1 Indonesia

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I. Introduction

The name of "Indonesia" is derived from historical sequences that occurred in the middle of 19th century. Some historical manuscripts revealed that Indonesia is a set of islands that spread between Indo-China and Australia by various names. Eduard Douwes Dekker (1820-1887), known as "Multatuli", cited Indonesia as Indian islands. On the other side, "Indonesia", this name means Indian Islands, invented by J. R. Logan, in Malaya in 1850. Taken from the Greek, *Indos*(India) and *nesos*(island), it has parallels in Melanesia, "black islands"; Micronesia, "small islands"; and Polynesia, "many islands." A German geographer, Adolf Bastian, used it in the title of his book, *Indonesien*, in 1884, and in 1928 Indonesian nationalists adopted it as the name of their nation.

Consisted of more than 17.000 islands, Indonesian lands spread out between two big continents Asia and Australia and lay over the Equator between the Indian Ocean and the Pacific Ocean. While the land borders with the north to East Timor and Papua New Guinea and to the east with Malaysia, it also neighbors Australia to the south, and Philippines, Vietnam, Singapore, and Thailand to the north, also India to the northwest.

After the independence day at 17 August 1945, the national anthem titled "Indonesia Raya" have been sung by children throughout the country to begin the school day, by civil servants at flag-raising ceremonies, over the radio to begin and close broadcasting; in cinemas and on television and at national day celebrations. Radio and television, government owned and controlled for much of the second half of the twentieth century, produced nationalizing programs as diverse as Indonesian language lessons, regional and ethnic dances and songs, and plays on national themes. Officially recognized "national heroes" from diverse regions are honored by schools and biographies and with statues for their struggles against the Dutch; some regions monumentalize local heroes of their own.

Indonesia is a unitary state that called "Negara KesatuanRepublik Indonesia" (The Unitary States of The Republic of Indonesia). It extended from west to east (Sabang to Merauke) and from north to south (Mianggas to Rote Island). After its independence day at August 17th 1945, Indonesia founding fathers decided that unitary state is an ideal form for Indonesia. It was not easy for Indonesia's founding fathers to establish unitary state because Indonesia was Dutch's colony. Through some diplomacies and conferences, Dutch recognized Indonesia's sovereignty as unitary state in Round Table Conference (KonferensiMejaBundar) at December 27th 1949.

The Bhinneka Tunggal Ika ("Unity in Diversity") is Indonesia motto, the concept that this country always united even the country's citizen divide themselves along a vast slew of ethnicities, clans, tribes and even castes. The nation's official ideology, first formulated by President Sukarno in 1945, is the "Pancasila", or Five Principles: belief in one supreme God; just and civilized humanitarianism; Indonesian unity; popular sovereignty governed by wise policies arrived at through deliberation and representation; and social justice for all Indonesian people.

I.1 History and Culture

The modern of Indonesia begins in the period from 2500 BC to 1500 BC with a wave of light brown-skinned Austronesia immigrants, thought to have originated in Taiwan. This Neolithic group of people, skilled in open-ocean maritime travel and agriculture are believed to have quickly supplanted the existing, less-developed population. Indonesian history has been influenced by foreign powers drawn to its natural resources. Muslim traders and Sufi scholars brought the now-dominant Islam, while European powers brought Christianity and fought one another to monopolize trade in the Spice Islands of Malukuduring the Age of Discovery.

There is no one unified Indonesian culture as such, but the Hindu culture of the former Majapahit empire does provide a framework for many of the cultural traditions found across the central islands of Sumatra, Java, Bali and Lombok. Perhaps the most distinctively "Indonesian" arts are wayangkulit shadow puppetry, where intricately detailed cutouts act out scenes from the Mahabharata and Ramayana and other popular folk stories, and its accompaniment the gamelan orchestra, whose incredibly complex metallic rhythms are the obligatory backdrop to both religious ceremonies and traditional entertainment. Modern-day Indonesian popular culture is largely dominated by the largest ethnic group, the Javanese.

Indonesia consists of 34 provinces. Each province has its own culture. It could be looked at from Traditional houses, cultural events, traditional clothing, folk songs, local languages, traditional dances and some local wisdom. Regarding language, National language is Indonesia (Bahasa). Indonesia language has been united Indonesia from communication perspective formally even though local people still use local language informally. Indonesia still upholds hierarchy in daily life continuously. Hierarchy is very important in Indonesian society and people's status should be respected at all times. Status is mainly based on a person's age and (job) position. Most Indonesians - but in particular those of higher status - should be addressed with a specific title (*Bapak* for men and *Ibu* for women). This can be in combination with their name (*Bapak Aditya*) or position (*BapakPresiden*). These titles should continuously be used when talking to a person of higher or similar status. And it is always good to talk in a subtle (almost soft) manner. Like other Asian Countries, personal relationship is very important for Indonesian people like building business relationship, involving in social community and Working Together (*GotongRoyong*).

