



## Chapter 8

# Government Finances

# Chapter 8: Government Finances

Implementation of fiscal policies in 2007 faced some fairly serious challenges. The high price of crude oil on international markets, which was accompanied by a decline in domestic oil lifting put fairly significant pressures on efforts to keep the fiscal deficit within a safe level. Nonetheless, various government policy measures which included the extensification and intensification of government revenues, the policy to cut down and increase efficiency of Ministry/Institutional spending were able to safeguard fiscal sustainability. This was reflected in the decline of government debts to GDP ratio and the preservation of the primary balance surplus.

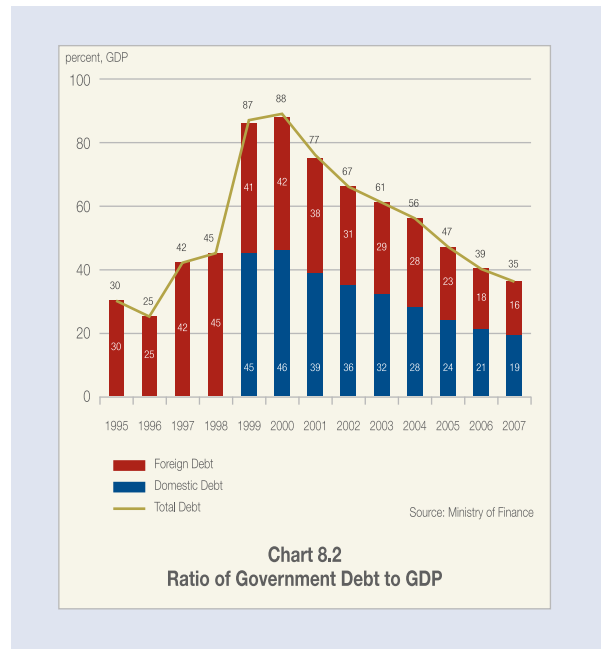
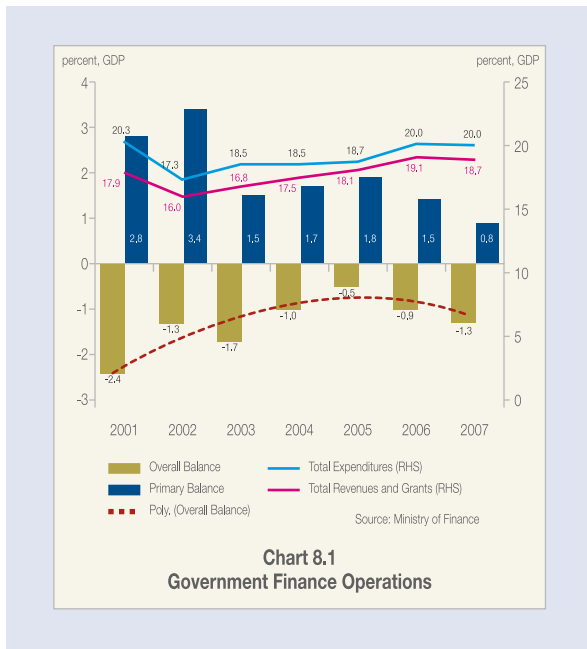
Fiscal policy in 2007 was, in general, aimed at increasing the fiscal stimulus by continuing to ensure fiscal sustainability. With this expansionary direction, the APBN-P 2007 deficit was fixed at 1.5% of GDP, or higher than the 2006 realized deficit of 0.9% of GDP. Fiscal expansion was expected to increase the fiscal contribution to the real sector, either through government consumption or investment. Besides the direct contribution, the government also gave a number of tax incentives to increase activity in the real sector without sidelining efforts to increase government revenues. Meanwhile, to reduce the level of poverty the government still carried out various programs to help the people. The increase in the deficit has not harmed the prospects for fiscal sustainability, as reflected in estimates of a fall in the outstanding Government debt ratio and the continuing primary balance surplus.

Implementation of the 2007 APBN faced a number of challenges which originated from both external environment and internal problems. On the external side, the budget was implemented at a time of continued increases in the price of crude oil since the second quarter of 2007. Overall, the yearly price of crude oil reached around \$72.3/barrel<sup>1</sup> on average, or above the assumption in the 2007 APBN-P of \$60/barrel. Accompanied by various parameters in the calculation of energy subsidies, which exceeded the initial estimates at the beginning of the year, the increases in the price of crude oil significantly pushed up the amount of subsidies, thereby potentially increasing the budget deficit toward

2% of GDP. Entering the third quarter of 2007, the subprime mortgage crisis in the United States triggered a decline in the price of Government debts which could affect the financing of the budget deficit. From the domestic side, national finances were impacted by the domestic oil lifting which continued to decline. Overall, yearly oil lifting reached on average 899,000 barrels per day, or below the 2007 APBN-P assumption of 950,000 barrels per day. This condition led to lower revenues from the oil and gas sector. Other internal challenges concerned the absorption of Government Expenditure which lagged behind in the first half of 2007 although efforts have already been made in regard to regulations connected to the procurement of government goods and services. This lag in the absorption of Government Expenditure was caused by increased caution and efficiency in the carrying out of procurement auctions for government goods and services.

Facing various challenges, the government was still consistent in undertaking fiscal consolidation such that it was able to control the budget deficit which, in turn, had a positive impact on macro economic stability. From the aspect of tax revenues, various government policies have helped the 2007 APBN-P tax revenues target be realized. This is an improvement from the situation last year. From the aspect of non tax revenues, the higher price of crude oil and the greater rupiah depreciation than assumed in the 2007 APBN-P meant that there was additional revenues from CPO export taxes and dividend payments by state owned companies. The realization of these tax and non tax revenues meant that the target of Government Revenue and Grants was

<sup>1</sup> Average ICP January-December 2007 used to calculate fuel and electricity subsidies.



surpassed. From the aspect of expenditures, increased efficiency in Ministry/Institutional spending allowed the government to pay energy subsidies in the framework of safeguarding price stability. With these steps, the deficit is still expected to remain in line with the target set in the 2007 APBN-P, that is 1.5% of GDP. From the aspect of financing, the front loading strategy in issuing Government Debts (SBN) meant that the financing target deficit could be met before financial sector conditions experienced volatility due to the sub-prime mortgage crisis in the United States.

The realization of a lower-than-targeted budget deficit was mainly attributable to the absorption of Ministry/Institutional spending (K/L spending) which was below the target set in the 2007 APBN-P. Steps taken to improve efficiency, which were accompanied by greater caution in the procurement of government goods and services, meant that the government was still able to provide fuel subsidies despite large increases in the price of crude oil. Nonetheless, as a consequence, the realization of the Government Spending was lower than the realization of the State Income such that realization of the deficit lagged behind. From March until November 2007, government financial operations continued to accumulate a budget surplus. At the end of the year, the deficit only reached 1.3% of GDP<sup>2</sup>, or below the 2007 APBN-P target of 1.5% of GDP. This deficit was supported by the prospect of fiscal sustainability. The ratio of government debt declined from 39% of GDP in 2006 to 35% of GDP in 2007. Meanwhile, the

primary balance still recorded a surplus of 0.8% of GDP (Chart 8.1 and Chart 8.2).

