Current Account	3.9	3.4	1.1
Good and Service Export/GDP	33.9	29.7	31.1
Non-oil and Gas Export/GDP	23.2	20.5	21.0
Interest Payment of Foreign Debt/GDP	2.7	2.3	2.2
Total Payment of Foreign Debt/Goods and Service Export	33.1	34.1	29.5
Capital Flows/GDP	-0.6	-0.4	0.9
Foreign Debt Position/Export of Goods and Services	193.9	190.8	169.8
Foreign Debt Position/GDP	65.7	56.8	52.9
Foreign Reserve/Payment of Foreign Debt	142.9	158.9	153.5
Foreign Reserve/Foreign Debt Position	24.4	26.8	26.7
Foreign Reserve/Import and Payment of Government Foreign Debt (month)	6.6	7.1	5.6
Foreign Debt Position (Billions of $)	131,343.0	135,402.0	136,140.0
Foreign Reserve Position (Billions of $)	32,039.0	36,296.0	36,320.0

Source: Bank of Indonesia Annual Report

On the inflows side, disbursements of government foreign loans mostly came from loan commitments obtained through the Consultative Group on Indonesia (CGI) forum. Although disbursements increased in 2004, they were relatively low compare to the commitments at around 60%. Low levels of disbursements are normally due to any of several problems, including accomplishment of agreed policy matrix by donor countries, slow project implementation and shortages of counterpart funds.

Most of government foreign debt is owed to bilateral institutions (37.8%), followed by multilateral institutions (35.6%), export credit facilities (22.3%) and other debtors. This composition has shifted slightly since end-2003, when multilateral debt recorded the largest share at around 37.0%, followed by bilateral debt of 36.9%, export credit facilities of 22.7%, and the remaining belong to other debtors.

Table 11 Foreign Debt Outstanding

(Million of $)

Items	2001	2002	2003	2004			
				Mar	Jun	Sep	Dec
Government	**69,404**	**74,497**	**80,910**	**81,217**	**78,811**	**77,430**	**80,278**
Private	**60,058**	**55,212**	**51,942**	**52,836**	**52,102**	**52,293**	**52,501**
a. Financial Institutions	7,713	7,642	7,537	7,968	7,514	7,760	8,180
- Bank	6,649	4,870	4,316	4,479	3,771	3,734	3,872
- Non Bank	1,064	2,772	3,221	3,489	3,742	4,026	4,308
b. Non Financial Institutions	52,345	47,570	44,405	44,868	44,588	44,533	44,321
Securities	**3,612**	**1,634**	**2,550**	**2,626**	**2,466**	**3,074**	**3,361**
- Government	1,974	164	756	896	735	1,241	1,991
- Bank	---	---	1	23	2	2	4
- Non Financial Institutions	1,638	1,470	1,793	1,707	1,729	1,832	1,367
Total	**133,074**	**131,343**	**135,402**	**136,679**	**133,379**	**132,797**	**136,140**

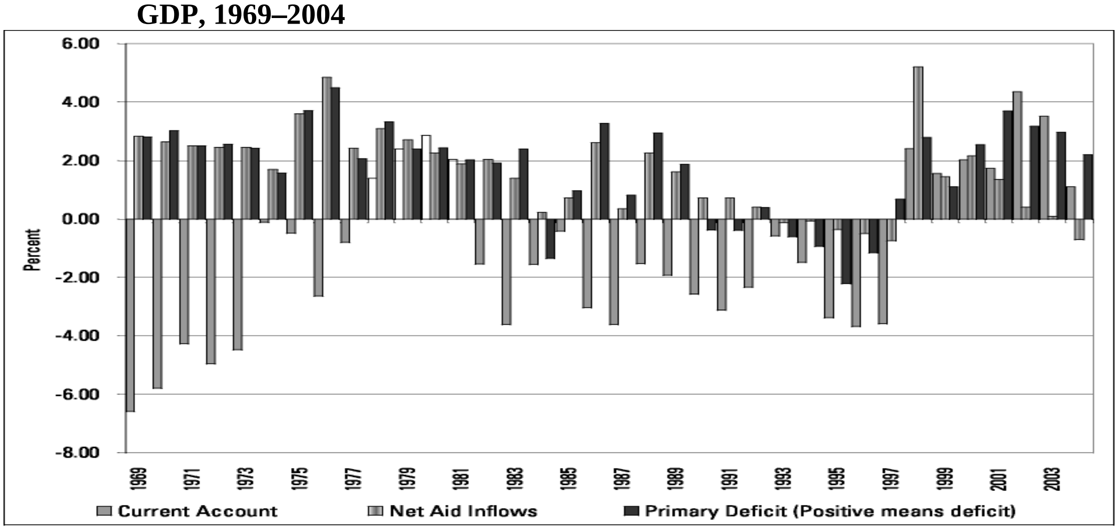
Source: Bank of Indonesia Annual Report

6) Aid

In 2004, the AID-GDP ratio stood at slightly over 1 per cent, a figure much less than what it was in the early 1990s. The trend of foreign aid as a percentage of government revenue is almost identical to that of aid-GDP ratio. After a steady decline since 1988 from nearly 39 per cent of government revenue to close to 12 per cent in 1977, foreign aid rose to about 28 per cent of government revenue in 1998. From its post-crisis peak, aid-revenue ratio declined to about 8 per cent in 2004.

Foreign aid flows to Indonesia relate very closely to the times of economic difficulties. Gross aid flows declined steadily to less than 2 per cent of GDP as the economy began to show signs of improvement in the early 1970s. It dropped to about 1.5 per cent of GDP in 1977, but since then continued to rise until 1988, peaking at roughly 6.5 per cent of GDP.

Figure 2 Budget Deficit, Current Account Deficit, and Net Aid Flows as Percentage of GDP, 1969–2004



Source: *Financial Memorandum,* MOF, various years, and *Indonesia Balance of Payments,* Bank of Indonesia, various years.

The sharp rise in aid in 1988 was due to problems caused by the drop in oil and gas revenues from a peak of nearly 65 per cent of total government revenue in 1981 to about 30 per cent in 1988–89. Since then official aid flows continued to decline as private capital inflows surged in the early 1990s. Of course the situation has changed markedly since the economic crisis of 1997–

98. Gross foreign aid flows rose from 2 per cent in 1996–97 to about 4.5 per cent of GDP in 1999. This figure does not include the loan received from the IMF. The IMF loan is not regarded as "development assistance" and is provided as a short- to medium term support for the balance of payments.

B. Domestic Environment

1) Economic Growth Rate

Despite a number of challenges from the international and domestic sides, the economy grew stronger in 2004 than in 2003, exceeding expectations of many. Policy synergies adopted during 2004 and rising enthusiasm on the part of the business community have led to fairly encouraging results. The Indonesian economy expanded at a solid pace with a healthier compositional pattern, most notably the increasing role of investment and exports. On the production side, supported in part by improved labor condition, almost all sectors accelerated with the largest contributions still coming from manufacturing, trade, and transportation.

Higher economic growth in 2004 has improved general welfare levels, as reflected in higher per capita income and a decrease in the number of poor. Notwithstanding, the growth was insufficient to fully absorb additions to the labor force and unemployment remained high. In achieving higher growth, the Indonesia's economy, faced various challenges and risks. On the international side, soaring oil prices and rising interest rates hindered the external sector's performance caused some disruptions on Rupiah exchange rate stability and put a bit of pressure on inflation. On the domestic side, efforts to boost investment faced financing constraints, low competitiveness and various other impediments that made for less than favorable investment climate for much of the year.

Table 12 Gross Domestic Product

Industrial Origin	At Current Prices		At Constant Prices 2000		Growth Rate
	2003	2004	2003	2004	2004
1. Agriculture, Livestock, Forestry & Fishery	325.7	354.4	243.1	252.9	4.06
2. Mining and Quarrying	169.5	196.9	168.4	160.7	-4.61
3. Manufacturing Industry	**590.1**	**652.7**	**441.8**	**469.1**	**6.19**
4. Electricity, Gas and Water Supply	19.5	22.9	10.4	11.1	5.91
5. Construction	112.6	134.4	90.1	97.5	8.17
6. Trade, Hotel and Restaurant	**337.8**	**372.3**	**256.3**	**271.2**	**5.8**
7. Transport and Communication	**118.3**	**140.6**	**85**	**95.8**	**12.7**
8. Financial, Ownership & Business Service	174.3	194.5	140.1	150.9	7.72
9. Services	198.1	234.3	144.4	151.4	4.91
GDP	**2,045.9**	**2,303**	**1,579.6**	**1,660.6**	**5.13**
GDP without Gas	**1,872.4**	**2,095.4**	**1,423.9**	**1,511.8**	**6.17**

Source: Bank of Indonesia Annual Report

Table 13 Contribution to Growth

Items	2001	2002	2003	2004
1. Agriculture, Livestock, Forestry & Fishery	0.6	0.5	0.7	0.6
2. Mining and Quarrying	0.04	0.1	-0.1	-0.5
3. Manufacturing Industry	0.9	1.5	1.5	1.7
4. Electricity, Gas and Water Supply	0.1	0.1	0.04	0.04
5. Construction	0.3	0.3	0.4	0.5
6. Trade, Hotel and Restaurant	0.7	0.6	0.9	0.9
7. Transport and Communication	0.4	0.4	0.6	0.7
8. Financial, Ownership & Business Service	0.6	0.5	0.6	0.7
9. Services	0.3	0.4	0.4	0.5
GDP	**3.8**	**4.4**	**4.9**	**5.1**

Source: Bank of Indonesia Annual Report

2) Inflation Rate

During 2004, inflation expectations were relatively stable at the high level of 6 to 7 %. Core inflation was relatively stable at 6.69%, just within the range of 6 - 7%. This core inflation was a bit lower than both the core inflation in 2003 and the core inflation forecast at the beginning of 2004. The fundamental factors affecting inflation had a minimal impact, as reflected in stable core inflation within the range of 6%-7%. Prices of goods and services at the consumer level were relatively well contained, despite an upturn relative to 2003. CPI inflation reached 6.40% (y-o-y), up from 5.06% (y-o-y) during 2003. The seasonal pattern in 2004 did not change much from that in 2003, when inflation tended to pick up towards year end in conjunction with Idul Fitri festivities. The highest monthly inflation occurred in December at 1.04% stemming among others from a LPG price hike and the psychological impact of the plan to increase fuel prices in 2005. The lowest monthly inflation was in February at 0.02%, prompted by the start of the harvest season, particularly for vegetables.

Inflationary pressures coming from non fundamental factors were more significant as they rose sharply, mainly originating in volatile foods inflation. In contrast, administered inflation declined relative to 2003. The pickup in volatile foods inflation was due to the absence of favorable supply shocks to foodstuffs, unlike in 2003. Consequently, volatile foods inflation rose sharply to 6.54% (y-o-y) from deflation of 2.36% (y-o-y) in 2003.

Table 14 Evaluation of Inflation

Inflation Desegregation	Inflation	
	2003	2004
CPI	5.1	6.4
Core Inflation	6.9	6.7
Administered	9.1	5.4
Volatile Food	-2.4	6.5

Source: Bank of Indonesia Annual Report

This outcome was a bit higher than the original forecast of 5.7%. This situation also stemmed from the policy to prohibit rice imports, which aimed to prevent a plunge in rice prices during the harvest season. Results of the non-fundamental factors were mixed. In line with the absence of adjustments to strategic administered prices, administered price inflation fell from 9.08% in 2003 to 5.42% in 2004. However, this was still higher than the beginning-of-year forecast, due to several unexpected administered prices adjustments, such as hikes in telephone tariffs and LPG prices. The contribution of volatile foods inflation rose; the contribution of core inflation did not experience any meaningful change; and the contribution of administered goods inflation declined.

Table 15

(%)

Government Policy	Increased In Price/Fare	Impact to Inflation
LPG	21.93	0.11
1 st Period (March 15, 2004)	5.26	0.03
2 nd Period (Dec 19, 2004	16.67	0.08
Train Fare	13.00	0.01
Water Tariff	22.00	0.20
Phone (April 2004)	34.8	0.76

Source: Bank of Indonesia Annual Report

By contribution to inflation, the category with the largest impact on inflation during 2004 was the housing, water, electricity, gas, and fuel category, which added 2.04%. It was followed by the foodstuffs category and the processed food, beverages, cigarettes and tobacco category that contributed 1.51 % and 0.86%, respectively. In the housing category, the dominant item was housing rent. Within the foodstuffs category, the largest contributors to inflation were rice and spices; as for the processed-foods category, the major contributors to inflation were refined sugar and instant noodles.

3) Consumption

Consumption recorded similar growth with last year, but its dominance has started to decline. By contrast, investment and exports increased. The growth of total consumption in 2004 was attributable to the accelerated growth of private consumption, which offset the slower growth in government consumption, as for private consumption it rose by 4.9% versus 3.9% in 2003.

The expansion of private consumption stemmed from higher levels of income. The Provincial Minimum Wages increased appreciably and corporate performance improved. Provincial Minimum Wages in almost all provinces increased in the range of 1.0 to 29.0% over last year. Also, the profits of companies listed on the Jakarta Stock Exchange increased relative to last year, which suggests greater capacity to compensate their employees. The quite large increases in nominal income and controlled inflation have elevated purchasing power.