I.2 Geography and Climate

As explained above, Indonesia has 34 provinces that located in more than 17,000 islands providing 108,000 kilometers of beaches.

Table 1: Provinces and Capital Cities

Name of Province	Name of Capital City
Nanggoro Aceh Darusalam	Banda Aceh
Sumatera Utara (North Sumatera)	Medan
Sumatera Barat (West Sumatera)	Padang
Riau	Pekanbaru
Kepulauan Riau (Riau Islands)	Tanjung Pinang
Jambi	Jambi
Bengkulu	Bengkulu
Sumatera Selatan (South Sumatera)	Palembang
Kepulauan Bangka Belitung (Bangka Belitung Islands)	Pangkal Pinang
Lampung	Lampung
Banten	Serang
DKI Jakarta	**Jakarta** (Indonesia's Capital City)
Jawa Barat (West Java)	Bandung
Jawa Tengah (Central Java)	Semarang
Special Region of Yogyakarta	Yogyakarta
JawaTimur (East Java)	Surabaya
Bali	Denpasar
Kalimantan Barat (West Kalimantan)	Pontianak
Kalimantan Tengah (Central Kalimantan)	Palangkaraya
Kalimantan Selatan (South Kalimantan)	Banjarmasin
Kalimantan Timur (East Kalimantan)	Samarinda
Kalimantan Utara (North Kalimantan)	Tarakan
Sulawesi Barat	Mamuju
Sulawesi Selatan (South Sulawesi)	Ujung Pandang
Sulawesi Tengah (Central Sulawesi)	Palu
Sulawesi Utara (North Sulawesi)	Manado
Sulawesi Tenggara (South East Sulawesi)	Kendari
Gorontalo	Gorontalo
Nusa Tenggara Barat (West Nusa Tenggara)	Mataram
Nusa Tenggara Timur (East Nusa Tenggara)	Kupang
Maluku	Ambon
Kepulauan Maluku Utara (North Maluku Islands)	Sofifi
Papua Barat (West Papua)	Manokwari
Papua	Jayapura

Indonesia also has an area of 1,916, 862 sq. km. The distance between Aceh in the West and Papua in the East is more than 4,000 km (2500 miles). The Ring of Fire Indonesia has more than 400 volcanoes, of which 130 are considered active, as well as many undersea volcanoes. The island of New Guinea (on which the Indonesian province of Papua is located) is the second largest island in the world. Here are some main islands in Indonesia:

- Sumatra (incl. the Riau Islands and Bangka-Belitung), wild and rugged, the 6th largest island in the world has a great natural and cultural wealth with more than 40 million inhabitants. It is habitat for many endangered species.
- Kalimantan (Borneo), the vast majority of this, the world's third largest island, is covered by the Indonesian province. Uncharted jungles, mighty rivers, home of the orangutan, a paradise for the adventurer.
- Java (and Madura), the country's heartland, big cities including the capital Jakarta, and a lot of people packed on this island. Also features the cultural treasures of Yogyakarta, Borobudur temple and Prambanan temple.
- Bali, by far the most popular visitor destination in Indonesia, Bali's blend of unique culture, legendary beaches, spectacular highland regions and unique underwater life make it a perennial favorite amongst global travelers.
- Sulawesi (Celebes), strangely shaped, this island houses a diversity of societies and some spectacular scenery, Toraja culture, rich flora and fauna, world class diving sites.
- Nusa Tenggara, also known as the Lesser Sunda Islands, the "Southeast Islands", contain scores of ethnic groups, languages and religions, as well as Komodo lizards and more spectacular diving.
- Maluku (Moluccas), the historic Spice Islands, fought over to this day, largely unexplored and almost unknown to the outside world.

- Papua (Irian Jaya), the western half of the island of New Guinea, with mountains, forests, swamps, an almost impenetrable wilderness in one of the most remote places on earth.

Indonesia is a warm place. It has no spring, summer, autumn, or winter, just two seasons: rainy and dry, both of which are relative (it still rains during the dry season, it just rains less). While there is significant regional variation, in *most* of the country (including Java and Bali) the dry season is April to October, while the wet season is November to March. In the highlands temperatures will naturally be cooler, and there are even snow-covered peaks in Papua, whose mountains can soar above 5000 meter.