### Government Revenues and Grants

The performance of Government Revenues and Grants in 2007 was marked by good performance in tax collection, but was overshadowed by weak performance in the oil and gas sector due to further declines in oil lifting. As estimated in the 2007 APBN-P, the performance of Government Revenues and Grants in 2007 recorded lower growth than in 2006 when the growth reached 29%. This slowdown in growth was mainly due to the decline in revenues from the oil and gas sector. Meanwhile, the performance of the tax sector was quite reasonable. The tax revenue increased by 20% in line with the 2007 APBN-P. This figure is higher than the growth in 2006 of 18%. With this development, Government Revenues and Grants reached around 19% of GDP, relatively unchanged from the level in 2006 (Chart 8.3). Around 69% of Government Revenues and Grants stemmed from tax revenues with a tax ratio of 13% of GDP, while the rest stemmed from non tax revenues (PNBP) amounting to 6% of GDP (Chart 8.4).

The less than optimal performance of the oil and gas sector is reflected in lower oil and gas revenues at a time when crude oil price continued to increase and reached a level of \$69.7/barrel<sup>3</sup>. This condition can be partly explained by the lower domestic oil lifting which has continued to decline to 899,000 barrels/day. From

2 Or 1.2% of GDP by using realized 2007 GDP of Rp3.957 trillion.

3 Average ICP December 2006-November 2007 to calculate oil and gas revenues.

**Table 8.1**  
**Summary of Government Finance Operation**

| Description                                     | Realization in 2006 |       |        |                     | Budget of 2007 |       | Revised Budget of 2007 |       | Realization in 2007 <sup>1</sup> |       |        |                     |
|---|---------------------|-------|--------|---------------------|----------------|-------|------------------------|-------|----------------------------------|-------|--------|---------------------|
|   | Trillions Rp        | % GDP | % yoy  | % of Revised Budget | Trillions Rp   | % GDP | Trillions Rp           | % GDP | Trillions Rp                     | % GDP | % yoy  | % of Revised Budget |
| A. Total Revenues and Grants                    | 638.0               | 19.1  | 28.8   | 96.8                | 723.1          | 20.5  | 694.1                  | 18.5  | 708.5                            | 18.7  | 11.0   | 102.1               |
| I. Domestic Revenues                            | 636.2               | 19.1  | 28.8   | 97.1                | 720.4          | 20.4  | 690.3                  | 18.4  | 706.8                            | 18.7  | 11.1   | 102.4               |
| 1. Tax Revenues                                 | 409.2               | 12.3  | 17.9   | 96.3                | 509.5          | 14.4  | 492.0                  | 13.1  | 491.8                            | 13.0  | 20.2   | 100.0               |
| 2. Non-Tax Revenues                             | 227.0               | 6.8   | 54.5   | 98.7                | 210.9          | 6.0   | 198.3                  | 5.3   | 215.0                            | 5.7   | (5.3)  | 108.4               |
| – Oil and Gas                                   | 158.1               | 4.7   | 52.4   | 98.9                | 139.9          | 4.0   | 107.7                  | 2.9   | 124.8                            | 3.3   | (21.1) | 115.9               |
| II. Grants                                      | 1.8                 | 0.1   | 40.6   | 43.3                | 2.7            | 0.1   | 3.8                    | 0.1   | 1.7                              | 0.0   | (7.6)  | 44.3                |
| B. Total Expenditures                           | 667.1               | 20.0  | 30.9   | 95.4                | 763.6          | 21.6  | 752.4                  | 20.0  | 757.2                            | 20.0  | 13.5   | 100.6               |
| I. Central Government Expenditures              | 440.9               | 13.2  | 22.8   | 92.2                | 504.8          | 14.3  | 498.2                  | 13.2  | 504.0                            | 13.3  | 14.3   | 101.2               |
| a. Personnel Expenditures                       | 73.3                | 2.2   | 35.0   | 92.6                | 98.5           | 2.8   | 98.0                   | 2.6   | 90.4                             | 2.4   | 23.4   | 92.3                |
| b. Goods Expenditures                           | 47.2                | 1.4   | 61.7   | 84.3                | 71.9           | 2.0   | 61.8                   | 1.6   | 54.2                             | 1.4   | 14.9   | 87.7                |
| c. Debt Interest Payment                        | 79.1                | 2.4   | 21.3   | 95.9                | 85.1           | 2.4   | 83.6                   | 2.2   | 79.6                             | 2.1   | 0.6    | 95.2                |
| d. Subsidies                                    | 107.4               | 3.2   | (11.0) | 99.8                | 103.0          | 2.9   | 105.1                  | 2.8   | 150.2                            | 4.0   | 39.8   | 142.9               |
| e. Capital Expenditures                         | 55.0                | 1.6   | 67.1   | 78.8                | 76.9           | 2.2   | 71.7                   | 1.9   | 64.4                             | 1.7   | 17.1   | 89.8                |
| f. Grants Expenditures                          | 0.0                 | 0.0   | 0.0    | 0.0                 | 0.0            | 0.0   | 0.0                    | 0.0   | 0.0                              | 0.0   | 0.0    | 0.0                 |
| g. Social Assistance                            | 40.7                | 1.2   | 63.5   | 99.2                | 50.7           | 1.4   | 52.3                   | 1.4   | 50.7                             | 1.3   | 24.6   | 97.1                |
| h. Other Expenditures                           | 38.3                | 1.1   | 19.9   | 90.7                | 18.8           | 0.5   | 25.8                   | 0.7   | 14.6                             | 0.4   | (62.0) | 56.4                |
| II. Regional Budget Expenditures                | 226.2               | 6.8   | 50.3   | 102.4               | 258.8          | 7.3   | 254.2                  | 6.8   | 253.3                            | 6.7   | 12.0   | 99.6                |
| C. Primary Balance                              | 49.9                | 1.5   |        | 117.5               | 44.6           | 1.3   | 25.3                   | 0.7   | 30.8                             | 0.8   |        | 121.9               |
| D. Budget Surplus/(Deficit)                     | (29.1)              | (0.9) |        | 72.9                | (40.5)         | (1.1) | (58.3)                 | (1.5) | (48.8)                           | (1.3) |        | 83.7                |
| E. Financing                                    | 29.1                | 0.9   |        |                     | 40.5           | 1.1   | 58.3                   | 1.5   | 48.8                             | 1.3   |        |                     |
| I. Domestic Financing                           | 55.7                | 1.7   |        |                     | 55.1           | 1.6   | 70.8                   | 1.9   | 72.7                             | 1.9   |        |                     |
| 1. Domestic Bank                                | 18.6                | 0.6   |        | 103.9               | 13.0           | 0.4   | 10.6                   | 0.3   | 14.9                             | 0.4   |        | 140.3               |
| 2. Domestic Non-Bank                            | 37.1                | 1.1   | 54.9   | 99.3                | 42.1           | 1.2   | 60.2                   | 1.6   | 57.8                             | 1.5   | 56.0   | 96.1                |
| a. Privatization (net)                          | 0.4                 | 0.0   |        | 40.0                | 2.0            | 0.1   | 2.0                    | 0.1   | 0.3                              | 0.0   | (25.0) | 15.0                |
| b. Sales of Banking Restructuring Program Asset | 2.7                 | 0.1   | (58.9) | 104.7               | 1.5            | 0.0   | 1.7                    | 0.0   | 2.4                              | 0.1   |        | 144.8               |
| c. Government Bond Sales, net                   | 36.0                | 1.1   | 59.4   | 100.6               | 40.6           | 1.1   | 58.5                   | 1.6   | 57.1                             | 1.5   | 58.8   | 97.6                |
| d. Government Investment Funds                  | (2.0)               | (0.1) | (61.5) | 100.0               | (2.0)          | (0.1) | (2.0)                  | (0.1) | (2.0)                            | (0.1) |        | 100.0               |
| II. Foreign Financing (net)                     | (26.6)              | (0.8) | 158.6  | 173.9               | (14.6)         | (0.4) | (12.5)                 | (0.3) | (23.9)                           | (0.6) | (10.0) | 190.6               |
| 1. Foreign Withdrawal (gross)                   | 26.1                | 0.8   | (2.7)  | 69.5                | 40.3           | 1.1   | 42.2                   | 1.1   | 34.0                             | 0.9   | 30.2   | 80.5                |
| 2. Amortization                                 | (52.7)              | (1.6) | 42.0   | 99.7                | (54.8)         | (1.6) | (54.8)                 | (1.5) | (57.9)                           | (1.5) | 9.9    | 105.8               |
| Assumptions:                                    |                     |       |        |                     |                |       |                        |       |                                  |       |        |                     |
| Economic Growth (%)                             | 5.5                 |       |        |                     |                | 6.3   |                        | 6.3   |                                  | 6.3   |        |                     |
| Inflation (%)                                   | 6.6                 |       |        |                     |                | 6.5   |                        | 6.0   |                                  | 6.59  |        |                     |
| Average Exchange Rate (Rp/\$)                   | 9.063               |       |        |                     |                | 9.300 |                        | 9.050 |                                  | 9.140 |        |                     |
| Average 3-months SBI Rate (%)                   | 11.7                |       |        |                     |                | 8.5   |                        | 8     |                                  | 8     |        |                     |
| International Oil Prices (\$/barrel)            | 63.8                |       |        |                     |                | 63    |                        | 60    |                                  | 69.7  |        |                     |
| Indonesian Oil Lifting (million barrel/day)     | 0.959               |       |        |                     |                | 1.000 |                        | 0.959 |                                  | 0.899 |        |                     |