Government consumption decelerated from 10.0% in 2003 to 2.0% in the reporting year. This was in line with government fiscal consolidation, which gradually narrowed the budget deficit. The growth in government consumption was mainly due to payment of civil servants 13th month salary, increased shared revenue allocations in line with rising crude oil prices, and spending on the general election.

Table 16 Types of Expenditure

Type of Expenditure	Current Market Prices (Trillion Rupiah)		Constant Prices 2000 (Trillion Rupiah)		Growth Rate 2004 (%)
	2003	**2004**	**2003**	**2004**	
1. Private Consumption Expenditure	1,372.08	1,532.39	956.59	1,033.81	4.94
2. General Gov. Consumption Exp.	163.7	187.77	121.4	123.77	1.95
3. Gross Domestic Fixed Capital Formation	386.22	438.44	310.78	359.6	15.71
4. a. Change in Stock	-26.17	40.9	-4.71	39.98	-
b. Statistics Discrepant ion	-6.04	-33.07	16.74	10.99	-
5. Export of goods and services	627.06	711.78	612.56	664.46	8.47
6. Import of goods & services	471	620.18	433.81	542.04	24.95
GDP	**2,045.85**	**2,303.03**	**1,579.55**	**1,660.57**	**5.13**

Source: Bank of Indonesia Annual Report

4) Investment

Total Private and Public gross domestic fixed investment increased significantly in 2004. It grew by 15.7%, much higher than 2003 growth of 1.0%.

Table 17 GDP Growth by Expenditure

(%)

Component	2001	2002	2003	2004
Total Consumption	**3.9**	**4.7**	**4.6**	**4.6**
Private	3.5	3.8	3.9	4.9
Government	7.6	13	10	2
Investment	6.5	4.7	1	15.7
Exports and Services	0.6	-1.2	8.2	8.5
Imports and Services	4.2	-4.3	2.7	25
GDP	**3.8**	**4.4**	**4.9**	**5.1**

Source: Bank of Indonesia Annual Report

By economic sector, the expansion of investment was concentrated in manufacturing, communications and mining. In manufacturing, there was a jump in the issuances of business licenses by the Capital Investment Coordination Board, up 75.6% for domestic investments and 53.4% for foreign investments, compared to last year. The strongest sub-sectors were chemicals, pharmaceuticals, food, paper and printing industries. In the communications sector, capital spending by telecommunication companies expanded significantly, notably for increasing the number of base transceiver systems and individual telephone lines.

5) Stock Market

The capital market during the reporting period remained very active, as reflected in the large number of issuers seeking funds through the stock and bond markets. Although the total value of issuances was not as high as in 2003, the number of issuers did increase. The issuances were directed more for the issuer business expansion rather than for debt restructuring.

Continuing the trends of 2003, the stock market in 2004 remained bullish, pushing the composite index above the 1,000 level before year-end. This level was attained despite some pressures during the first half of 2004, owing to a decline in international and regional bourses, as a reaction of Fed Fund rates hike. The bullish domestic stock market resulted from continuously improving fundamentals, both in macro and micro contexts, as well as market optimism over the new government. Total market capitalization in the Jakarta Stock Exchange was up by 47.69% followed by total transaction value which was recorded at Rp247 trillion or a 96.89% increase from the same number recorded in the previous year. These developments indicated access increased of business players to the stock market financing.

Table 18 Capital Stock

Items	2003	2004
Total Public Offerings (Number)	75	75
Total Public Offerings (IDR Trillion)	7.51	2.19
Right Issue (IDR Trillion)	2.46	4.34
Bonds/Convertible Bonds Offering/Sharia Bond (IDR Trillion)	25.67	19.17
Total Net Asset Value of Investment Fund (IDR Trillion)	69.48	104.04
Jakarta Stock Exchange (JSX) Market Capitalization (IDR Trillion)	460.37	679.95
JSX Annual Trading (IDR Trillion)	125.46	247.01
Surabaya Stock Exchange (SSX) Market Capitalization (IDR Trillion)	404.95	605.39
SSX Annual Trading (IDR Trillion)	3.1	8.23

Source: Indonesia Capital Market Supervisory Agency

The Initial Public Offerings (IPO's) collected Rp17.4 trillion from 32 companies. Meanwhile, in the corporate bonds market, trading frequency rose by around 50% to 4,149 transactions with total trading volume of Rp14.2 trillion. Low saving interest rates have made private bonds trading vigorous. In addition, the new bonds gave investors more choice for their portfolios.

6) Money Supply

In the reporting year, the average growth rates for narrow money (M1) and broad money (M2) increased in both nominal and real terms relative to the previous year. Nominal M1 and M2 grew by 17.7% and 7.4%, respectively; real M1 and M2 were up 11.65% and 1.32%. These growths rates reflected higher economic purchasing power, in line with rising economic growth and controlled inflation.

Table 19 Money Supply and Its Affect

(Trillion Rp)

Items	2002 Dec	2003 Dec	2004 March	2004 June	2004 Sept	2004 Dec	2003 Annual Changes	2004 Annual Changes
M2	883.9	955.7	935.2	975.2	986.8	1,033.5	71.8	77.8
M1	191.9	223.8	219.1	233.7	240.9	253.8	31.9	30.0
Currency	80.7	94.5	86.9	97.6	99.5	109.3	13.9	14.7
Demand Deposits	111.3	129.3	132.2	136.2	141.4	144.6	18.0	15.3
Quasi Money	692.0	731.9	716.2	741.4	745.9	779.7	39.9	47.8
Time Deposit in Rupiah	359.8	350.9	327.7	334.3	336.2	349.1	-9.0	-1.8
Saving Deposit in Rupiah	191.7	241.8	246.4	259.1	269.5	295.0	50.2	53.2
Deposit in Foreign Currency	140.5	139.2	142.1	148.0	140.2	135.6	-1.3	-3.6
In Millions of USD $	15,712.0	16,442.0	16,543.0	15,719.0	15,293.0	14,596.0	0.7	-1,845.0
Factors Affecting M2	883.9	955.7	935.2	975.2	986.8	1,033.5	71.8	77.8
Net Foreign Assets	250.7	271.8	275.8	280.1	258.7	263.6	21.1	-8.2
Bank of Indonesia	212.4	226.0	241.4	235.0	224.0	244.8	13.5	18.8
Commercial Bank	38.3	45.8	34.4	45.1	34.7	18.9	7.6	-27.0
Net Domestic Assets	633.2	683.9	659.4	695.1	728.1	769.9	50.7	86.0
Net Claims on Central Government	510.4	479.9	449.0	468.9	476.5	498.0	-30.5	18.1
Bank of Indonesia	168.5	174.2	156.7	192.6	204.1	226.6	5.7	52.4
Commercial Bank	341.8	305.7	292.3	276.3	272.3	271.4	36.2	-34.3
Claims to Business Sector	389.3	466.8	477.5	550.0	576.8	615.8	77.5	149.0
Total Credit	365.4	437.9	446.6	486.1	513.2	553.5	72.5	115.6
Credit in Rupiah	271.9	342.0	347.4	376.0	404.2	438.9	70.2	96.9
Credit in Foreign Currency	93.6	95.9	99.2	110.0	109.1	114.7	2.4	18.8
In millions of USD	10,465.0	11,331.0	11,556.0	11,687.0	11,892.0	12,343.0	0.9	1,012.0
Other Claims	23.9	28.9	30.9	63.9	63.6	62.3	5.0	33.4
Others (Net)	-266.4	-262.8	-267.1	-323.8	-325.1	-343.9	3.6	-81.1

Source: Bank of Indonesia Annual Report 2004

7) Employment

The pickup in economic growth has yet given a significant impact on improving unemployment condition. In 2004, the unemployment rate was 9.4%, changed a little from 9.5% last year. This stagnant unemployment condition was partly due to regulatory problems in the real sector. This situation of fewer available jobs relative to the number of job seekers was suspected to stem from production sector activity that was inadequate for creating work opportunities.

During 2004, the labor force increased by 2.4 million people, from 100.3 million people in 2003 to 102.8 million people. Meanwhile, the economic growth of 5% in 2004 was able to absorb 2.3 million people from the labor force. All economic sectors made a contribution, with the largest in the services, trade, and agriculture sectors. The composition of the labor force in 2004 is relatively unchanged from the pre-crisis period, when most workers worked in agriculture, followed by trade and services. With additions to the labor force exceeding new jobs, unemployment increased in the reporting year to 9.7 million people, up from 9.5 million people last year. If the underemployed category included (some 30 million people), the level of unemployment becomes extremely high.

II.2 Fiscal Position

A. Government expenditure

The state budget performance was generally in line with fiscal policy stance aimed at strengthening fiscal reliance through deficit reduction. Despite lower than last year, the deficit exceeded the targeted amount, either the beginning of year target from the original State Budget (Rp24.4 trillion or 1.2% of GDP) and the mid year target from the revised State Budget (Rp26.3 trillion or 1.3% of GDP). Although there was a strong pressure on expenditures, fiscal consolidation was consistently pursued, causing the fiscal deficit to narrow from last year.

The government decision not to adjust domestic fuel prices put a heavy pressure on government expenditures mainly due to spending on fuel subsidies that was tripled the amount budgeted at the beginning of 2004, despite a jump in world crude oil prices. Which exceeded the beginning-of-year target of Rp14.5 trillion and the mid-year target of Rp59 trillion. In addition to the fuel subsidy, another type of subsidy that increased in 2004 was subsidies paid by the government to cover taxes, mainly owed by state-owned enterprises.

One expenditure component that declined was interest payments on debt. This decline was largely due to lower interest rates on domestic debt, essentially the 3-month SBI rate, which is the reference for the coupon rate on much of domestic debt (SUN). However, interest payments on foreign debt rose compared to 2003, due to the weaker Rupiah exchange rate. In 2004, the government obtained sizable revenues from privatization and asset sales by the Asset Management Company, as sources for financing the deficit. This was complemented by drawing down government accounts at Bank of Indonesia and commercial banks. The sources of financing (privatization, asset sales and accounts draw downs) with support from the surplus on primary balance provided room for the government to reduce its debt. Both the level of debt and the ratio of debt to GDP declined during 2004, despite the financing pressures brought on by the end of debt rescheduling facility post the IMF program.

Table 20 Summary of Government Financial Operation

(Trillions of Rp)

Items	2003		2004			
	Realization (Temporary)		State Budget		State Budget (Revised)	
	Nominal	% to GDP	Nominal	% to GDP	Nominal	% to GDP
A. Government Revenue & Grants	**341.3**	**19.1**	**349.9**	**17.5**	**403.8**	**20.3**
I. Domestic Revenues	**340.9**	**19.1**	**349.3**	**17.5**	**403**	**20.3**
1. Tax Revenues	242	13.5	272.2	13.6	279.2	14
2. Government Revenues	98.8	5.5	77.1	3.9	123.8	6.2
i. Oil	42.9	2.4	28.2	1.4	63.9	3.2
ii. Gas	18.5	1	15.8	0.8	23.8	1.2
II. Grants	0.4	0	0.6	0	0.7	0
B. Government Expenditures	**376.5**	**21.1**	**374.4**	**18.7**	**430**	**21.6**
I. Central Government Expenditures	**256.2**	**14.3**	**255.3**	**12.8**	**300**	**15.1**
1. Routine Expenditures	**186.9**	**10.5**	**184.4**	**9.2**	**228.1**	**11.5**
a. Personnel expenditures	47.6	2.7	56.7	2.8	54.2	2.7
b. Material expenditures	14.9	0.8	17.3	0.9	16.8	0.8
c. Interest Payment	65.3	3.7	65.7	3.3	63.2	3.2
d. Subsidies	43.8	2.5	26.4	1.3	69.9	3.5
e. Other routine expenditures	15	0.8	18.4	0.9	24	1.2
2. Development expenditures	**69.2**	**3.9**	**70.9**	**3.5**	**71.9**	**3.6**
II. Regional Expenditures	120.3	6.7	119	6	130	6.5
C. Primary Balance [A-(B-B.I.1c)]	30.2	1.7	41.2	2.1	37	1.9
D. Budget Surplus (Deficit) (A-B)	**-35.1**	**-2**	**-24.4**	**-1.2**	**-26.3**	**-1.3**
E. Financing	**35.1**	**2**	**24.4**	**1.2**	**26.3**	**1.3**
I. Domestic Financing	34.5	1.9	40.6	2	50.1	2.5
1.Domestic banks financing	10.7	0.6	19.2	1	23.9	1.2
2.Non domestic banks financing	23.8	1.3	21.4	1.1	26.1	1.3
a. Privatization	7.3	0.4	5	0.3	5	0.3
b. Recovery of bank asset	19.6	1.1	5	0.3	12.9	0.6
c. Government bonds (Net)	-3.1	-0.2	11.4	0.6	8.2	0.4
- Issuance	11.3	0.6	32.5	1.6	32.3	1.6
Domestic Bonds	11.3	0.6	24	1.2	23.4	1.2
International Bonds	-	-	8.5	0.4	8.9	0.4
- Due Date	-6.2	-0.3	-20.1	-1	-23.1	-1.2
- Buyback	-8.3	-0.5	-1	-0.1	-1	-0.1
II. Foreign Financing (Net)	0.5	0	-16.1	-0.8	-23.8	-1.2
1. Foreign Debt Drawing (Bruto)	20.3	1.1	28.2	1.4	21.7	1.1
a. Program Aid	1.7	0.1	8.5	0.4	3.1	0.2
b. Project Aid	18.5	1	19.7	1	18.6	0.9
2. Interest Payment of Foreign Debt	-19.8	-1.1	-44.4	-2.2	-45.5	-2.3

Source: Ministry of Finance

The sources of financing (privatization, asset sales and accounts draw downs) with support from the surplus on primary balance provided room for the government to reduce its debt. Both the level of debt and the ratio of debt to GDP declined during 2004, despite the financing pressures brought on by the end of debt rescheduling facility post the IMF program.