Since the country is very large, Indonesia is divided into three time zones:

GMT +7: Western Indonesian Time (WIB, *Waktu Indonesia Barat*) Sumatra, Java, west/central Kalimantan.

GMT +8: Central Indonesian Time (WITA, *Waktu Indonesia Tengah*) Bali, south/east Kalimantan, Sulawesi, Nusa Tenggara.

GMT +9: Eastern Indonesian Time (WIT, *Waktu Indonesia Timur*) Maluku, Papua.

I.3 Demography

In 2018, Indonesia has more than 265 million populations. The population is unevenly spread throughout the islands within a variety of habitats and levels of development, ranging from the megalopolis of Jakarta to tribes in Papua Provinces are usually grouped around larger islands and include smaller surrounding islands. Indonesia also has the world's largest Muslim population. Ethnically it is highly diverse, with more than 300 local languages. The people range from rural hunter-gatherers to a modern urban elite. To get appropriate the fixed number of population, Indonesia government carries out population census every ten years.The table below shows the distribution of populations from 1971 until 2010 by provinces:

Table 2: Distribution of Population

Province	Population					
	1971	1 980	1 990	1 995	2 000	2 010
Aceh	2,008,595	2,611,271	3,416,156	3,847,583	3,930,905	4,494,410
Sumatera Utara	6,621,831	8,360,894	10,256,027	11,114,667	11,649,655	12,982,204
Sumatera Barat	2,793,196	3,406,816	4,000,207	4,323,170	4,248,931	4,846,909
Riau	1,641,545	2,168,535	3,303,976	3,900,534	4,957,627	5,538,367
Jambi	1,006,084	1,445,994	2,020,568	2,369,959	2,413,846	3,092,265
Sumatera Selatan	3,440,573	4,629,801	6,313,074	7,207,545	6,899,675	7,450,394
Bengkulu	519,316	768,064	1,179,122	1,409,117	1,567,432	1,715,518
Lampung	2,777,008	4,624,785	6,017,573	6,657,759	6,741,439	7,608,405
Kepulauan Bangka Belitung	-	-	-	-	900,197	1,223,296
Kepulauan Riau	-	-	-	-	-	1,679,163
DKI Jakarta	4,579,303	6,503,449	8,259,266	9,112,652	8,389,443	9,607,787
Jawa Barat	21,623,529	27,453,525	35,384,352	39,206,787	35,729,537	43,053,732
Jawa Tengah	21,877,136	25,372,889	28,520,643	29,653,266	31,228,940	32,382,657
DI Yogyakarta	2,489,360	2,750,813	2,913,054	2,916,779	3,122,268	3,457,491
Jawa Timur	25,516,999	29,188,852	32,503,991	33,844,002	34,783,640	37,476,757
Banten	-	-	-	-	8,098,780	10,632,166
Bali	2,120,322	2,469,930	2,777,811	2,895,649	3,151,162	3,890,757
Nusa Tenggara Barat	2,203,465	2,724,664	3,369,649	3,645,713	4,009,261	4,500,212
Nusa Tenggara Timur	2,295,287	2,737,166	3,268,644	3,577,472	3,952,279	4,683,827
Kalimantan Barat	2,019,936	2,486,068	3,229,153	3,635,730	4,034,198	4,395,983
Kalimantan Tengah	701,936	954,353	1,396,486	1,627,453	1,857,000	2,212,089
Kalimantan Selatan	1,699,105	2,064,649	2,597,572	2,893,477	2,985,240	3,626,616
Kalimantan Timur	733,797	1,218,016	1,876,663	2,314,183	2,455,120	3,553,143
Sulawesi Utara	1,718,543	2,115,384	2,478,119	2,649,093	2,012,098	2,270,596
Sulawesi Tengah	913,662	1,289,635	1,711,327	1,938,071	2,218,435	2,635,009
Sulawesi Selatan	5,180,576	6,062,212	6,981,646	7,558,368	8,059,627	8,034,776
Sulawesi Tenggara	714,120	942,302	1,349,619	1,586,917	1,821,284	2,232,586
Gorontalo	-	-	-	-	835,044	1,040,164
Sulawesi Barat	-	-	-	-	-	1,158,651
Maluku	1,089,565	1,411,006	1,857,790	2,086,516	1,205,539	1,533,506
Maluku Utara	-	-	-	-	785,059	1,038,087
Papua Barat	-	-	-	-	-	760,422
Papua	923,440	1,173,875	1,648,708	1,942,627	2,220,934	2,833,381
INDONESIA	119,208,229	147,490,298	179,378,946	194,754,808	206,264,595	237,641,326