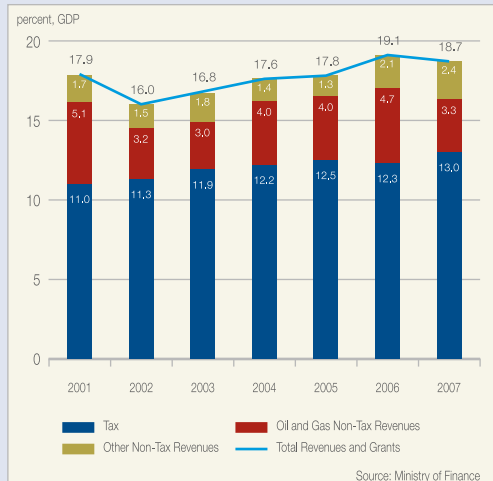
Source: Ministry of Finance

1 Provisional Figures, January 2008

the point of view of the 2007 APBN-P target, the tax income target was able to be achieved due to the fact that all components of tax revenue exceeded its target. Meanwhile, realization of non tax revenue (PNBP) also surpassed its target. This is still mostly contributed by oil and gas income, albeit lower than last year's, due to the fact that higher increase of oil prices outweighed the decline in oil lifting. With this development, the realization

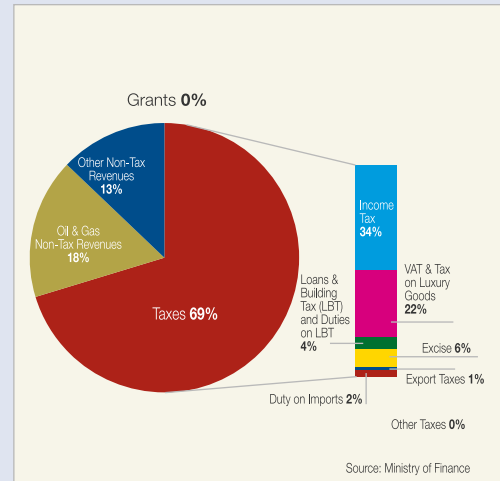
of Government Revenues and Grants exceeded the target in the 2007 APBN-P (Table 8.1).

The better performance in the tax sector was partly due to the impact of more conducive macro economic conditions. Continuation of tax policies from previous years, such as extensification through widening the type of businesses which have to pay tax, intensification



**Chart 8.3**  
Total Revenues and Grants Component

Source: Ministry of Finance



**Chart 8.4**  
Total Revenues and Grants Composition in Year 2007

Source: Ministry of Finance

toward tax subjects and objects, improvement of the tax system and administration, increased monitoring efforts and increased excise tax tariffs, combined with the better macro economic conditions, resulted in better performance in tax collection. This better performance was reflected in both the increase of the tax ratio which reached 13% of GDP, up from 12.3% of GDP in 2006 as well as the increase in the number of tax objects from around 20.8 million in 2006 to around 23.1 million in 2007<sup>4</sup>. The increase in tax revenues occurred in all components of tax revenues with the largest increase stemming from Export Tax revenues. The increase in Export Tax revenues was mainly due to higher exports of CPO, mineral fuels and mining products along with rubber and rubber made goods, which were driven by higher oil prices. In terms of Domestic Taxes, the main increase occurred in Value Added Taxes (VAT), and other taxes and excise taxes in line with private consumption growth which has continued to rise since the first quarter of 2007.

The increase in tax revenues was also influenced by policy factors. Especially concerning excise taxes, the increase in excise tax revenues was supported by both higher production volumes of products such as cigarettes and alcoholic drinks and the impact of increases in the retail selling prices (HJE) for all types of cigarette by 7% per stick/gram effective March 1, 2007 and the imposition of specific taxes of Rp3-7/stick according to the industry group effective as of July 1,

4 Including tax payer (WP) who doesn't have a NPWP.

2007<sup>5</sup>. Efforts to prevent the sale of cigarettes without banderole or with fake banderole also helped to boost excise tax revenues. From all components of income tax revenues, only the realization of non oil and gas income tax (PPh) failed to reach its target. This was due, among other things, to a decline in the amount of PPh Section 25 (PPh for firms) year 2007 due to the low realization of profits in a number of large companies and a number of potential tax payers in 2006, as well as because of natural disasters in 2006-2007 which affected activities in the real sector for a time.