B. Public borrowing

Financing from domestic sources was reasonably large, as reflected in the ratio of savings to GDP of 22.1 % in the reporting period, slightly lower than last year due to the surge in private investment activities. For its part, sources of offshore investment financing increased markedly. The balance of payments recorded capital inflows increase of 21.7% in the form of foreign direct investment compared to the previous year.

Much of the domestic financing came from banks and the capital market. Expansion in bank financing was facilitated by Bank of Indonesia"s policy to reduce SBI interest rates during the last few years through mid-2004. From the capital market financing it rose also in line with government policy to enhance the capital market"s role in financing development and with the optimism of market players. In accordance with the downward trend in interest rates, bank investment credits increased by Rp22.5 trillion during 2004, growing 20% on average.

Table 21 Ratio to GDP

(%)

		2001	2002	2003	2004
Government	Saving	1.8	2.6	3.7	4
	Investment	4.2	3.9	5.4	5.2
	Deficit/Surplus	-2.4	-1.3	-1.7	-1.2
Private	Saving	21.6	20.3	18.5	18.1
	Investment	15	15.1	13.4	15.8
	Deficit/Surplus	6.6	5.2	5.1	2.3
Total	**Saving**	**23.4**	**22.9**	**22.3**	**22.1**
	Investment	**19.2**	**19**	**18.9**	**21**
	Deficit/Surplus	**4.2**	**3.9**	**3.4**	**1.1**
Notes:	GDP (Trillion of Rp) base year 2000	1,684.3	1,863.3	2,045.9	2,303.0
	Current Account (Million of $)	6,901.0	7,823.0	8,106.0	2,878.0
	Average Exchange Rate (Rp/$)	10,526.0	9,318.0	8,572.0	8,940.0

Source: Bank of Indonesia Annual Report

On the side of domestic debt the financing through the issuances of SUN run as expected, as was the case for repayments of maturing SUN as well as the SUN buyback program. On the side of foreign debt, issuance of the government"s international bond (INDO 14) exceeded all preliminary expectations; it received a positive response from the market, as reflected in low yield at the initial offering. The positive response from the market on the performance of the government"s financial operations was also reflected in an improved government debt rating, which was evidence of rising international confidence in Indonesia"s fiscal sustainability

Table 22 Saving - Investment Gap

		2001	**2002**	**2003**	**2004**
		Current Price (Trillions of Rp)			
Government	Saving	31.1	48.7	76.4	92.9
	Investment	71.6	72.2	111.5	119.2
	Deficit/Surplus	-40.5	-23.6	-35.1	-26.3
Private	Saving	363.6	378.2	379.3	416.3
	Investment	252.3	281.8	274.7	364.2
	Deficit/Surplus	111.3	96.5	104.5	52
Total	Saving	394.7	426.9	455.7	509.2
	Investment	323.9	354	386.2	483.4
	Deficit/Surplus	70.8	72.9	69.4	25.7

Source: Bank of Indonesia Annual Report

C. Aggregate Tax Revenue

The types of taxes can bee seen in the breakdown of tax revenue and ratio of tax revenue to general revenue below. For Domestic Taxes Income Tax that consists of Corporate and Personal Income Tax is the main contributor followed by Value Added Tax (VAT), Excise Tax, The Property Land Building Tax, and by Other Taxes. As for International Trading we rely upon Import Tax and apply fewer taxes for export.

Table 23 Tax Revenue

Fiscal Year	Domestic Tax					International Tax		Total of Tax Revenues (A)	Total Revenues (B)	Ratio (A) / (B) %
	Income Tax	VAT	Land & Build. Tax	Excises	Other Tax	Import Duties	Export Tax			
1994/1995	18,764.1	16,544.8	1,647.3	3,153.3	301.9	3,900.1	130.6	44,442.1	66,418.0	66.9
1995/1996	21,012.0	18,519.4	1,893.9	3,592.7	452.8	3,029.4	186.1	48,686.3	71,340.1	68.2
1996/1997	27,062.1	20,351.2	2,413.2	4,262.8	590.7	2,578.9	81.0	57,339.9	86,278.1	66.5
1997/1998	34,388.3	25,198.8	2,640.9	5,101.2	477.8	2,998.7	128.5	70,934.2	101,768.7	69.7
1998/1999	55,944.3	27,803.2	3,565.3	7,732.9	413.0	2,305.6	4,630.2	102,394.5	156,408.5	65.5
1999/2000	72,729.0	33,087.0	4,107.3	10,381.2	610.9	4,177.0	858.6	125,951.0	200,643.7	62.8
2000	57,073.0	35,231.8	3,525.3	11,286.6	836.7	6,697.1	331.2	114,981.7	205,334.5	56.0
2001	94,576.0	55,957.0	5,246.2	17,394.1	1,383.9	9,025.8	541.2	184,124.2	301,077.7	61.2
2002	103,313.9	67,800.0	6,030.6	22,469.1	1,455.2	11,839.2	305.3	213,213.3	305,151.2	69.9
2003	114,832.1	76,761.4	10,906.2	26,396.4	1,654.3	10,847.3	229.6	241,627.3	336,155.5	71.9
2004	133,967.6	86,272.7	10,698.6	27,671.0	1,614.0	11,636.0	315.2	272,175.1	349,933.70	77.8
2005*	141,858.5	98,828.4	13,486.9	28,933.6,	2,039.9	12,017.9	344.8	297,510.0	377,886.3	78.7

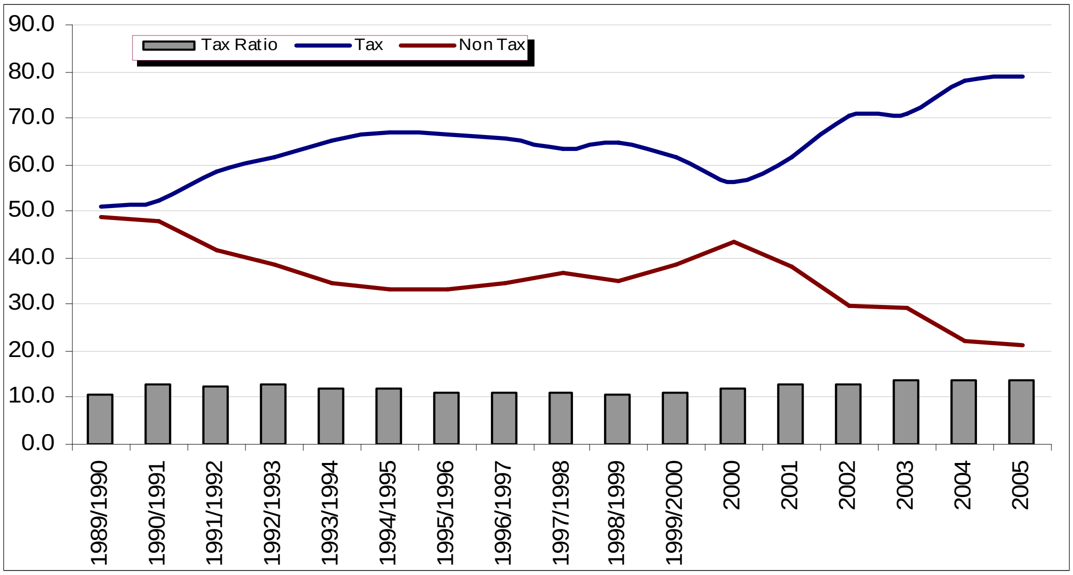
*) Proposed Budget
Source: Ministry of Finance

III. Tax Structure: Institutions and the Reality

III.1 Overview of the Role of Taxation in Indonesia

Tax revenue has a very important role in sustaining the operation of Government fiscal not only in current expenditure and capital expenditure but also in managing and controlling the macro economic policy. The main sources of revenue to finance government expenditures in the past had been dominated by non-tax revenues, especially that of oil and gas, and foreign loans. Although tax also played an important role in contributing to government revenue during those time, but the number was inferior to the two sources mentioned. However, ever since the 1990s, a gradual shift of domination took place as oil and gas reserves as well as other natural resources declined over time. Of the total revenue raised in 2003, the amount raised from tax amounted to 70.9% while 29.1% was generated from non-tax revenue. There is a growing dependence on tax revenue, as can be seen in figure 1, especially now that Indonesia has stop its dependency on foreign loans.

Figure 3 Trends in Tax Ratio[1] and Government Revenue from Tax and Non-tax sources (in percentage)



* Figure in 2005 is a proposed amount
Sources: Board of Fiscal Analysis, MoF, 2004, www.fiskal.depkeu.go.id

A. Indonesian Tax Reform

The Indonesian first tax reform was just started in 1983 when Indonesian Government launched some new tax laws then it was revised in 1994 and 2000. The prime goals of the new legislation include a further broadening of the tax base in line with the enhanced economic capabilities of the taxpayers and securing increased revenues from taxes. In addition, its provisions also reflect wider aims of encouraging and supporting development through:

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

The latest Indonesian Tax Laws arising from the recent tax reform review are:

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

These new laws were signed by the President on August 2, 2000 and apply from 1 January 2001.

The tax reform had changed many aspects of the Indonesian tax system and tax administration, included organizational aspect. The fundamental change was the self-assessment system coupled with withholding scheme, which took place in replacing the old official assessment system.

The old system prior to the reform, every taxpayer should be assessed by tax authority and then assessment notice will be issued if there is a discrepancy between what actually paid by Taxpayers and what should have been paid according to tax official. Under the new self-

[1] Tax Ratio is defined as the ratio of Tax Revenue Collected in one fiscal year over Gross Domestic Product (GDP) in the same period.

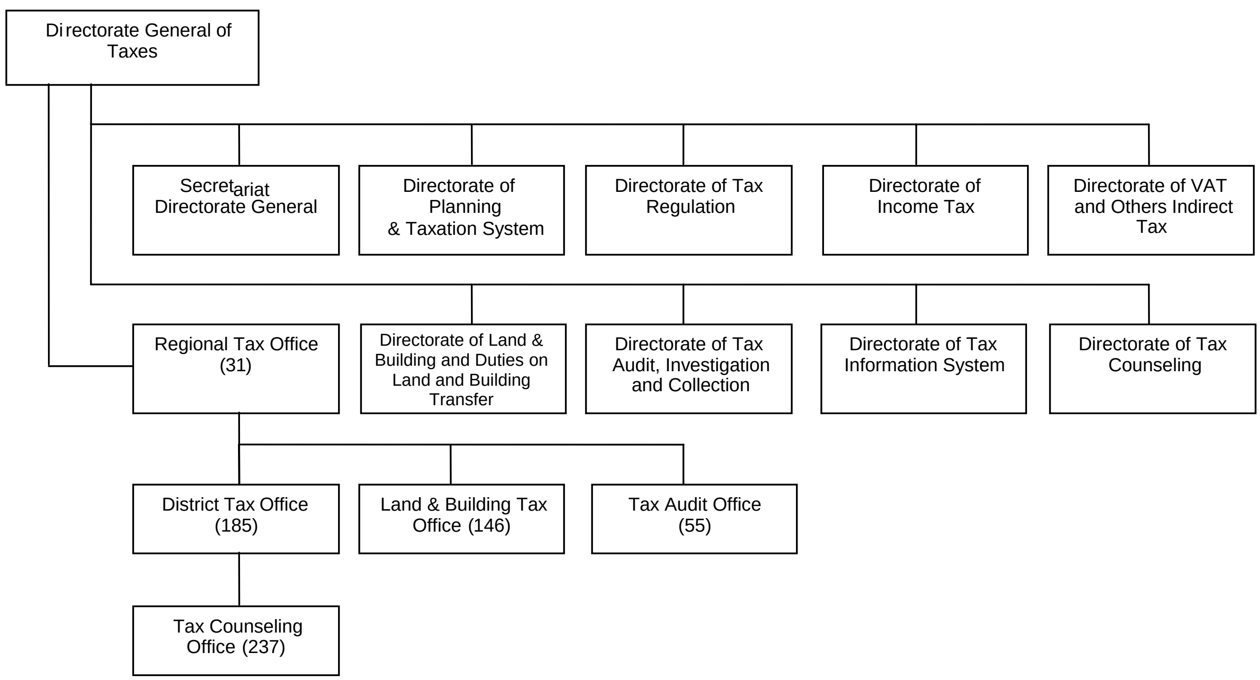
assessment system, the taxpayers are accorded greater trust and responsibility because the law authorizes taxpayer:

a. to determine by him/her self the amount of taxes should be paid based on his/her income;
b. to calculate, pay and reconcile the prepaid taxes;
c. to report the amount of taxes which have been paid to local tax authority.

