



USAID Macroeconomics and Fiscal Reform Project - Indonesia

RESIDENT FISCAL ADVISER - REPORT ON PROGRESS: 1 August 2002 – 31 January 2003

This is the **first** report of the Resident Fiscal Adviser in the Ministry of Finance (Agency for Fiscal Analysis – Badan Analisa Fiskal, or BAF) under the USAID Macroeconomics and Fiscal Reform Project.

Introduction

As the result of particularly disruptive political, local and other circumstances that have driven the Programme some distance away from the objectives and path as set out in the Task Order, this reporting period covers **six months rather** than three.

Of importance, following a decision of the US State Department, in response to the heightened security situation in Indonesia, there was an ordered departure of contractors and the Resident Fiscal Adviser has been re-located temporarily in the BearingPoint Singapore office since mid-October. Local Project staff have remained active in the Ministry, under the direction of the Fiscal Adviser.

Quite apart from the above, there have been further disruptions at a local partner level. Some of these are inter-related and are elaborated at various points in what follows.

Assistance to the Supreme Audit Board

In the early part of 2002, the Director General of the Supreme Audit Board (BKP) Mr Billy Judoeno approached USAID and requested technical assistance to help establish the foundations for good practice in the domain of official government audit, particular, the budget process and associated activities. The Project Task Order incorporated provision for short-term technical assistance to meet the request. The intention was for the Programme Director, new CTO and the

Resident Fiscal Adviser to meet with Pak Billy in order to discuss details, establish working contacts in order to proceed.

Despite numerous efforts to make contact and establish proper foundations for support, it proved impossible to proceed. The reasons are quite unknown. There may be other agendas and Pak Billy, in the past has been a good friend of USAID. A possibility is that three important finance laws are in draft stage and under discussion in the Indonesian Parliament. One of these is an important draft State Audit Law. Being realistic, this Law provides a direct threat to such activities as money laundering, unofficial rent seeking and the like. One can speculate that the Director General found the pressure to great to proceed with his intentions.

In any event and for whatever the true reasons might be, the CTO (Mr Bruno Cornelio) decided that we should withdraw from BPK and review. (e-mail 7 September 2002).

As of the present time, there have been no further developments. Significantly, the draft Audit Law remains in the Parliament as a controversial piece of intended legislation. With a new government election in 2004, it seems unlikely that we will see progress in this area – at least for some time.

From a Project perspective, the planned short term consultancy visits could not be implemented.

Inspector Generals Office

The Inspector Generals Office is located in the Ministry of Finance. During July/August, Pak Agus Mohammed (the IG) requested technical assistance from USAID to help frame a taxpayers code of conduct, set up the terms of reference for a conduct committee, a tax ombudsman, train officials etc. At the same time, the IMF was pursuing similar objectives via their Large Taxpayer Office initiative and also looked to USAID for assistance. Others involved included FSVC, Elips and the IMF.

Several meetings were held with the IG, and his staff, including the IMF and Elips to try take the work forward. The role of the Fiscal Adviser and the local economist in particular, was to co-ordinate participants rather than be directly involved.

[None of this activity, appears in the Task Order; rather it has been a response to USAID.]

Despite several delays connected with uneasy relationships between DG Tax and the IG's Office, FSVC is now providing technical support. Although none of this led to a deliverable as specified, the Project local economist was

instrumental is laying out the path, co-ordinating efforts and maintaining contacts between contractors, other donors and Indonesian partners. *This can be scored as a success.*

Support to Ministry of Finance – Financial Management Group

Given the gap created by the loss of Supreme Audit Board work, the Resident Adviser proposed that support be provided to the Director General of Financial Management, Pak Mulia Nasution. Under the previous Fiscal Project, there had been substantial involvement and participation by the Fiscal Adviser. This had been in respect of the White Paper on Financial Management Reform and the three draft Finance Laws before the DPR (the State Finance Law, a State Treasury Law and the State Audit Law, noted above). It was felt that the resources made available could be used to continue this support. The proposal was approved by the USAID CTO (Cornelio e-mail).

It was envisaged that technical assistance could help Pak Mulia in his task of ensuring that the precise drafting of the Finance and Treasury Laws was consistent with the approaches that had been set out in the government's (Ministry of Finance) White Paper. Further, to ensure that the approaches incorporated were in line with good international practice.

Rudolph Penner, a former CBO Director and who has worked as a consultant with the Fiscal Project previously and who has wide international experience in this area, was identified as the short-term expert who could provide such assistance and a TOR was circulated and agreed. Steps were taken to engage Dr Penner.

Unfortunately, (a) the tightening up on short term clearances, followed by (b) the Bali bombing incident, effectively took this initiative off the agenda for the time being. The circumstances have been explained to Pak Mulia and other relevant Indonesian partners.

