PD-ABZ-756

BearingPoint.
Formerly KPMG Consulting

USAID Macroeconomics and Fiscal Reform Project - Indonesia

RESIDENT FISCAL ADVISER - REPORT ON PROGRESS: 1st February – 30 June 2003

This is the **second** 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 with the previous Report and because of the particularly disruptive political, local and other circumstances this reporting period covers *a period of five months rather than three.*

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.

The Fiscal Adviser was permitted to return to Jakarta for a three week period in February.

The ordered Departure ended in mid -April and the Project was re-located back to Jakarta. Thus, the Project was disrupted for 50 per cent of its overall timescale as originally planned.

Assistance to the Supreme Audit Board
Following from the detailed reasons set out in the last Report, there have been no further developments on this front. The issue of technical support under this Programme, now, effectively is closed.

Inspector Generals Office
As noted earlier, none of this work forms a part of the existing Task Order, and emerged as a response to a request from the IG to USAID. The technical support has been provided by FSVC, with the Macro-Fiscal Project providing a facilitating and role and holding a watching brief only.

In fact, it has proved to be useful in helping develop good contacts with the IG and in providing additional links with DG Pajak given the relevance of the IG's work to tax administration.

Support to Ministry of Finance – Financial Management Group
This has continued to be active and picked up some pace on return to Jakarta. The State Finance Law has now passed through Parliament and the other two laws (State Treasury and State Audit) have been given a higher priority in the legislative timetable.

Of much significance is the forthcoming (probably end-year) *re-organisation of MOF*. From everything that we have heard, the new structure will be a big improvement and will be following advice given consistently by ourselves and other donors over a period of some years. The success of the three Laws mentioned above in fact, assumes a new institutional structure and their effectiveness could not be realised in the absence of major change.

Pak Mulia the DirGen of Bakun - Akutansi, still values any informal commentary that we may care to make and the Project maintains very good relations with him.

IT Procurement
Under this Task Order heading, the PC's, six in all, have now been procured and are in the process of being handed over to MOF (Badan Analisa Fiskal). They will become the formal property of MOF at the end of the current Project.

Training – Fiscal Policy Analysis
Formal training as an activity is not specified in the original Task Order. However, given the unusual circumstances, in order to compensate for lack of presence in MOF, it was decided to run a series of training modules in fiscal policy analysis. This was arranged to be delivered by the economic research arm of the University of Indonesia.

The modules were delivered (in Bahasa) over a four week period with the emphasis being placed on fiscal analysis in the current situation in Indonesia. Some 25 officials from BAF and DG Pajak attended throughout. There was a small examination at the end, *the results from which indicate that the exercise was highly successful.*

Revenue Analysis
As noted in the previous Report, the pressure for a thorough going review of the *tax policy structure* has been increasing. The Minister (Pak Boediono) has now instigated formal review, the first analytical tranche to be completed by end-September. This is far too ambitious.

Even so, the Project has been involved at all stages and has been providing briefs and memos on a number of issues. The team has attended all policy meetings, both internal and external.

In broad terms, the Review is following Project recommendations. Namely that the basic structure of the original 1984 reforms was good, with the laws following good international practice. The aim of the Review should continue to respect the original spirit of these earlier initiatives in reducing complexity, improving transparency and accountability and so contributing to efficiency. All this, whilst taking into account the more recent international developments and understanding on the tax policy front

To date, emphasis on possible options has fallen on the personal income tax plus the expenditure taxes. In the case of income taxes:
- making more clear in the law, the distinction between personal and corporate
- revaluing the untaxed personal tax allowance
- considering a re-structuring of the marginal tax rate structure

For the expenditure taxes:
- abolishing the luxury sales taxes
- creating a wider range of excise duties
- perhaps having a higher rate of VAT

This work and involvement of the Project *can be regarded as a big success and reflects the Project's substantial investment that has resulted in winning both acceptability and confidence in/of the Ministry*

Tax Administration
The local economist continues to maintain good contacts with DG Tax officials. The main point here is that any success in reform of tax policy, cannot be effective unless it is complemented by good tax administration.

Currently, the relative successes with the LTO initiative are now being considered foe extension across the tax system as a whole. In this respect, within DG Pajak, there is renewed interest in the *'Blueprints Exercise'* developed under an earlier phase of the Project.

Again, this is a success, albeit with (not surprisingly) a long lag.

General In House Support
On return general economic support has continued as has been the case throughout, with the Fiscal Adviser being involved in a wide range of fiscal-macro/tax policy issues. A few topical examples will serve to illustrate.

- The macro-fiscal performance of Indonesia over the past three years has been good. In terms of any of the more normal assessments, the fiscal stance is sustainable. Growth is poor – but it is everywhere. The gross public debt/GDP ratio has fallen by around 30 per cent. Inflation is reducing as are interest rates and the Rupiah is strengthening. However, very little of this 'good news' is seeping into the wider public conscience. Meetings have been held with Pak Marwanto (MOF – International Co-operation) to consider what measures can be taken to improve matters and begin the task of winning back the confidence of the international investor.

- Medium Term Budget Policy: Advice on this continues – particularly in regard to the so-called 'exit strategy' from the IMF Programme.

- Continuing support on all aspects of revenue policy analysis.

Assessment
As mentioned in the last Report, the Project as set out in the Task Order has been driven seriously off course. It is now impossible for the original objectives to be met. Moreover, through physical absence, some opportunities have been lost e.g. planned technical assistance to the Financial Management team was 'grabbed' by a McKinsey team.

Even so, the Project is now, so well integrated in MOF that our advice, assistance and technical support is always in demand and actively sought after.

The aim over the remaining three months is to ensure that the tax policy review proceeds smoothly and reflects best international experience and practice that is relevant to the Indonesian situation.

Douglas Todd
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1st July 2003