It also implies that no official assessment is necessary except in certain circumstances.

In order to encourage higher voluntary compliance, the Directorate General of Taxes (DGT) keeps on performing counseling continually, increasing services provided for taxpayers, controlling tax compliance and enforcing fines for those who break the laws. These roles are performed by all units of DGT to provide services to the taxpayers. DGT consist of 8 Directorates, 31 Regional Tax Offices, 185 District Tax Offices (including 2 Large Taxpayers Office, 1 Middle Taxpayers Office and 15 Small Taxpayers Office), 146 Land and Building Tax Offices, 55 Tax Audit Offices, and 237 Tax Counseling Offices.

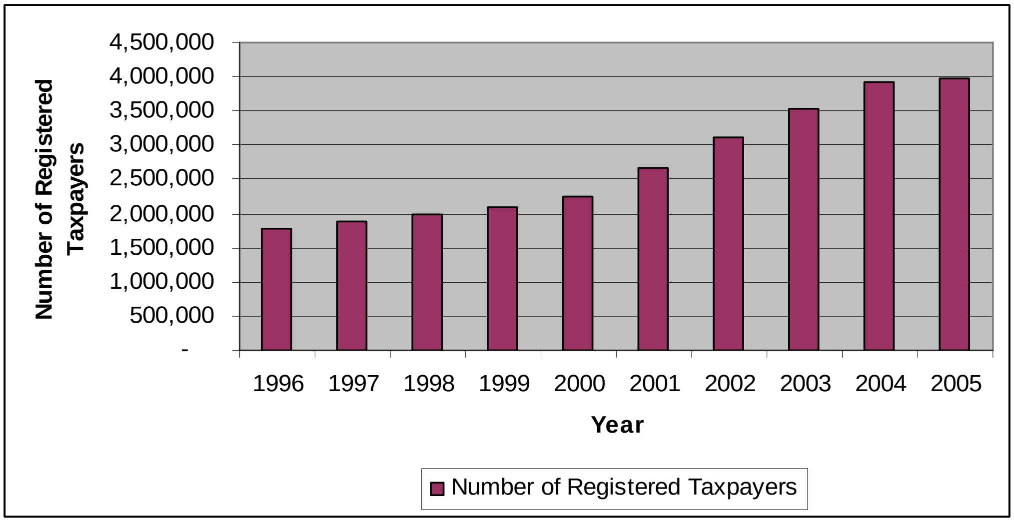
Figure 4 Organization Chart of Directorate General of Taxes



Taxpayer's Compliance

Indonesia's population has reached 219.898.300 people, which is a big potential for tax revenue. But the number of registered taxpayers shows only a little bit part of it, as can be seen in figure 5. This number can be increased and the quality of the registered one to contribute revenue for Indonesia can also be increased.

Figure 5 Number of Registered Taxpayers (1996-2005)



Source: Directorate General of Taxes, Intranet per 28 February, 2005

Voluntary compliance has been one of the challenges confronting tax administrations. The ways by which tax authorities interact with taxpayers effect the public image towards tax administration and to some extent impact the degree of voluntary compliance. The provision of service by providing assistance to taxpayers to comply with the tax laws and fulfill their tax obligations are crucial in the implementation of self assessment system. To encourage the service-oriented tax administration is based on this idea.

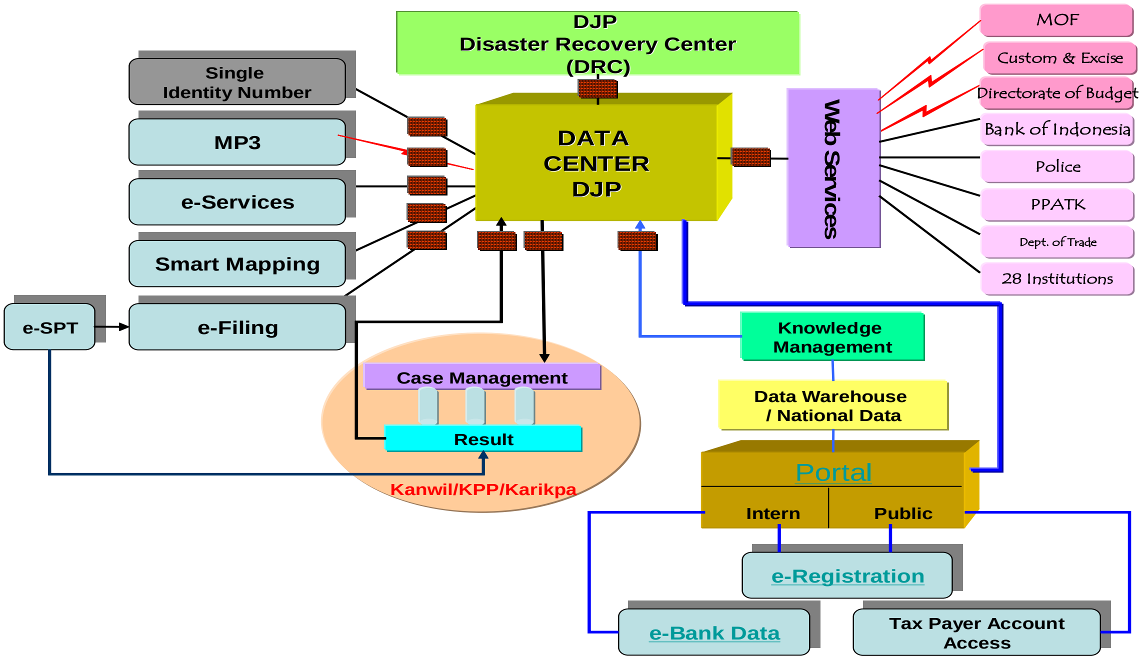
It is a fact that the degree of compliance in Indonesia is still much to be improved. The root of this matter is that the taxpayers are not fully acquainted with their tax obligations. Many people do not aware of why they must pay taxes. How to best educate and inform taxpayers about the tax law and tax law changes and about their responsibility in relation to paying tax is an indispensable factors contributing to the increase of compliance. Informing large business is less of a problem since it can be done through their accountant and lawyers, but educating individual taxpayers and informing small business people about such things as their obligation to file returns and to keep records is more problematic.

A significant percentage of non-compliance has been one of the most difficult challenges facing tax administration, not only in Indonesia, but also in most countries in the world. There is nearly a universal agreement concerning basic administrative goals of tax policy that taxes should be easy to understand and comply with, and they should be enforced and administered in a competent and fair manner. While strategies are mostly aimed at reducing the scope of non-compliance, they should equally aim at providing some incentives for compliance. The strategies taken by tax authorities to improve voluntary compliance may vary among countries according to their many different backgrounds such as culture, economic condition, history, and social values. Voluntary compliance should not only be seen as one-sided obligation of the taxpayer to comply with tax laws but it should also be seen as the obligation of tax administration to encourage the compliance by providing excellent taxpayer services in a way that it enhances taxpayers' confidence toward tax administration.

B. Information Technology

Information technology has been used to increase the quantity and quality of the information available to the tax administration. Information systems computerized have been focused on recording and controlling information on the compliant taxpayers, rather than detecting those who are evading or in arrears.

The enhancement of computer technologies and networks and the widespread use of computer software have enabled tax administration to take control of the computer system they need and to use them as an integrated part of the administrative process.

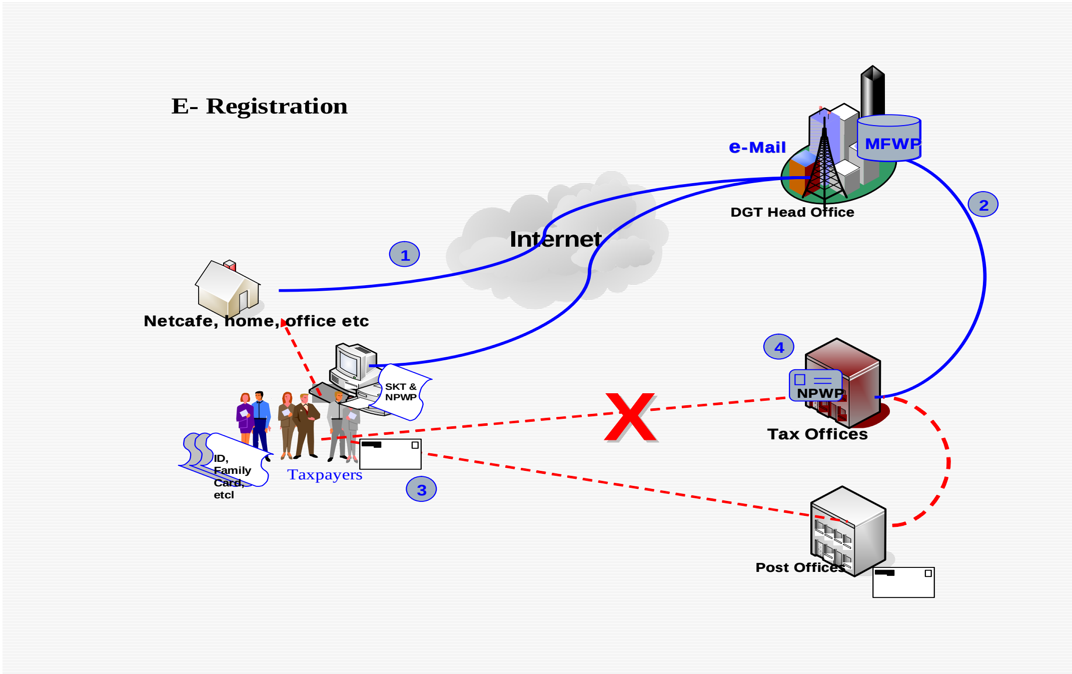


Voluntary compliance is being enhanced through a wide range of service programs from taxpayer assistance to electronic filing and funds transfer. A modern tax administration needs to be integrated with private information systems which provide third party information used to assist in the enforcement of taxes, the information systems of other public programs which are administered by the revenue system.

In providing taxpayers services, both DTG and tax counsel office still rely much upon telephone to answer questions other than face-to-face consultation and those by letters. In the case of DTG, the use of internet and Automatic Voice Response are also utilized to answer frequently asked questions (FAQ). On the Directorate General of Taxes' web site (www.pajak.go.id), people may find tax laws and regulations, the latest news, and also tax forms.

A more modern and sophisticated system such as e-filing and e-payment has been implemented in certain tax offices such as the Large Taxpayer Office (LTO), the Medium Taxpayer Offices (MTO) and Small Taxpayer Offices (STO) in order to provide ease of administration for the taxpayers. Furthermore, facilities like touch panel system are also provided in LTO and MTO. The content of the system is not focused on how to fill in the tax return which later can produce a completed tax return but rather intended to give general information about taxation such tax procedures and regulations.

Currently, the LTO, MTO and STO are developing tax knowledge base to answer even complicated matters about taxation in the form of database that can be easily accessed. What's more, the DGT has been implementing an online taxpayer registration system. With the system, one can registers himself as a taxpayer through the internet. Later, if he wants to make any changes in address or status, he can do so also through the internet.



It must be recognized that there have been many failures more than the number of successes in the implementation of computerized information systems for tax administration. The increasing change and complexity of the tax environment has made it more difficult for an official or automatic system of assessment to operate effectively. A system has some important limitations. The system might have been appropriate when it was developed but it has become less so the tax environment becomes more variable and complex.

C. Human Resources

For years the Government has been adopting "zero growth policy" for civil servant recruitment, therefore the process only aimed to replace retired civil servants. Government issued a policy that newly recruited employee's education shall not be lower than high school, which means they will be admitted as a Rank II employee. Newly recruit civil servants in DGT are classified into ranks. The ranks are as follow:

Table 24 Civil Servants Rank

Rank	Level of Education	Max Rank
I/a	Elementary School	II/a
I/c	Junior High School	II/c
II/a	Senior High School or 1-year Diploma Program (Diploma I)	III/b
II/b	2-year Diploma Program (Diploma II)	III/b
II/c	3-year Diploma Program (Diploma III)	III/c
III/a	Bachelor Degree or Associate Degree certificate (Diploma IV)	III/d
III/b	Master Degree	IV/a
III/c	Doctorate Degree	IV/b

Source: www.depkeu.go.id

Development of human resources in DGT is a continuous program. Regardless of how effective the selection and recruiting system is, most of the employees still require additional training to help them grow and develop in their job. Secretariat of DGT through Personnel Development Section is responsible for Education and Training Practices in DGT. Personnel Development Section acts as the coordinator of all training programs.

There is an agency under Ministry of Finance responsible for this development of human resource. Finance Education and Training Agency (FETA), is an internal organ of the Ministry of Finance, which is responsible for improving the professionalism of the employees of the Ministry of Finance. There is a special training agency for DGT personnel within FETA, which is Taxation Education and Training Center.