IT Procurement

The Task Order has provision for a modest upgrading of IT hardware for BAF. This is a repeat of a similar procurement under the earlier Project. The PC's plus software are intended primarily for use in the Revenue Directorate.

This part of the Project is now in hand and BearingPoint is in the process of seeking quotations as required under the existing USAID rules.

It is anticipated that the IT procurement will be completed *with delivery taking place within the next few weeks.*

Budget 2003

Provided advice on meeting the financing gap 2003 -2004

Produced the BAF Budget 2003 brief to be used by the Minister and which subsequently has been made available to the media.

Revenue Analysis

The range of tax elasticities in BAF, (time series based on national accounts data and cross section, using the Sussenas Household Expenditure data) have been re-estimated. These will be used in the Budget 2004 exercise that is to start shortly. Advice on standard requests involving such topics as international tax comparisons and international practice across both developing and developed countries continues. This kind of work is most important as a means of maintaining a high degree of integration of the Project in BAF and the Ministry more widely.

The Fiscal adviser was invited to take part in a series of senior discussions to consider a wide range of options for change in tax policy. These included both tax and customs duties. Following these discussions, a brief was provided for the Director General of BAF on what changes might be feasible.

[NB There was much opposition from both of the revenue departments, the result of which has been to produce exactly the opposite reaction to that intended. If anything, the momentum for some major changes is now gaining ground and much further work is to be required]

Tax Administration

Work on this front has become relatively quiet. DG Tax is still in the process of implementing the IMF Large Taxpayer Unit initiative. The first Unit opened open July 2002.

The local economist has been maintaining useful and good contacts with DG Tax officials with a view to continuing a limited amount of support once the political situation permits.

There has been an informal request from DG Tax for help in looking at the methodology used currently to estimate tax potential for some of the major tax instruments. Although not in the Task Order, it has been agreed with the CTO that the matter might be explored further when circumstances become more favourable.

General In House Support

This has continued as has been the case throughout, with the Fiscal Adviser being involved in a wide range of fiscal/tax policy issues. Again, there has been considerable disruption because of political circumstances. Even so, the following serve as examples of continuous involvement in the Agency:

- **Investment incentives:** In previous years, Indonesia, like a number of other Asian countries, has made use of tax incentives to try and encourage new investment. Three years ago, following a Barents (now BearingPoint) /USAID conference on the subject held in Jakarta, tax incentives were taken off the policy agenda. However, due to a number of domestic pressures, they have appeared again as a possible policy instrument in the new Investment Law. Advice again has been given, and a note provided to show that the case remains weak at best. International evidence suggests that incentives to attract FDI, may have an apparently beneficial effect in the short run only. In the long run, such policies can turn out to be very expensive and the efficiency benefits are doubtful if indeed, they exist at all. Even so, it must be acknowledged that in Indonesia, there is a lot of interest in the subject and that climate at present remains favourable to the introduction of incentives. The topic needs to be monitored closely.
- **Fiscal Policy NGO:** For some time, the authorities have been considering the value of having an independent body that might provide independent analysis of fiscal policy options. There are several such examples in a number of countries. Advice has been given on the status, operation and effectiveness of representative examples of similar institutions. The topic is still alive.
- **Medium Term Budget Policy:** Advice including a number of simple simulation-type of exercises have been produced as a contribution to this work. The objective is to explore the implication of various exit strategies from the IMF Programme by end 2004. *This important work is continuing.*
- **Public Debt:** The Fiscal Adviser provided inputs to work on both debt sustainability and debt solvency. In fact, in Indonesia, substantial progress has been made in bringing the debt/GDP ratio down from a figure of 100 per cent in beginning 2002, to around 70 per the present time. This was noted at the recent CGI conference. *All of the work in BAF is done using the debt sustainability system provided by BearingPoint.*
- **Other:** Prepared official BAF briefing for Rating Agencies and other consultants e.g. Fitch, Oxford Analytica etc.

Assessment

The Project as set out in the Task Order has been driven seriously off course. It is doubtful, given the time available whether all of the original objectives can be met. The matter has been discussed in detail with Indonesians partners in BAF.

The USAID Programme Director has met with the new Director General of BAF. Following this, the Fiscal Adviser met with him also and there have been a large number of subsequent discussions with Directors and other officials. These Officials have confirmed that there exists a big demand for the technical support that the Project provides. In short, once the political situation permits, there certainly will be sufficient demands forthcoming to fill the gaps in the Programme. *With the co-operation of BAF partners, a viable portfolio of work has now been established and will be discussed with the Project CTO.*

Douglas Todd
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