Implementation of tax polices also included providing a limited fiscal stimulus and continuing a program to harmonize tariffs. Various tax facilities were given in 2007 which were aimed at raising production activities and investment. In the field of income tax, facilities given include a reduction in net income by 30% from the specified amount of investment, speeding up depreciation and amortization, lowering the Income Tax rate on dividends which are paid to Overseas Tax Subjects, lengthening of the period for loss compensation<sup>6</sup>; the granting of exception facilities for agriculture goods<sup>7</sup>; along with the granting of PPN facilities on contributions and donations in the

5 Finance Minister regulation No. 118/PMK.04/2006 concerning the two changes above PMK No. 43/PMK.04/2005 on Setting the Base Price and Excise Tax Tariffs for Cigarette Products.

6 Government Regulation No. 1 Year 2007 Concerning Income Tax Facilities for Investment in Certain Areas and/ or Certain Regions.

7 Government Regulation No. 7 Year 2007 Concerning the Third Amendment to Government Regulation No. 12 Year 2001 concerning Imports and/ or the surrender of certain taxable goods that are Strategic in Nature which were Exempted from the Imposition of Value Added Tax.

framework of the rehabilitation and reconstruction of Nanggroe Aceh Darussalam (NAD) and Nias<sup>8</sup>. In the field of international tax, the Program to Harmonize Import Duties is still carried out. This program was aimed at raising the efficiency and competitiveness of domestic industry, providing business certainty to investors, anticipating economic globalization, increasing customs administration efficiency and preventing smuggling.

In terms of non-tax revenues, the continued decline in domestic oil lifting was the main factor in the decline of the non tax revenue realization (PNBP). As assumed in the 2007 APBN-P, the performance of PNBP experienced a decline compared to 2006, mainly due to the fall in receipts from oil and gas. The decline in oil and gas PNBP was due to domestic oil lifting which only reached 899,000 barrels/day, or lower than the assumption of 950,000 barrels/day, while the price of crude oil actually rose to \$69.7/barrel, or above the assumption of \$60/barrel. This decline in domestic oil lifting was related to high natural declining rate of oil wells in Indonesia now reaching around 5%-11% per year due to its mature age, while new wells like Cepu and Lapangan Jeruk are not yet producing.

The decline in the realization of PNBP was also caused by lower profits contributed by SOE and other PNBP. This was because the carried over SOE dividends and the excess Surplus of Bank Indonesia were not included in the calculation of SOE 2007 profit as was the case in 2006. Receipts from excess surplus of Bank Indonesia were put in a separate component in the 2007 APBN-P and were realized in line with the target, that is around Rp13 trillion. Nonetheless, SOE contributed profits exceeded the target in the 2007 APBN-P because of an increase in the dividends contribution in relation to higher crude oil prices. Meanwhile, the lower increase in other PNBP, among other things, was because receipts from the auction for rights to use certain radio frequencies to support third generation based cellular telecommunication services were not included in the calculation as they were in 2006.

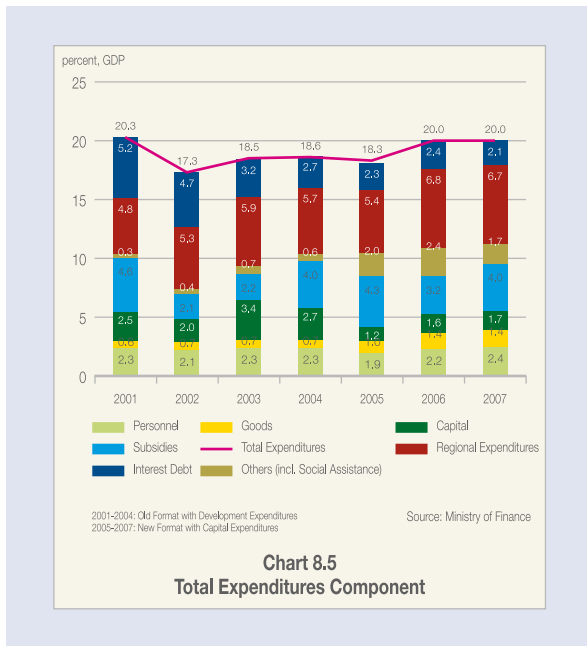
### **Government Expenditure**

The implementation of Government Expenditure in 2007 was marked by price stabilization policy, greater fiscal stimulus and continuation of poverty alleviation programs.

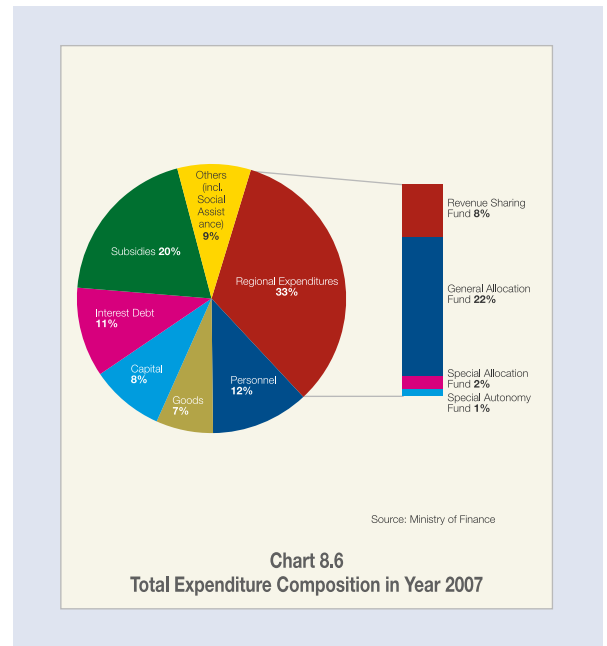
Policy to safeguard price stability was carried out through the commitment to providing various types of subsidy. The policy to increase the stimulus was carried out through raising State Apparatus Income; improving the quality, efficiency and effectiveness of services and governance through raising the budget for Expenditure on Goods; increasing the budget for infrastructure in Capital Expenditure; along with increasing the education budget. To reduce the level of poverty, programs in the fields of education and health - especially for poor people - were maintained. With this policy direction, Government Expenditure in 2007 reached around 20% of GDP, or the same as in 2006, with the bulk (33%) used for Regional Spending which was followed by expenditures for Subsidies and Debt Interest (31%), around 27% for fiscal stimulus from the Central Government (Spending on Salaries, Spending on Goods and Capital Spending) and the remainder (9%), among other things, for poverty alleviation programs through the Social Aid budget. From all these components of Government Expenditure, only the components on Spending on Employees, Subsidies and Regional Spending experienced an increased share of GDP compared to 2006 (Chart 8.5). Meanwhile, the share of Capital Expenditure and Expenditure on Goods was still minimal and stable as it was in 2006, that is only around 1%-2% of GDP.