III.2 Indonesian Tax Laws

A. Tax Law of General Provision and Taxation Procedure

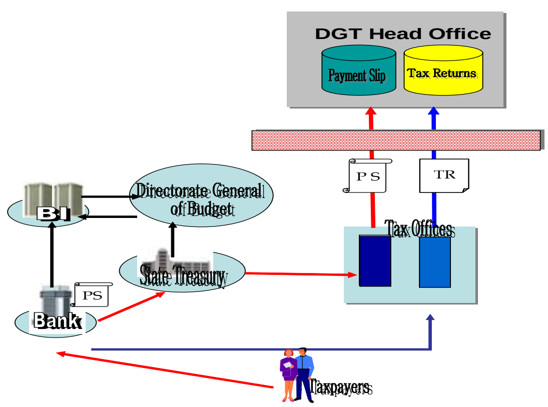
1) Tax Collection in Indonesia

i. Procedure for security of tax payment

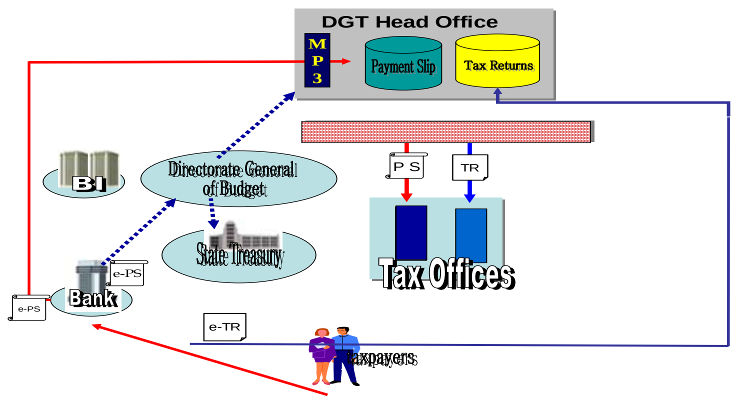
Under the self assessment system, taxpayers compute tax amount and pay tax into the state treasury by themselves before fill in tax returns. In order the secure the payment, taxpayers do not pay at the tax offices but straight to the banks or post offices.

Directorate General of Taxes (DGT) has made improvement in the system of payment as shown below:

Old Tax Payment System



New Tax Payment System



Within the new tax payment system, when taxpayers pay their tax, they will be automatically connected to the server in the DGT head office. The records of tax payments are stored in the data center of DGT head office.

ii. Tax Collection

Tax collection in Indonesia is stipulated in consolidation of Law of The Republic Indonesia Number 6 of 1983 concerning General Provisions and Tax Procedures (GPTP) as lastly amended by Law Number 16 of 2000.

The basis of tax collection are notice of tax collection, notice of tax underpayment assessment, notice of an additional tax underpayment assessment, notice of tax correction, decision on objection, or decision on appeal that increase the amount of tax payable. These are called as administrative instrument for the DGT to collect tax.

According to Article 19 of GPTP Law, if tax payable under notice of tax underpayment assessment, notice of an additional tax underpayment assessment, and additional tax payable under notice of tax correction, decision on objection, or decision on appeal, are not paid or underpaid upon the due date, the amounts of underpaid or unpaid tax are subject to an administrative penalty in the form of interest of 2% (two percent) per month calculated from the due date up to the date of issuance of the notice of tax collection, and fraction of a month is deemed as a 1 (one) month period.

Taxpayer is allowed for installments or postponements to pay tax but it subject to an interest of 2% (two percent) per month, and fraction of the month is deemed as a 1 (one) month period. According to the Ministry of Finance Decree number 541/KMK.04/2000, the application for postponement and installment should be submitted to the tax office not later than 15 days before the due date for tax payment. The decisions shall be issued within 10 days after the complete document is received. If this time limit elapses, the application shall be considered granted/approved.

If a taxpayer is allowed to postpone for filing Tax Returns and the tentative calculation of tax payable, referred to certain cases where Director General of Taxes may appoint a place for filing Tax Return other than places that is already stipulated, turn out to be less than the actual tax payable, the shortages are subject to 2% (two percent) interest per month, calculated from the end of the period of obligation to file Tax Return, and a fraction of a month is deemed as a 1 (one) month period.

iii. The Right to collect taxes

The State has preemptive rights over the assets owned by Tax Bearers for the purpose of collecting tax. It covers principal tax, administrative penalty in the form of interest fines, and surcharges, and tax collection expenses. The preemptive right of priority of the purpose of tax collection supersedes all other priorities, except for:

1. Legal expense arising solely from a court order to auction movable and or immovable goods;
2. Expenses incurred for securing the goods;
3. Legal expenses, arising solely from the auction and settlement of inheritance.

The preemptive rights shall be elapsed after 2 years from the date of issuance of a notice tax collection, notice of tax underpayment assessment, notice of an additional tax underpayment assessment, notice of tax correction, decision on objection, or decision on appeal which result in an increase in tax payable unless during the two years period, a Coerce Warrant for paying is officially issued, or postponed of payment is granted.

The right to collect taxes, including interest, fines, surcharges and tax collection expenses shall elapsed after 10 years from the date the tax is payable, or from the end of the taxable period fraction of the taxable year, or taxable year.

*iv. **International Tax Collection***

In this globalization era, DGT need to enlarge the network of tax treaties for the mutual assistance of tax administration based on the reciprocal basis. The taxpayers DGT deal with, not only in Indonesia but also in other countries. In handling international tax problem, it requires a tax jurisdiction reconciliation of relevant countries. The tax jurisdiction of each relevant country is regulated firmly on the reconciliation, which is called Avoidance of Double Taxation Agreement, in order to lessen the possibility of double taxation. The agreement regulates the tax right distribution; therefore countries conducting the agreement could not fully implement their domestic tax laws. In general, the agreement reduces tax rates on interest income, dividend, royalty, and technical service fee. Right now, Indonesia has concluded tax treaty with 57 partner countries.

Table 25 Tax Treaty between Indonesia and:

No.	Country	Effective date	Portfolio Investment Dividend	Substantial Holding Dividend	General Interest	Specific Case Interest	General Royalty	Specific Case Royalty	Branch Profit Tax
1	Australia	1-7-1993	15	15	10	--	15	10	15
2	Austria	1-1-1989	15	10	10	--	10	--	12
3	Belgium	1-1-1975	15	15	15	10	10	--	15
4	Bulgaria	1-1-1993	15	15	10	--	10	--	15
5	Brunei Darussalam	1-1-2002	15	15	10	--	10	--	15
6	Canada	1-1-1980	15	10	10	--	10	--	15
7	China	1-1-2004	10	10	10	--	10	--	10
8	Czech	1-1-1997	15	10	12.5	--	12.5	--	12.5
9	Denmark	1-1-1987	20	10	10	--	15	--	15
10	Egypt	1-1-2000	15	15	15	--	15	--	15
11	Finland	1-1-1990	15	10	10	--	15	10	15
12	France	1-1-1981	15	10	15	10	10	--	10
13	Germany	1-1-1992	15	10	10	--	15	10.75	10
14	Hungary	1-1-1994	15	15	15	--	15	--	10
15	India	1-1-1988	15	10	10	--	15	--	10
16	Italy	1-1-1996	15	10	10	--	15	10	12
17	Japan	1-1-1983	15	10	10	--	10	--	10
18	Jordan	1-1-1999	10	10	10	--	10	--	20
19	Kuwait	1-1-1999	10	10	5	--	20	--	10
20	Luxembourg	1-1-1995	15	10	10	--	12.5	10	10
21	Malaysia	1-1-1987	15	15	15	--	15	--	12.5
22	Mauritius	1-1-1999	15	5	10	--	10	--	10
23	Mexico	1-1-2004	10	10	10	--	10	--	10
24	Mongolia	1-1-2001	15	10	10	--	10	--	10
25	Netherlands	1-1-1971	15	10	10	--	10	--	9
26	New Zealand	1-1-1989	15	15	10	--	15	--	20
27	Norway	1-1-1991	15	15	10	--	15	10	15
28	Pakistan	1-1-1991	15	10	15	--	15	--	10
29	Philippines	1-1-1983	20	15	15	10	15	--	20
30	Poland	1-1-1994	15	10	10	--	15	--	10
31	Portuguese	1-1-2005	10	10	10	--	10	--	10
32	Romania	1-1-2000	15	12.5	12.5	--	12.5	10	10
33	Russia	1-1-2001	15	15	15	--	15	--	15
34	Saudi Arabia[1]	1-1-1989	-	-	-	--	-	--	-
35	Seychelles	1-1-2001	10	10	10	--	10	--	20
36	Singapore	1-1-1992	15	10	10	--	15	--	15
37	Slovakia	1-1-2002	10	10	10	--	15	--	10
38	South Africa	1-1-1991	15	10	10	--	10	--	10
39	South Korea	1-1-1990	15	10	10	--	15	--	10
40	Spain	1-1-2000	15	10	10	--	10	--	10
41	Sri Lanka	1-1-1995	15	15	15	--	15	--	20
42	Sudan	1-1-2001	10	10	15	--	10	--	10
43	Suriname	1-1-2002	15	15	15	--	15	--	15
44	Sweden	1-1-1990	15	10	10	--	15	10	15
45	Switzerland	1-1-1990	15	10	10	--	12.5	5	10
46	Syria	1-1-1999	10	10	10	--	20	15	10

47	Taiwan	1-1-1996	10	10	10	--	10	--	5
48	Thailand	1-1-1983	15	15	15	--	15	10	20
49	Tunisia	1-1-1994	12	12	12	--	15	--	12
50	Turkey	1-1-2001	15	10	10	--	10	--	15
51	United Arab Emirates	1-1-2000	10	10	5	--	5	--	5
52	United Kingdom	1-1-1976	15	10	10	--	15	10	10
53	Ukraine	1-1-1999	15	10	10	--	10	--	10
54	USA	1-1-1991	15	10	10	--	10	10	10
55	Uzbekistan	1-1-1999	10	10	10	--	10	--	10
56	Vietnam	1-1-2000	15	15	15	--	15	--	10
57	Venezuela	1-1-2001	N.A	N.A	N.A	N.A	N.A	N.A	N.A

Source: http://www.pajak.go.id/treaty

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

v. Taxpayers Rights

Administrative

Taxpayers have right to:

a. receive the receipt of submitting the tax returns;
b. make a correction of the Tax Returns (as long as not yet audited);
c. make a request to suspend of submitting the Tax return;
d. make a request to suspend or make installments on tax payment;
e. make a request of re-calculation of tax payable on tax notification;
f. make request of tax refund;
g. make a request of write-off and deduction of sanction and correction of miscalculation tax notification;
h. give rights to other party to do his tax obligation under his name;
i. as a taxpayers that is withheld by withholding agent, he can ask for the proof of withholding tax to the withholding agent and can make an objection of this proof;
j. to make suit on a criminal prosecution against tax official who due to his/her negligence or deliberately fails to fulfill the obligation to withhold confidential information of the taxpayer.

Tax Incentives

There are incentives for comply taxpayers. Taxpayers who fall under criteria below, will receive the decision of pre-audit refund of tax overpayment upon request not more than 3 (three) months from the date of receipt of the income tax refund request, and not more than 1 (one) month from the date of receipt of the VAT refund request.

a. File tax return for all taxes in time within last 2 years;
b. Having no tax arrears;
c. Having no tax fraud and crime within last 10 years;
d. Having qualified opinion of certified public accountant.

A taxpayer who invests capital in certain sectors and or in certain regions may be granted tax incentives in the form of:

a. Up to 30% investment allowance;
b. Accelerated depreciation and amortization;
c. Extended loss carried forward up to 10 years; and
d. 10% withholding tax on dividends referred to Article 26 of the Income Tax Law (prescribed rate is 20%), unless the tax rate under the relevant tax treaty is lower.

Objection and Appeal

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

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

Confiscation and Auction

a. In case of confiscation, taxpayers have rights to receive the copy of force letter and confiscation memo;
b. Decide order of the goods that will be auctioned;
c. Before Auction, he has the last chance to pay the tax payable including cost of confiscation, advertisement and cancellation fee and report the payment to the head of tax district office.

B. Income Tax Law

1) Corporate Income Tax

i. Classification of Corporate Taxpayers

A corporation, for tax purposes, is classified as "resident" or "non-resident". Residency is determined on the basis of place of incorporation. A corporation is therefore considered "resident" if incorporated in Indonesia and non-resident if otherwise.

Resident corporations are taxed on their worldwide income. Tax credits are allowed for income that was taxed outside the country. Non-residents are taxed only on income derived from Indonesian sources, subject to any relief available under double taxation agreements. However, a non-resident entity with a permanent establishment (PE) in Indonesia, such as a branch office, is taxed on:

1. the PE's income from its business or activities, and from the assets it owns and controls;
2. the income of the head office arising from business activities, or sales of goods or services in Indonesia of the same type as those sold by the permanent establishment in Indonesia; and
3. all other income, either received or accrued by the head office such as dividends, interest, royalties, rent and other income connected with the use of property, fees for services, etc, provided that the property or activities producing the income is effectively connected with the PE in Indonesia.

Income attributable to a PE of a company that is resident of a treaty country should refer to the relevant treaty. In Indonesia a PE is generally defined as an operation in which a non-resident establishes a fixed place of business in Indonesia. This would include a management location, a branch office, an office building, etc.

A PE can also be established as a result of the non-resident entity's employees providing services in Indonesia for more than 60 days in any 12-months period. For companies from those countries with which Indonesia has concluded a Double Tax Agreement (DTA), the relevant definition can be somewhat modified.

ii. 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.

iii. Allowable Tax deductions

Taxable income is determined by subtracting allowable deductions from revenue. Certain expenses, such as employee benefits in kind and donations, are generally not tax deductible. In addition, interest incurred to finance the acquisition of shares is not deductible unless dividends from the shares purchased are taxable. Major allowable deductible expenses are:

Business Expenses

As a general rule, taxpayers may deduct from gross income all expenses related to earning, securing and collecting taxable income. Items that are not deductible include those incurred for the personal benefit of shareholders; benefits in kind (e.g. housing and vehicles) provided to employees, except for the provision of food and beverages for all employees and for certain benefits in kind provided to employees in certain remote areas; gifts; donations and support; "excessive" payments for goods or services where a special relationship is deemed to exist between the buyer and seller; and expenses incurred in the course of producing income that is exempt from tax or subject to final tax. Formation of a reserve or allowance is generally not tax deductible, with the exception of bad debt allowances for banks or finance leasing companies, reserves in insurance companies, and reserves for reclamation cost in the mining industry.

Research and Development

Expenses such as those for research and development carried out in Indonesia and eligible employee training qualify as regular allowable deductions. Indonesia has no special income tax deductions/relief for research and development and eligible employee training. The deductibility of research and development performed offshore remains unclear.

Depreciation and amortization

Depreciation cost on assets is deductible from the income before tax. Depreciable assets are grouped into four categories, depending on the useful life of the assets. Taxpayers may choose either the straight line method (for periods of less than 20 years) or the fast declining balance method (except for buildings).

The table below shows the allowable useful life of the assets as categorized and the annual depreciation rates:

Depreciation

Physical (Tangible) Asset	Useful Life (Years)	Method of Calculation	
		Straight Line (%)	Double Declining Balance (%)
I. Non Building :			
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 :			
Permanent	20	5	
Non Permanent	10	10	

Source: Republic of Indonesia, Law Number 17 Year 2000 on Income Tax Article 11

Amortization

Non-Physical Asset	Useful Life (Years)	Method of Calculation	
		Straight Line (%)	Declining Balance (%)
Group 1	4	25	50
Group 2	8	12.5	25
Group 3	16	6.25	12.5
Group 4	20	5	10

Source: Republic of Indonesia, Law Number 17 Year 2000 on Income Tax Article 11A

Loss Carryovers

Losses may in general be carried forward for five years. However, to encourage investment in certain business sectors and in certain areas of the country, a ten-year loss carry forward period is available.

Tax Rate

Income tax in Indonesia is progressive and a self-assessment method is used to compute the tax.

Taxable Annual Income	Income Tax Rate
Up to Rp. 50 million	10%
Over Rp 50 million to Rp 100 million	15%
Over Rp 100 million	30%

Source: Republic of Indonesia, Law Number 17 Year 2000 on Income Tax Article 17

Monthly Installments

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

2) Withholding Income Tax

Tax subjects or taxable entities according to Indonesian tax law are Individuals, Companies Partnerships, Firms, Co-operatives, Foundations, other organizations; or Permanent Establishments. 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.

i. Withholding Tax on Employee (Article 21)

This provision governs tax payment in a current year by way of withholding income tax on income derived by individual resident taxpayers in respect of employment, service rendered, or any other similar activity. The persons who are obliged to withhold, to make deposit, and to report tax are employers, government treasures, pension funds, entities, and event organizer.

The Indonesian income tax rate is applied progressively to the income of individual's resident taxpayers.

Taxable Income Brackets	**Tax Rate**
Rp 25,000,000 or less	5%
Over Rp 25,000,000 – Rp 50,000,000	10%
Over Rp 50,000,000 – Rp 100,000,000	15%
Over Rp 100,000,000 – Rp 200,000,000	25%
Over Rp 200,000,000	35%

Source: Republic of Indonesia, Law Number 17 Year 2000 on Income Tax Article 17

Allowed Deductions for individual unless an individual is an entrepreneur personal tax deductions are limited to non-taxable income (PTKP) and occupational deductions, and possibly pension contributions. The PTKP deduction varies depending on the marital status and dependent situation as detailed below:

Status	**Income**
Self	Rp 12,000,000
If Married	+ Rp 1,200,000
Per Dependent (Note 1)	+ Rp 1,200,000

Note 1: maximum of 3 persons related by blood or marriage

Married women are normally only allowed the "Self Allowance".

An occupational deduction is also allowed for an individual taxpayer equaling 5% of the gross income (to a maximum of Rp 108,000 per-month). For pensioners there is an additional deduction of Rp 432,000 per-year. Contributions to a pension fund approved by the Minister of Finance, together with the employee's payment to the Jamsostek social security system, are also deductible.

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

ii Withholding Tax on Imports and Certain Goods (Article 22)

The purpose of withholding tax accorded to this provision is to enhance public participation in collecting of fund by way of tax payment system and to achieve the principles of easiness, simplicity, and timely tax imposition.

Pursuant to this provision a person who is appointed as a withholding agent shall be:

a. Government treasures either for central or local governments, government institution or any statutory bodies in respect of the payment for supply of goods.
b. Certain institutions either government or private entities that carry out import activities, or any other business activities.

In The Ministry of Finance Decree No. 254/KMK.03/2001 dated April 30, 2001, Bank of Indonesia, Bulog, PT Telecommunication Indonesia (Telkom), PT Perusahaan Listrik Negara (PLN), PT Garuda Indonesia, PT Indosat, PT Krakatau Steel, Pertamina and State Owned Banks are appointed as Article 22 collectors and they must collect 1.5% Article 22 on any payments from State Treasury to purchase goods.

The table below indicates some of the rates of Article 22:

Type of Income	Tax rate	Nature
Import – with Importer Identification Number	2,5%	creditable
Import - without Importer Identification Number	7,5%	creditable
Sale on cement by domestic company	0,25%	creditable
Sale on cigarette by domestic company	0,1%	final
Sale on paper by domestic company	0,1%	creditable
Sale on steel	0,3%	creditable
Sale on automotives	0,45%	creditable

iii. Withholding Tax on Certain Income (Article 23)

This article governs withholding tax on resident taxpayers and permanent establishment's income derived or received from capital, furnishing services, or other activities in which not being withheld under Article 21, paid or payable to government institution or resident taxable person, event organizer, permanent establishment, or other representative of foreign company.

Domestic withholding tax operates on the basis that the payer of the fee withholds the appropriate tax and forwards this to the State Treasury on behalf of the person providing the services or receiving the payment. This is regarded as a prepayment of the provider's year end tax obligation.

The withholding tax base under this provision varies between gross income and estimated net income. The withholding tax base for income in the form of dividend, interest, royalty, gift, and prize are gross income. The withholding tax base for rent and other income related to the use of properties are estimated net income.

Income from furnishing services such as technical, management, construction, consultant, and other services except regulated under article 21, are subject to withholding tax. The gross amount on which to calculate withholding tax for construction and catering services is the total compensation including the procurement of goods/materials. The gross amounts for services other than construction and catering shall be only the amount of the compensation paid for the providing of services, unless the contract does not separate the compensation between provision of services and deliveries of goods. In all other cases the entire invoice is subject to withholding tax.

The table below indicates the rates of withholding taxes that are applicable to certain types of income:

Type of Income	Withholding Rate	
	Resident	Non Resident *)
Royalties, Interest	15%	20%
Prizes	25%	20%
Dividends	15% **)	20%
Brokerage Services (primary market)	6%	20%
Technical, management services, design services, installation and assembly services, repair and maintenance services, intermediaries, dubbing/mixing film, custodial, storage & deposit	6%	20%
Services, information services in technology sector, telecommunication services that are not for public use, contract manufacturing, agency fees and forest felling		
Professional services including legal consulting, tax consulting, accounting and bookkeeping services, appraisal services and actuarial services.	7.5%	20%
Pest Control and cleaning services	1.5%	20%
Drilling, mining & supporting services for mining, oil & gas sector	6%	20%
Mining and supporting services in the non-oil & gas sector	6%	20%
Equipment rental	6%	20%
Land transport vehicle rental	3%	20%
Recruitment services & provision of manpower	6%	20%
Air charter, passenger or cargo	1.8%	2.64%
After-tax income of a PE	n/a	20%
Construction services	2%	20%
Construction planning or supervision services	4%	20%

*) unless otherwise specified by a Double Tax Agreement.

**) the rate is 0% for corporate shareholders holding at least 25% of the paid up capital, that also have an active business other than share ownership.

iv. Withholding Tax on Non-Residents' Income (Article 26)

Non-resident individuals or corporate bodies are subject to Article 26 withholding tax at 20% (subject to tax treaty provisions) on Indonesian source income (see the table above of Article 23). Residents of tax treaty countries generally can obtain a lower rate of withholding tax. With regard to non-resident withholding tax (Article 26), the tax is regarded as a final payment of any Indonesian tax liability.

v. Final Tax

Final withholding tax is levied on certain classes of income. The taxes are calculated as a defined percentage of the gross payment. This tax is not a prepayment of income tax and can not be credited against tax payable on other sources or income. The income subject to final tax is not subject to further tax at year end.

The regulations of Final tax are as follows:

a. Transfer of title of land /building
   Rate: 5% of gross value (normal) 2% (low cost housing)
   Object: Any kind of transfer of title over land / building
   Subject: Companies and individuals receiving the income (Except Real Estate Company)
   Mechanism: Paid by the recipient of income upon payment. Notary public will only sign the transfer deed on the presence of the tax payment slip
b. Rent of land and building

Rate: 10% for payments to individuals or to corporate
Object: Any kind of lease/rent and other associated income, maintenance, service charge, etc.
Subject: Any recipient of such income
Mechanism: Withholding on payment in the case of corporate lessee. Payment direct to the State Treasury by the landlord in the case of individual lessee

c. Income from Construction, Construction Planning or Supervision Services are subject to Article 23, unless these meet the following requirements:
   - The taxpayer has been certified by an authorized institution to undertake contracts of less than Rp. 1 billion in value, and
   - The contract in question must be less than Rp. 1 billion in value

   The final tax rates are as follows:
   - Construction Services: 2% of gross income
   - Construction Planning & Supervision Services:
   - 4% of gross income

d. Income from shipping business
   Rate: 1.2% of gross income (resident tax payers): 2.64% of gross income (foreign)
   Object: All kinds of income, including charter, from freight or passenger
   Subject: Tax residents in shipping business, local or international
   Mechanism: Withholding if the payment is made by deemed tax collector. Paid by the taxpayer on any other payments.

e. Securities traded on stock exchange
   Rate: 0.1% of gross transaction, 0.5% for founder shareholders
   Object: Securities already traded on the stock exchange, not including IPO (Initial Public Offering) transaction
   Subject: Parties involved in the transaction including securities brokers.
   Mechanism: Through withholding by the stock exchange authority. Prepaid Monthly Income Tax Installment

vi. Withholding Tax Compliance Timetable

Article 21

- ❖ Periodic Tax Return
  Payment: 10th of the following month
  Report: 20th of the following month.
- ❖ Annual Tax Return
  The annual employee income tax return is a recalculation and full reporting of the salary and the tax payable for each employee during the year.
  Payment: 25 March
  Report: 31 March

Article 22

Article 22 withholding tax for importation goods should be paid at the same time with the payment of import duty. If the import duty is deferred or exempted, the payment for Article 22 tax should be made at the end of import documentation's process.

Article 23/26

Payment: 10th of the following month
Report: 20th of the following month

Final Taxes: 20th of the following month

Payment: Late reporting penalties are due if monthly or annual tax returns are lodged after the due date:
Periodic Tax Return Rp 50.000
Annual Tax Return Rp 100.000

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

1) Value Added Tax (VAT)

VAT is imposed on most goods and services at a rate of 10%. VAT rate on the export of Taxable Goods is 0% (zero percent). Government regulations can adjust the rate to as low as 5% and as high as 15%. Value Added Tax shall be imposed on:

- a supply of Taxable Goods carried out in the Customs area by a firm;
- importation of Taxable Goods;
- rendering of Taxable Services in the Custom area by a Firm;
- utilisation of intangible Taxable Goods obtained from outside the Customs Area within the Customs area;
- utilisation of Taxable Services obtained from outside the Customs Area within the Custom Area; or
- the export of Taxable Goods by a Taxable Person for VAT purposes.