Efforts to increase the fiscal stimulus were still hampered. As targeted in the 2007 APBN-P, the achievement of Government Expenditure of 20% of GDP was attributable to slower growth in Government Expenditure than that in 2006, either from Central Government Expenditure or Regional Spending. At the central level, unlike in the 2007 APBN-P, which expected that the slowdown in Central Government Expenditure in 2007 would stem from lower subsidies, the slowdown in Central Government Expenditure was, in fact, due to the slowdown in nearly all components of Central Government Expenditure which were larger than the 2007 APBN-P target along with declines in Other Expenditures, while the Subsidies actually experienced an increase due to developments in the price of crude oil (Chart 8.6). This condition was due to the absorption of Central Government Expenditure, especially for Expenditure on Salaries, Spending on Goods, Capital Expenditure and Other Expenditures which were below the 2007 APBN-P. In the last two years following the reformation of government finances in 2005, absorption of a number of components in Central Government Expenditure were always below target, although various efforts to improve regulations concerning the procurement of government goods/services had already

8 Finance Minister Regulation No. 43/PMK.03/2007 concerning the imposition of PPN and PPhBM on the Carrying out of Government Projects for the Rehabilitation and Reconstruction of Districts and the People's Lives in the Province of Nanggroe Aceh Darussalam and the Nias Province of North Sumatra Post the earthquake and Tsunami Natural Disasters which were Funded by Overseas Grants.



**Chart 8.5**  
**Total Expenditures Component**



**Chart 8.6**  
**Total Expenditure Composition in Year 2007**

been carried out<sup>9</sup>. This condition was related to the increased caution in carrying out Government auctions for the procurement of goods and services as well as steps to economize Ministry/Institutional spending (K/L) in anticipation of increased needs for payments of energy subsidies. At the regional level, the realization of Expenditures for the Regions was relatively in line with the target although overshadowed by payments for Special Allocation Funds (DAK) and Special Autonomy Funds and Adjustments (DOKP) that were below target.

In general, the increases in Central Government Expenditures were influenced by policy factors. Central Government Expenditures rose around 14% with the increase occurring in all expenditure components, except Other Expenditures. With regard to the civil service, the main policies included adjustments to the basic salary of state workers by around 15%, payment of the thirteen-month salary<sup>10</sup> and adjustment of structural allowance along with functional allowance. In the area of education, the education budget rose from the realized Rp29.3

trillion in 2005 to Rp45.3 trillion in 2006, and is expected to increase to Rp51.3 trillion in the 2007 APBN-P. This increase was related to Government efforts to fulfill the constitutional mandate to allocate at least 20% of the APBN for the education budget<sup>11</sup>. The increase in Expenditure on Goods was used to assist developments in activities requiring support for operational cost and maintenance (around half of the Expenditure on Goods budget), to handle post-flooding expenditures, and to procure the bird flu vaccine. In the area of investment, the infrastructure budget rose from around Rp32.2 trillion in 2006 to around Rp43.8 trillion in 2007<sup>12</sup> which, among other things, was used to speed up development of east flood canal and west flood canal to tackle floods in the Jabodetabek area, to construct Kuala Namu Airport in Medan, and Hasanudin Airport in Makassar.

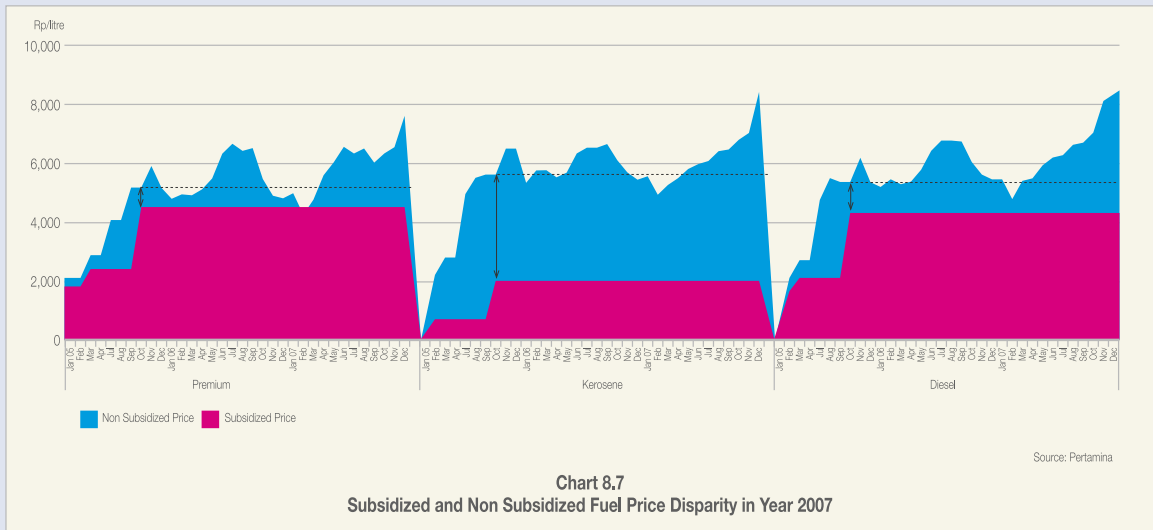
In regard to subsidies, both energy subsidies and various other subsidies experienced an increase. Food subsidies rose from Rp10.8 million in 2006 to Rp15.8 million in 2007 due to an increase in the number of targeted poor households (RTM) receiving subsidies. Fertilizer subsidies rose in connection to increases in the maximum retail price (HET) of fertilizer as of January 2007. This increase was due to the national program to boost rice production by two million tons which needs an additional 800 thousand tons of subsidized fertilizer. Meanwhile, subsidies on interest for program loans rose in order to support the increase of the volume of subsidized house construction, a program to subsidize bio-fuels energy

9 A number of important points in Presidential Decree No. 8 Year 2006 and Presidential Decree No. 79 Year 2006 stated ministries and state institutions along with Regional Governments and leaders of SOE and BUMD can conduct the procurement process of goods/services before the budget document is approved for related activities which have already been allocated, with the stipulation they issue an appointment letter to supply goods/services (SPPBJ) and a signed contract for the goods/services is done after the budget document for activities/projects is approved. Beside that, the PP also regulates when certification is not required for officials making a commitment as well as allowing for direct appointment for auctions of projects up to Rp50 million.

10 Regulation of the Director General of the Treasury No.33/PB/2007 dated 13 June 2007 concerning 13 month Salaries/pensions/allowances in the 2007 budget to Civil Servants, State Officials and Receivers of Pensions/Allowances.