Basically, goods and services that are consumed in Indonesia are subject to VAT except unless the Law says as "negative list". There are goods and services that are exempt from VAT. The following is a list of certain industries currently exempt from VAT according to the new tax amendment effective January 1, 2001:

- Products of Mining and drilling, taken directly from source, e.g. crude oil;
- Basic commodities e.g. rice;
- Food and beverages served at a hotel, restaurant, food stall and such other places;
- Money, gold bars and valuable documents;
- Healthcare services ;
- Social welfare services;
- Postal delivery services;
- Banking, insurance and financial leasing;
- Religion services;
- Education services;
- Culture and entertainment services which have been imposed by entertainment tax;
- Broadcasting (non-advertising in nature) services;
- Public transportation services;
- Manpower services;
- Hotels;
- Governmental service.

The following goods and services are categorised as strategic goods that are exempted from the imposition of VAT, under certain circumstances, on their import and delivery:

- Certain machinery and factory equipment used to manufacture taxable goods excluding spare parts);
- agricultural, plantation and forestry products, animal husbandry products, including hunting and trapping, and cultivation or fishery products, including the catching and cultivation of fish produced by farmers;
- electricity, except household electricity exceeding 6,600 watts;
- piped water, or through drinking water tankers;
- cattle, poultry and fish feed, and the raw materials for manufacturing cattle, poultry and fish feed; and
- seeds and seedlings for agricultural, plantation, forestry, farm and animal husbandry products.

In addition, imports and local deliveries of the following goods or services are exempted from VAT:

- weapons, ammunition and transportation for use by the armed forces which are not yet produced in Indonesia;
- polio vaccines for the National Immunization Program;
- general textbooks and religious books;
- ships and spare parts imported for use by national commercial shipping companies or national fishing companies;
- services received by national commercial shipping companies or national fishing companies, including ship rental, seaport services and ship maintenance or docking services;
- aircraft and spare parts imported for use by national commercial airline companies including aircraft rental and maintenance services;
- trains and spare parts imported by PT Kereta Api Indonesia;
- train maintenance and repair services received by PT Kereta Api Indonesia;
- low-cost housing, modest flats and student accommodation;
- services rendered for the construction of low-cost housing, modest flats and places of worship; and
- leasing services for low-cost housing.

The taxes are generally collected by Taxable Persons for VAT purposes which are firms which supply taxable goods and renders taxable services which are subject to tax according to Law number 8 of 1983 as lastly amended by Law Number 18 of 2000. These firms are required to submit VAT returns monthly.

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

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

Minister of Finance Decree Number 571/KMK.03/2003 regulates that primary production companies and small businesses (corporations or individuals) with annual sales of less than Rp. 600 million have the option to be exempted from imposing VAT.

The local purchaser of imported goods and services, including intangible goods, is responsible for all payments of VAT on goods and services and customs duty on goods. VAT and customs duty are collected at the port of entry for imported goods. A self- assessed VAT payment mechanism is applied in connection with the following:

- The utilization of intangible VAT-able goods obtained from outside the Indonesian customs area and utilized within the Indonesian customs area; and
- The utilization of VAT-able services obtained from outside the Indonesian customs area and utilized within the Indonesian customs area.

i. VAT Collectors

According to Director General of Taxes Decree Number 73/PJ./2004 and Director General of Taxes Circular Letter Number SE 06/PJ./2004, Companies as VAT collectors, who self -collect the VAT due from the goods purchased or services received and forward the payments to the State Treasury, are abolished.

During 2004 only the State Treasury qualified as a VAT collector. This situation continued up to 1 February 2005 when PSC contractors were reappointed as VAT collectors. Since then VAT collectors have comprised the State Treasury and PSC contractors. Given the change, the ordinary input - output mechanism should be applicable for any transaction involving VAT except those requiring payments from the State Treasury and PSC contractors.

ii. VAT Refund

In principle, input VAT on purchases related to a taxpayer's business may be credited against output VAT due on sales with some exceptions, most notably VAT on expenditures associated with making exempt supplies and employee benefits-in-kind. Input VAT on imports paid by an importer on a customs underpayment assessment issued by the Customs Office may also be credited against output VAT. Any excess of output VAT over input VAT must be paid to the Tax Office by the 15th of the following month. Where input VAT exceeds output VAT, a refund of input VAT can be requested on a monthly basis or the excess amount can be credited against the output tax in future periods. The approval periods for refunds are determined as follows:

- Certain qualifying taxpayers will receive approval within 1 month;
- Exporters and suppliers to VAT collectors who do not qualify for the 1 month approval will receive approval within 2 months
- Other taxpayers will receive approval within 6 months;
- If the Tax Office elects to audit all taxes, the refund in all cases must be determined within 12 months.

Except for (a), VAT refunds are subject to the tax authority's audit/review before payment. An input tax credit must be claimed not later than three months after the end of the tax period in which it should have been claimed. If this deadline is missed, the credit can still be claimed, but only by submitting an amended VAT return for the period when it should have been claimed.
An input VAT invoice issued late for more than 3 months, is considered as an invalid tax invoice. Therefore, it is not creditable.

iii. VAT in Batam

Batam has been treated as a special bonded zone with more VAT facilities than those granted to ordinary bonded zones. After several times of deferment, certain steps have finally been taken to turn Batam into an ordinary bonded zone. Starting from 1 January 2004 VAT and luxury sales goods tax (LST) has been applied in Batam as follows:

- Starting 1 January 2004 VAT shall be imposed on deliveries of automotive, cigarette and liquor products
- Starting 1 March 2004 the list of taxable goods shall be extended to include electronic products
- No more goods and services have been added to the list of taxable goods and services after 1 March 2004 despite the original target to extend the list every 6 months.

There is an exception for companies qualifying for a bonded zone status.

iv. Special Rate for VAT

Special rates apply to certain goods and services. For example, VAT on:

- services rendered by a travel agent are levied at 1% of invoice value;
- cigarettes sold by manufacturers are levied at 8.4% of invoice value;
- courier services are levied at 1% of invoice value;
- independent construction (self-building) is levied at 4% of total costs incurred or paid, exclusive of the acquisition price of land;

- factoring services is levied at 0.5% of the total fee, including service fees, provisions, and discounts;
- sales of second-hand motor vehicles by motor vehicle dealers is levied at 1% of total sales value.
- redemption of VAT on "paid" stickers on audio tapes and video recordings;
- own use and free gifts of taxable goods and/or services are levied at 10% of the cost of sales.

2) Sales Tax on Luxury Goods

In addition, there is also sales tax on luxury goods ranging from 10 per cent to 75 per cent, whenever applicable. New conditions for a luxury good are that the good:

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

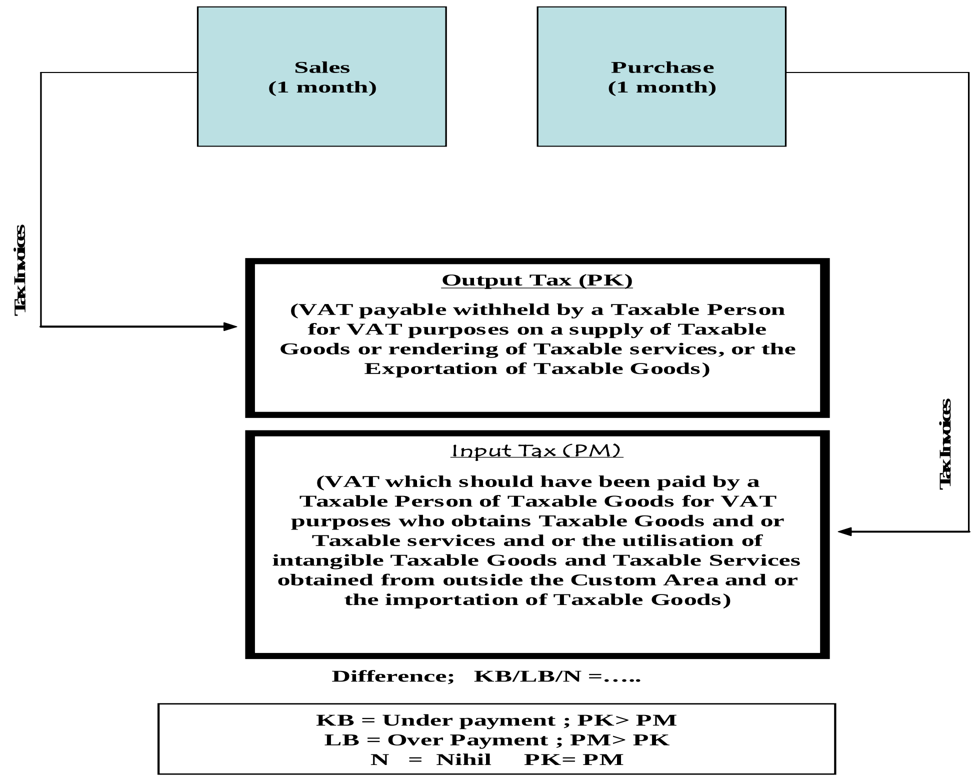
Government Regulation No. 145/2000 dated 22 December 2000 details various goods subject to Sales tax on luxury goods. It is apparent that the Sales Tax base has been broadened. The rate applicable to many types of goods has been increased. For example:

- Housing with floor space over 400 m^2 or electricity usage of more than 6,600 Watts, Apartments, condominiums and town houses are now subject to 20% (previously 10%).
- Perfume is subject to 20% (previously 10%).
- Helicopters and aircraft are now subject to 50% (previously 35%).

The maximum rate of Sales Tax has increased to 75%. Examples of goods subject to this maximum rate are:

- Sedans/ station wagons/ vans with spark or compression ignition internal combustion reciprocating piston engines exceeding 3,500 cc with seating capacity of less than ten persons
- Certain types of liquor and wine
- Luxury yachts
- Jewelry and anything made from precious stones or pearls

A Simple Way to Understand VAT Mechanism



3) Land & Building Tax

Indonesia's land legislations do not recognize the concept of freehold land rights. Instead the various rights attached to the land are subdivided into separate titles.

The Basic Agrarian Law (Law No. 5 of 1960) recognizes type of rights on land of non-state-forest area, whereas for the state-forest area, the Law No. 5 of 1967 on forestry is applied. Three main rights are:

- the Land Cultivation Right (Hak Guna Usaha, abbreviated as HGU), is the right to use a State Owned Land for the purposes of agriculture namely plantation, fishing, or cattle rising. By law the title is granted for a maximum period of 35 years, but can be extended to 25 years if the land is properly used and managed. This title of right is given to Indonesian individual(s) or legal entities domiciled in Indonesia including PMA companies. It can be used as a collateral or transferred to other party with the government approval.
- the Right of Building on Land (Hak Guna Bangunan, abbreviated as HGB), is the right to construct and own buildings on a piece of land that one has purchased. The title is granted for a maximum period of 30 years and can be extended for a maximum period for 20 years for Indonesian individual(s) and /or legal entities domiciled in Indonesia, including PMA companies, and can also be used as a collateral or transferred to other party. This is also applicable and generally granted to tenants in industrial estates.

- ❖ the Right of Use on Land (Hak Pakai, abbreviated as HP), is the right to use land for a specific purpose and granted for a period of 25 years and can be extended for period of 20 years or as long as the land is used for a certain (normal) utilization. Now, this right can also be used as a mortgage. In addition, it can also be transferred to other party through a government approval.

Land & building tax is payable annually on land, buildings and permanent structures. The effective rates are nominal, not more than one tenth of one percent per annum (0.1%) of the value of property. An effective rate of 0.2% is applicable to certain tax objects such as forestry, plantations, mining and other objects that have a value of more than Rp 1 billion.

Tax is imposed on individuals, companies or organizations that have certain rights to or obtain benefits from land, or possess, control or obtain benefits from ownership of land and buildings. The tax is based on the sales value of the land and buildings as determined by the Ministry of Finance, except in certain regions, where it is determined annually according to development in the region concerned. Land value is reassessed every three years in most areas and every year in rapidly developing areas.

Objections to assessments may be submitted to the Head of the Tax Office for Land and Building Tax (KPP-PBB) in the area where the property is located.

4) Land and Building Transfer Duty

Land and building transfer duty (BPHTB) of 5% is payable by an individual or corporate entity obtaining rights to land or buildings. The 5% rate is computed on the transfer value or the value forming the basis of the land and building tax (NJOP), whichever is higher.

BPHTB applies only if the acquisition value is greater than certain value which is stipulated by each regional government but may not be more than Rp. 60,000,000. The non-taxable tax object acquisition value of rights acquired due to an inheritance is stipulated regionally at no more than Rp. 300,000,000. Numbers of exemptions or reductions apply, including:

- Transfers to diplomatic representatives and certain international organisations;
- Transfers intended for general government activities or in the public interest;
- Rights conversions without changes in the name of ownership;
- Wakaf (religious donations);
- Transfers for religious purposes;
- Where the land or buildings are used for social or educational activities that are non-profit-seeking ñ 50% reduction;
- Grants to blood relatives in a straight line, either one step above or below ñ 75% reduction;
- Where the land and/or buildings are transferred in connection with a merger ñ 50% reduction;
- Where the land or buildings are auctioned and the purchase price is lower than the NJOP ñ reduction equal to the difference between the transfer duty according to the NJOP and the transfer duty according to the auction price.

A notary is prohibited from signing a transfer of title deed until duty payment has been made

5) Exit Tax

This is commonly known as “Fiscal Tax” and is paid by Indonesian residents and foreign nationals residing in Indonesia whenever they leave the country. Minister of Finance Decree No. 30/KMK.04/98, sets the rates at:

- ❖ Rp. 1,000,000 for departure by air,
- ❖ Rp.500,000 by sea, and
- ❖ Rp. 250,000 by land.

If an employer pays the tax in the course of an employee’s business travel, it can be used as a credit in the employer’s annual income tax return. If an individual pays the tax in a personal capacity, it can be claimed as a tax credit on his/her personal income tax.

Foreign nationals working for a representative office of a foreign company are exempt from fiscal tax if certain criteria are met. Indonesians and nationals of ASEAN Sub-regional Cooperation Areas (SCA), who reside in the Indonesian-designated SCA and departing through Indonesian SCA ports for a corresponding ASEAN SCA territory within its grouping are exempted from paying Fiscal Tax. As an example, under the Indonesia-Malaysia-Thailand Growth Triangle Cooperation Area, nationals from Indonesia, Malaysia, and Thailand residing in the Aceh special region, North/ West Sumatera and Riau are exempted from paying fiscal exit tax.

6) Custom Duty

Most duties are in the 5% to 40% range. The minimum rate is 0% and the maximum rate is 200%.

7) Stamp Duty

According to The Law Number 13 Year 1985 on Stamp and Duties and Government Regulation Number 24 Year 2000 dated on April 20, 2000 on Changes of Stamp Tariffs and Nominal Amount Due to Stamps, stamp duty is nominal only at either Rp 3,000 or Rp 6,000 on certain documents.

The rate of Rp 6,000 is applicable for:

- Letters of agreement and other letters (such as authorization letters, letters bestowing gifts, declarations) which are prepared for the purpose of being used as evidence of act, fact, or condition of a civil nature;
- Notarial deeds and their copies;
- Deeds prepared by Pejabat Pembuat Akta Tanah (officers who are responsible for the preparation of land deeds), including their copies;
- Documents to be used as instruments of evidence before a court:
- ordinary letters or internal papers
- papers originally exempt from stamp duty on the basis of their purpose of use, if they serve other aims or are used by other parties, and deviate from their original purpose.

For documents bearing a sum of money which:

- state the receipt of money
- state the recording or deposit of money in a bank
- contain notification of a bank balance
- contain the acknowledgement of debt wholly or partly paid or compensated
- are in the form of valuable documents such as drafts, promissory notes, acceptances
- are in the form of securities in whatever name or form
- are in the form of cheques.

The rate as follows:

- Rp. 6,000, when the money value stated in the document is more than Rp. 1 million;
- Rp. 3,000 when the value is between Rp. 250,000 and Rp. 1 million.
- Values below Rp. 250,000 are not subject to stamp duty;
- For cheques, the rate is Rp. 3,000 regardless of the money value stated.

IV. Country-Specific Fiscal Issues

Directorate General of Taxes (DGT) faces some issues that are different from time to time. DGT now has a new vision: to be a public service model that performs a world class tax system and management that is trustworthy and a pride to the public. To achieve this vision, there are many steps that DGT has done.

First, for improving services and monitoring to taxpayers DGT has plans to modernize its institution. Starting from the beginning of year 2002, DGT initiated Large Taxpayers Regional Office that consists of 2 Large Taxpayer Offices which is a prototype of future tax service office. The program of reforming the form of tax service office to modern tax service office is still running. For the regional of DKI Jakarta, it had been targeted that all tax service offices will be changed to modern taxpayer offices in 2007. This 2005 all of the tax service offices in the Special Regional Tax Office and Tax regional Office DGT Jakarta I, had become modern tax offices.

Second, DGT made some efforts to improve the quality of its Tax Laws. A team had been established in making the elucidation of 2000 Tax Laws. Due to the changes in Presidential from Megawati Soekarno Putri to Susilo Bambang Yudhoyono, there are some points of the exposure draft that have to be reconsidered again. Basically, points of changes in tax law are shown in the table below:

No.	Point of Change	Now	Proposed Change	Purpose
1.	Corporate Income Tax Rate	3 rates: 10%, 15%, 30%	Single rate: 30%	Simplify the tax administration
2.	Personal Income Tax Rate	5 rates: 5%, 10%, 15%, 25%, 30%	4 rates: 5%, 15%, 25%, 30%	
3.	Tax Rate for the Taxpayer without Tax Identification Number (TIN)	Not defined	Tax higher 20% - 50% than Taxpayer with TIN	Encourage people to have TIN
4.	Interest Rate from Bond	Not object of Income Tax	Object of Income Tax	
5.	VAT on Agricultural Product	Object of VAT	Not Object of VAT	Primary product
6.	Merger Transaction	Object of VAT	Not Object of VAT	Cash Flow of the Corporation
7.	VAT Invoice	2 kinds: Standard and Simple	Just Tax Invoice	Simplify the VAT administration

Nowadays, Public Relation of DGT plays a significant role. Trying to change the image is not an easy thing. That is why there are so many activities to give information to public about these changes with the help of "Arjuna and Srikandi Pajak" as the ambassadors of tax. The latest public relation activity that had been done was an award from President Susilo Bambang Yudhoyono at Merdeka Palace for the 10th million taxpayer on October 19th, 2005.

The fiscal policy incentives provided by the Government will consist of a range of policy actions aimed at building the competitiveness of industry, enhancing the investment climate, and compensating households (workers) not covered by the direct cash subsidy program

The fiscal incentive program that will be implemented from October 1, 2005, through January 1, 2006 includes:

1 Change in VAT status for primary products to Non-Taxable Goods.

The change in VAT status for primary products to non-taxable goods is aimed at providing incentives to agricultural producers. This change is part of the tax reform and will be effective from January 2006.

Deferred imposition of non-tax levies on export and import transactions

This policy seeks to expedite exports and imports and reduce associated transaction costs. This deferment is set out in Amendment to Government Regulation No. 44/2003, and will apply from November 1, 2005, for a 3-month period pending effective imposition of the levies.

2. Increase in Tax-Free Income Allowance

   This policy has the objective of easing the tax burden on low-income workers. The tax-free income allowance will be raised from Rp 1million per month to Rp 1.1 million per month, effective from January 1, 2006.

3. Import duties reduced or eliminated for selected products.

   Import duties will be reduced or eliminated altogether to enhance industrial competitiveness particularly among user industries, mostly small and medium enterprises.

   Sugar tariffs will be eased while taking account of the interests of sugar cane farmers and consumers, which include intermediate consumers such as the food and beverages industry in addition to end consumers.

The changes in import duties are as follows:

a) Import tariffs on raw materials and components for heavy equipment manufacturing reduced to 0%;
b) Import tariffs on imported engine assemblies for public transportation reduced to 0%;
c) Tariffs on sugar imports reduced as follows:
   - Raw sugar from Rp 550/kg to Rp 250/kg
   - Refined sugar from Rp 790/kg to Rp 550/kg
   - White sugar from Rp 790/kg to Rp 550/kg
d) Converter kits for energy use exempted from import duties.

4. Accelerated annulment of Regional Government Regulations on taxes and user charges that hamper business activity.

   This policy, which comprises part of a current program under the Government Annual Work Plan for 2005 and 2006, aims to build an improved investment climate. This program is part of an existing program that will be taken forward with the Amendment to Act No. 34 of 2004.

5. Easing of base import tariffs for public transportation vehicles.

This policy will be introduced as a facility for public transport operators. The change is set out in Regulation of the Minister of Trade No. 16/2005.

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

Fiscal policy in 2005 would continue to give priority to strengthening fiscal sustainability. Hopefully, the fiscal deficit would be narrower in 2005 from 1.4% in 2004. In line with this policy direction, the debt to GDP ratio is expected to decline further. However achieving a lower fiscal deficit is likely to face risks, because several budgetary assumptions, most notably the inflation rate and world oil prices, remain lower than forecast.

In relation to risks in achieving the target deficit, the assumed world oil prices of $24 a barrel is hardly to achieve. Continued high oil prices would raise state expenditures, as spending for fuel subsidy and revenue sharing for the districts increase. Another risk is potential over spending for the recovery and reconstruction of Nanggroe Aceh Darussalam and North Sumatera following the Tsunami disaster. These risks should be anticipated with a strategy to mobilize state revenues and grants; optimize tax and non tax revenues, and at the same time, properly put priority and increase effectiveness of spending as well as compensation fund from the reduction of the fuel subsidy. However, these risks are projected to widen the budget deficit by around 1% of GDP and should be taken into account in the scenarios for 2005 growth projections.

The pace of higher economic growth is expected to gather momentum in 2005. The Government's commitment to improve the investment climate and to accelerate infrastructure development has created a positive perception on economic prospect. This optimism is also underpinned by macroeconomic stability as reflected in the inflation target and strengthened fiscal consolidation. Although initially economic prospects for 2005 are somewhat overshadowed by the tsunami disaster in late 2004, the prompt response by the Government and the people in addition to the generous assistance from the international community are expected to minimize any adverse impact. Against this background, the Indonesian economy is projected to grow in the range of 5.0-6.0% in 2005 in tandem with a more balanced pattern of GDP components. Despite the forecast of a stronger economic recovery in 2005, various risk factors should be monitored closely. These risks have the potential to put pressure on macroeconomic stability, including:

1. Continued high world oil prices. Soaring international oil prices are expected to have an impact on various commodities in the global market, owing to higher production costs. This would lower the domestic economy's capacity to import, and would put pressure on the exchange rate as well as push up imported inflation. In view of the high dependence of the domestic economy on imported goods, a declining capacity to import would hurt overall economic performance. Continued high world oil prices would also reduce the ability of fiscal policy to provide economic stimulus, due to swelling fuel subsidies. In this regard, the Government is likely to limit its subsidies by raising fuel prices, which will lead to increasing inflationary pressure.
2. The economy dependency on short term foreign portfolio flow that is very sensitive to short term expectations. However, several other structural weaknesses remain to induce Rupiah volatility in the period ahead. These include: (a) Persistent excess demand for foreign currency due to mismatches in flows of goods in international transactions, as well as low competitiveness of domestic industries; and (b) supplies of foreign exchange that are dominated by short-term capital flows, that could easily reverse. These weaknesses are exacerbated by scarcity of hedging facilities in the domestic foreign currency market.
3. Impact of global imbalances on Indonesian economy. Global imbalances arising from major current account and fiscal deficits in the US have created a risk for world economic growth and financial market stability. Lower US imports and higher exports could cause a decline in the economic growth of US trade partner countries, including Indonesia. Further significant US dollar depreciation would underpin capital inflows to the emerging countries. Following by the increase of US interest rate, this will, however, lead to higher Rupiah exchange rate volatility.

The prospects for maintaining the momentum for rapid economic expansion in 2005 would be supported greatly by more strengthening confidence on the part of the public, which will be bolstered by the Government's commitment and breakthroughs in various economic areas.

References

BPS Statistics Indonesia : Statistical Yearbook of Indonesia 2003-2004

Been, ASEAN Economic Bulletin Vol.22 No.2, 2005.

Chowdury Anis and Sugema Iman, How Significant and Effective Has Foreign Aid to Indonesia

Price Waterhouse Coopers, Indonesian Pocket Tax Book 2005, 2005

Ramakrishnan Uma and Vamvakidis Athanasios, Forecasting Inflation in Indonesia, IMF Working Paper June 2002

Sanjaya Nyoman, Assisting Taxpayers in Meeting Their Tax Obligations: a comparative study between Japan and Indonesia: Tokyo, 2005.

Sundari Mega, Improving the Staff Training System in Directorate General of Taxes in Indonesia: Lessons from Japan: Tokyo, 2005.

The Government of Republic of Indonesia, *Law Number 16 Year 2000 on Amendment of Law Number 6 Year 1983 on General Rules and Procedures of Taxation*, Indonesia National Development Information Office: Jakarta, 1996.

The Government of Republic of Indonesia, *Law Number 17 year 2000 on Amendment of Law Number 7 Year 1983 on Income Tax*, Indonesia National Development Information Office: Jakarta, 1996.

The Government of Republic of Indonesia, *Law Number 18 Year 2000 on Amendment of Law Number 8 Year 1983 on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods*, Indonesia National Development Information Office: Jakarta, 1996.

http//:www.bapepam.go.id/, The official homepage of Capital Market Supervisory Agency

http//:www.bi.go.id/, The official homepage of Central Bank of Republic of Indonesia

http//:www.bps.go.id/, The official homepage of Central Bureau of Statistic of Ministry of Republic of Indonesia

http//:www.depkeu.go.id/, The official homepage of Ministry of Finance of Republic of Indonesia

http//:www.eiu.com/, The official homepage of The Economic Intelligence Unit

http//:www.fiskal.depkeu.go.id/, The official homepage of BAPPEKI

http//:www.gatra.com/, The Gatra Magazine’s homepage

http//:www.imf.org/, The official homepage of International Monetary Fund

http//:www.kompas.co.id/, The Kompas Newspaper’s homepage

http//:www.worldbank.org/, The official homepage of World Bank

http://web.worldbank.org/