11 Source: Financial Notes for the 2008 APBN.

12 Source: Office for the Coordinating Minister of the Economy, December 2007.



and a program to revitalize plantations. To guarantee the continuation of the aid program to the people which has been in effect for a few years, the Government increased the Social Aid budget. This budget increase was used for a program to support school operations (BOS), scholarships for gifted pupils (BKM) in the field of education, free health services in Puskesmas and government hospitals and appointed third-class private hospitals, and on direct aid projects in the field of health and education. Meanwhile, the realization of Other Expenditure was lower than in 2006, mainly because of the discontinuation of Direct Cash Aid program. Other Expenditure budget included funds for policy measures, national movement to rehabilitate the forests, activities which had not yet been budgeted, and also rehabilitation and reconstruction of Yogyakarta and Central Java.

Policies to maintain subsidies amidst external shocks meant that the realization of Central Government Expenditures exceeded the target. Absorption and increases in Central Government Expenditures – which were above the target – were mainly because of Subsidy payments, especially fuel (BBM) Subsidies and Electricity Subsidies. This increase in fuel subsidies was driven by greater disparities between the price of fuel fixed by the Government with its economic price along with the realization of subsidized fuel consumption which exceeded the quota, that is from 36 million kilo liters to around 38 million kilo liters (Chart 8.7). The increase in subsidized fuel consumption was also related to the slow progress made in the program to get people to switch from kerosene to LPG (realization was only around 20,638 kilo liters or 6% of the target).

Meanwhile, the increase in electricity subsidies was also influenced by the increasing disparity between Basic Electricity Tariffs as set by the Government and production costs which have continued to increase. This increase in electricity production costs was caused by rising fuel prices, the increase in the portion of fuel used in producing electricity and the increase in the price of fuel set by Pertamina (as a result of an increase in profit margin from 6.5% to 9.5%), along with an increase in electricity sales to the public compared to what was originally planned. The commitment to maintain subsidies demonstrates the role of the Government in safeguarding economic stability<sup>13</sup>.

At the regional level, transfers of Expenditure for the Regions increased in line with increased Government revenue and infrastructure needs. In general, the expenditure policy for the regions was directed to lessen the fiscal inequities between the central government and regional governments and between the regions, to lessen the inequities in public services between regions, to support fiscal sustainability in macro economic policy, to increase regional capacity in harnessing the potential of regional income, to increase efficiency in national resources, and to increase the transparency and accountability of the allocation of Expenditure for the Regions. Realization of regional Expenditure in 2007 was relatively stable compared to 2006, that is around 6.7%-6.8% of GDP. All components of the Regional Spending Budget rose except for Profit Sharing Funds (DBH). This reflects the decline in oil and gas

13 In line with the results of the study "Fiscal and Monetary Interaction in Indonesia" (Hermawan, Munro, 2007).

receipts which was due to lower domestic oil lifting. The increase in the General Allocation Fund (DAU) reflects the increase in net government revenue. The increase in Special Allocation Fund (DAK) reflects the increasing transfers of deconcentration funds, aids and the policy to place shortage of DAK payment in 2005 to this years' DAK. Furthermore, the increase in Autonomous Fund and Adjustment (DOKP) was due to the allocation of adjustment funds for infrastructure. 30% of the DAK allocation was used in the fields of education, while another 30% was used in infrastructure; around 20% was used for health and the remainder was used for government infrastructure, maritime and fisheries, agriculture and environment. The realization of DAK and DOKP that were below target was due to, among other things, the delay in setting the APBD. This, in turn, resulted in delays in undertaking activities and absorbing funds.

### **Deficit Financing**

Financing of the 2007 APBN deficit was relatively in accordance with the target, especially the financing sourced domestically. Three strategic steps for the financing included increasing the use of domestic source of financing, reducing outstanding debts and reducing ratio of debts toward GDP in a progressive manner, also fulfilling debt repayment obligations on time. Implementation of these three strategies were carried out smoothly such that the target for deficit financing sources originated domestically could be attained and that debt repayment was done on time. Up to the end of December 2007, the amount of rupiah and foreign currency SBN already issued had reached Rp99.8 trillion<sup>14</sup>. After taking into account the government bond (SUN) maturity, the SUN buyback and the repayment of a portion of Government debts owed to Bank Indonesia (SRBI-01) (around Rp13.7 trillion), the net issuance of SBN reached Rp57.1 trillion, which was slightly below the 2007 APBN-P target of Rp58.5 trillion. From the point of view of assets sales, realization of the privatization program up to December was below target, whereas the banking asset sales from PT Perusahaan Pengelola Aset (PT PPA) was in line with the target. In 2007, the Government obtained funds from the SOE privatization program of around Rp3 trillion, slightly below the 2007 APBN-P target of Rp3.3 trillion. In December there were also payments for a number of SOE through PMN program of around Rp2.7 trillion, which exceeded the target of Rp1.3 trillion. As such, the net privatization proceeds obtained were around Rp0.3 trillion, or below the target of Rp2 trillion. Meanwhile, from the bank

restructuring program, the State Asset Management Company (PPA) contributed around Rp2.4 trillion, exceeding the 2007 APBN-P target of Rp1.7 trillion. In regard to external sources, the withdrawals of foreign loans only reached around 81% of the APBN-P target because the policy matrix was not met.

The main source of foreign loans still originated from the World Bank and ADB. These loans were used to fund various development programs in nearly all economic sectors. Meanwhile, repayments on principal were carried out on time which actually resulted in net withdrawals of foreign loans that were below target. With net issuances of SBN exceeding the target, and the deficit being lower than the target, the position of the government account in Bank Indonesia experienced a slight increase. This was contrary to what was expected in the 2007 APBN-P where the Government account in Bank Indonesia had been initially expected to show a decline since it was used to repay the deficit. Similar to the two previous years, financing policy was marked by government expenditures to fund infrastructure through Public Private Partnerships (PPP) that amounts to around Rp2 trillion.

The financing strategy enables the continuing down trend of outstanding Government debts to GDP ratio. The actual net issuance of SBN and net repayment of foreign loans caused outstanding Government debts ratio to decline to around 35% of GDP, from 39% of GDP in 2006. This decline stemmed from the drop in the amount of foreign debts outstanding from around 18% of GDP in 2006 to around 16% of GDP in 2007 and the decline in domestic debts from 21% of GDP in 2006 to 19% of GDP in 2007. From the perspective of its share, domestic and foreign loans share were stable, each at 53% and 47% of total Government debts. This condition was in line with the Government's long-term debt strategy which is directed more toward domestic debts, mainly as part of efforts to minimize exchange rate risk. The year 2007 was marked by the termination of CGI in January 2007, this was done in order to improve Indonesia's autonomy in bilateral debt negotiations such that loan conditions more advantageous. Furthermore, in accordance with the budget refinancing strategy which was aimed at reducing refinancing risks, the Government continued its SUN buyback program in 2007, as well as switching short-term SUN with long-term SUN through an auction mechanism. The SUN buyback program was carried out for Rp2.9 trillion of SUN which will mature in the period 2008-2012, while the debt switching program was carried out by reorganizing the maturity profile of

<sup>14</sup> Source: Bank Indonesia.

**Table 8.2**  
**Summary of Government Bonds Issued in Year 2007**

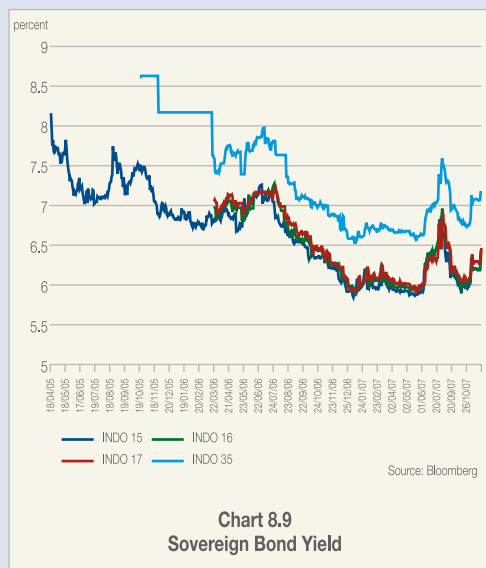
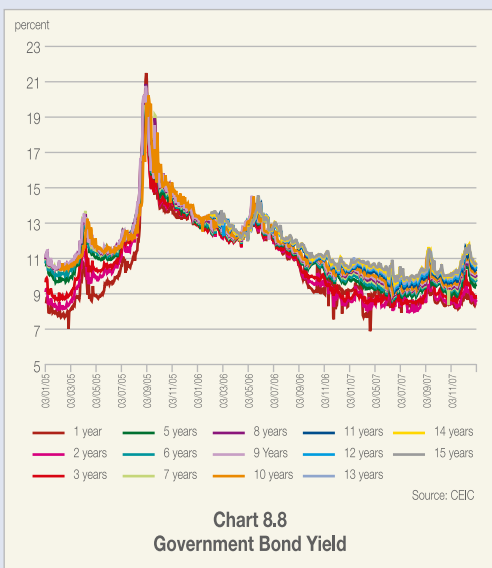
| Government Securities (SUN)     |         |         |                     |                     |                     |                     |                     |                     |                      |         |                     |                     |          |                     |
|---------------------------------|---------|---------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|----------------------|---------|---------------------|---------------------|----------|---------------------|
| Issuing Date                    | 23-Jan  | 22-Feb  | 20-Mar              | 17-Apr              | 24-May              | 19-Jun              | 17-Jul              | 21-Aug              | 28-Aug               | 20-Sep  | 25-Sep              | 30-Oct              | 20-Nov   | 4-Dec               |
| Series                          | FR042   | FR043   | FR028,<br>FR043     | FR028,<br>FR044     | FR042,<br>FR045     | FR043,<br>FR045     | FR045,<br>FR046     | FR046,<br>FR047     | FR047,<br>ZC001      | ZC002   | FR047,<br>FR048     | FR047,<br>FR048     | ZC003    | FR027;<br>ZC004     |
| Indicative Target (trillion Rp) | 3       | 4       | 3                   | 3; 3                | 3                   | 2                   | 3                   | 3                   | 3                    | 3       | 3                   | 3                   | 2        | 2                   |
| Bidding Amount (trillion Rp)    | 20.0    | 7.6     | 7.0; 8.6            | 11.1;<br>8.9        | 10.4;<br>10.8       | 9.9; 6.5            | 3.2; 4.3            | 2.1; 2.3            | 4.5; 9.1             | 6.5     | 6.3;<br>11.1        | 3.1; 4.0            | 2.2      | 6.2; 4.5            |
| Issuing Amount (trillion Rp)    | 4.8     | 4.0     | 4.1; 5.1            | 3.0; 4.0            | 2.6; 1.7            | 2; 2.5              | 2.2; 3.6            | 1; -                | 3.5; 6.0             | 3.0     | 3.5; 3.5            | 0.9; 0.1            | 1.5      | 4.1; -              |
| Coupon (%)                      | 10.25   | 10.25   | 10;<br>10.25        | 10;<br>10.25        | 10.25;<br>9.75      | 10.25;<br>10.56     | 9.75;<br>9.5        | 9.5; -              | 9.5; -               | -       | 10; 9               | 10; 9               | -        | 9.5; -              |
| Weighted Average Yield (%)      | 10.48   | 10.68   | 9.93;<br>10.48      | 9.82;<br>10.38      | 9.76;<br>10.07      | 9.35;<br>9.53       | 9.81;<br>9.71       | 10.61; -            | 10.34;<br>8.41       | 8.74    | 9.89;<br>9.39       | 10.15;<br>9.45      | 9.87     | 9.62; -             |
| Maturity                        | 15/7/27 | 15/7/22 | 15/7/17;<br>15/7/22 | 15/7/17;<br>15/9/24 | 15/7/27;<br>15/5/37 | 15/7/22;<br>15/5/37 | 15/5/37;<br>15/7/23 | 15/7/23;<br>15/2/28 | 15/2/28;<br>20/11/08 | 20/9/09 | 15/2/28;<br>15/9/18 | 15/2/28;<br>15/9/18 | 20/11/12 | 15/6/15;<br>20/3/09 |

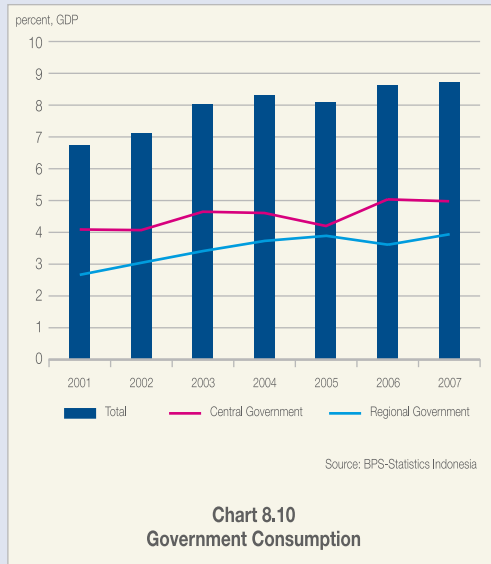
  

|  | ORI     |         | SPN           |               |               | Foreign Exchange Bond |
|--|---------|---------|---------------|---------------|---------------|-----------------------|
| Issuing Date                               | 28-Mar  | 12-Sep  | 30-May        | 27-Jun        | 25-Jul        | 7-Feb                 |
| Series                                     | ORI 002 | ORI 003 | SPN2008052801 | SPN2008052801 | SPN2008052801 | INDO 37               |
| Indicative Target (trillion Rp/billion \$) | n.a.    | n.a.    | n.a.          | n.a.          | n.a.          | n.a.                  |
| Bidding Amount (trillion Rp/billion \$)    | 6.3     | 9.5     | 12.9          | 3.9           | 2.7           | 5.0                   |
| Issuing Amount (trillion Rp/billion \$)    | 6.2     | 9.4     | 2.0           | 1.9           | 0.3           | 1.5                   |
| Coupon (%)                                 | 9.28    | 9.40    | -             | -             | -             | 6.63                  |
| Weighted Average Yield (%)                 | -       | -       | 8.5           | 8.45          | 8.46          | 6.75                  |
| Maturity                                   | 3/28/10 | 9/12/11 | 5/28/08       | 5/28/08       | 5/28/08       | 2/7/37                |

around Rp16 trillion of SUN which will mature in 2007-2012 to 2018-2025. This program gives room for the government to issue government securities (SBN) in shorter tenors in order to develop the SBN market and increase the confidence of investors and other market players toward the Government's ability in managing its debt portfolio.

The success in meeting the financing target through issuance of SBN was supported by conducive macro economic conditions. As in 2006, the Government again faced a condition of oversubscription in nearly all of the SBN auctions in 2007. This condition reflects the confidence of market players in government macroeconomic policies and the prospects for fiscal





**Chart 8.10**  
**Government Consumption**



**Chart 8.11**  
**Government Investment**

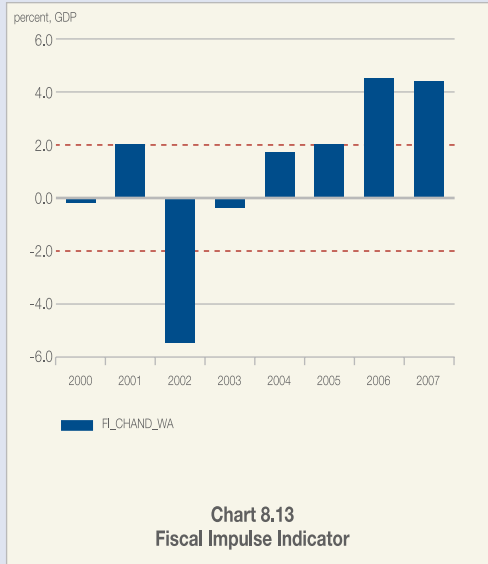
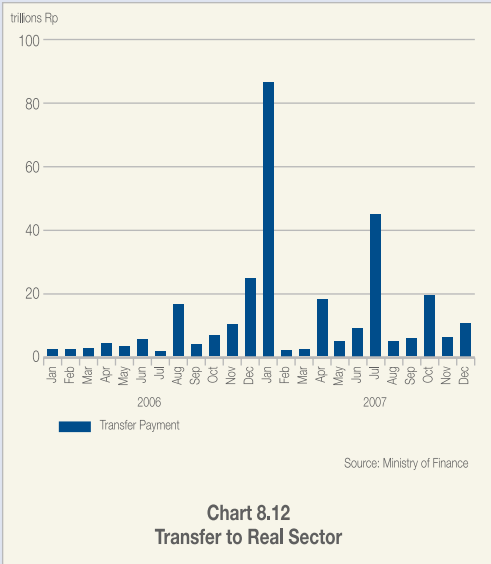
sustainability which was further supported by an attractive return (Table 8.2). From the international perspective, strong foreign investor interest was supported by the continued global excess liquidity in line with the high price of crude oil and the high expectations of the yield spread on SBN returns. In 2007, the Government carried out as many as 20 auctions for various types of SBN – both domestically and overseas – which had been carried out since January (frontloading). SBN which were issued were more varied than in previous years to accommodate various types of investor. In 2007, the Zero Coupon SBN series and the Treasury Bills (SPN) were first issued to complement the SUN, Government Retail Bond (ORI) and foreign currency debts auction. With these developments, the position of SBN at the end of 2007 reached Rp477.7 trillion with a composition of 57.7% in Fixed Rate series, 35.3% in Variable Rate series, 4.0% in ORI, 2.2% in Zero Coupon series and 0.9% in SPN series. The frontloading strategy meant that net issuances of SBN up to the third quarter of 2007 already reached around 90% of the target such that the target was relatively unaffected by the conditions of the financial market, which in the third quarter of 2007, were affected by the impact of the US sub-prime mortgage crisis. The belief of market players in sustainable fiscal conditions also increased as reflected in SUN yield developments and foreign currency obligations which were relatively stable although the price of crude oil continued to rise from the first quarter of 2007 onward. Meanwhile, increasing yield during the third quarter of 2007 was due to the impact of

the sub-prime mortgage crisis, but this impact began to ameliorate soon after (Chart 8.8 and Chart 8.9).

### Implications on the Real Sector and the Monetary Sector

The policy of safeguarding fiscal sustainability while continuing to give a fiscal stimulus was still able to be done in 2007 although at a slower pace. The lag in Government consumption and investment was due to slower growth in Personnel Expenditures, Good Expenditures, Capital Expenditures and DAU in addition to the decline in Other Expenditures and DBH (Chart 8.10 and Chart 8.11). This lag was larger than that targeted in the APBN-P because the absorption of a number of expenditures were below the 2007 APBN-P target. Meanwhile, transfers to the real sector, such as Subsidies, Social Aid and Domestic Debt Interest, experienced an increase, especially due to an increase in Subsidy payments (Chart 8.12). These Subsidy payments also caused transfer payments to exceed the target in 2007. With this development, the fiscal impulse indicator<sup>15</sup> (Chart 8.13) indicated that the Government's

<sup>15</sup> The Fiscal Impulse Indicator (FI) is calculated by comparing the actual value of the deficit with the potential deficit (structural balance) which in conceptual terms should occur. The calculation of the FI indicator follows the Chand Model (1992) which incorporates a number of macro economic indicators in the calculation of the FI, such as MPC, sensitivity of tax toward economic growth and the multiplier from Government expenditures. If the value of the actual deficit exceeds the potential deficit then it can be said that fiscal impulse is expansive toward economic growth. The threshold from the FI value is contractive toward economic growth if  $FI < 2\%$  GDP, expansive if  $FI > 2\%$  GDP and neutral if  $-2\% \text{ GDP} < FI < 2\%$  GDP. The fiscal deficit only calculates domestic components of the APBN and excludes foreign components such as oil and gas income and interest payments on foreign debts.



financial operations were still expansionary toward economic growth.

From monetary point of view, in line with the budget deficit, the Government's financial operations recorded a rupiah expansion in 2007. In accordance with the budget surplus in January-November 2007 and the frontloading of SBN issuance, the Government's financial operations continued to have a contractive impact on base money. Yet in December 2007, there was significant rupiah

expansion especially to pay for projects, DBH and various subsidies such that the Government's finances were expansive in nature over the year. With the expansion in December, the Government's finances had an expansionary impact of Rp66.9 trillion over the year (Chart 8.14). The size of the expansion was less than the rupiah expansion in 2006 when it reached around Rp100 trillion with a lower deficit. The lower rupiah expansion was possible because of the greater use of domestic debt and the smaller use of Government accounts in Bank Indonesia compared to the previous year.