Source: Indonesia Statistics, 2018

The Indonesian archipelago has been an important region for trade since at least the 7th century, when Srivijaya and then later Majapahit traded with China and India. Local rulers gradually absorbed foreign cultural, religious and political models from the early centuries CE, and Hindu and Buddhist kingdoms flourished. From this point onward, dozens of kingdoms and civilizations flourished and faded in different parts of the archipelago. Some notable kingdoms include Sriwijaya (7th-14th century) on Sumatra and Majapahit (1293-c.1500), based in eastern Java but the first to unite the main islands of Sumatra, Java, Bali and Kalimantan as well as parts of Peninsular Malaysia. Indonesia also consists of hundreds of distinct native ethnic and linguistic groups, with the largest and politically dominant ethnic group being the Javanese. In a numerical scale, the largest ethnic groups are the Javanese (45%) from central and eastern Java, the Sundanese (14%) from western Java, the Maduranese (7.5%) from the island of Madura, and Coastal Malays (7.5%), mostly from Sumatra. This leaves 26% for the Acehnese and Minangkabau of Sumatra, the Balinese, the Iban and Dayaks of Kalimantan, and a bewildering patchwork of groups in Nusa Tenggara and Papua.

Religion, does play a very important role in Indonesian society. Indonesian nationals are obliged to adhere to one of the religions that have been selected by the government (Islam, Christianity, Catholicism, Hinduism, Buddhism and Confucianism). Islam is a majority religion in Indonesia. Indonesia also has the world's largest Muslim population. Approximately 87.2 percent of the total Indonesian population or 207.2 million individuals in absolute numbers - is Muslim. However, Indonesia is not an Islamic nation (only in the special region of Aceh on the northern tip of Sumatra Islamic Sharia law is being applied). But despite being a secular democracy, principles based on Islamic doctrine do play a large role in the politics, the economy and society of Indonesia. There are also some 16.5 million Protestants (6.9 percent of the total population), 6.9 million Catholics (2.9 percent of the population), and 4 million Hindus (1.7 percent) living in Indonesia. Lastly, there exist small minorities of Buddhists as well as those who practice Confucianism, mostly members of the ethnic Chinese community.

I.4 Government and Political Situation

The Indonesian governmental system consists of three branches, executive branch, legislative branch, and judicial branch. The executive branch consists of the president, the vice president and the cabinet. Both the president and vice president are chosen by the Indonesian electorate through presidential elections. They serve for a term of five years that can be extended once by another term of five years when re-elected by the people. During these elections the president and vice president run as a fixed, inseparable pair, which implies that the composition of this pair is of great political strategic importance. Important matters that are of influence include ethnic (and religious) background and (previous) social position in Indonesian society.

Indonesia's legislative branch is the People’s Consultative Assembly (*MajelisPermusyawaratan Rakyat*, abbreviated MPR). It has the power to set or change the Constitution and appoints (or impeaches) the president. The MPR is a bicameral parliament that consists of the People’s Representative Council (*DewanPerwakilan Rakyat*, abbreviated DPR) and the Regional Representative Council (*DewanPerwakilan Daerah*, abbreviated DPD).

The DPR, consisting of 560 members, draws up and passes laws, produces the annual budget in cooperation with the president and oversees the general performance of political affairs. It is elected for a five-year term through proportional representation based on general elections. The DPD deals with bills, laws and matters that are related to the regions, thus increasing regional representation at the national level. Every Indonesian province elects four members to the DPD (who serve for a five-year term) on non-partisan basis. As Indonesia contains 33 provinces, the DPD consists of a total of 132 members.

The highest court in Indonesia's judiciary system is the independent Supreme Court. It is the final court of appeal and also deals with disputes between lower courts. A relatively new court, established in 2003, is the Constitutional Court, which monitors whether decisions made by the cabinet and parliament (MPR) are in line with the Indonesian Constitution. However, most of the legal cases in Indonesia are handled by the public courts, administrative courts, religious courts and military courts. A Judicial Commission oversees the maintenance of honor, dignity and behavior of Indonesian judges.

II. Overview of Macroeconomics Activity and Fiscal Position

II.1 Macroeconomic Activity

Home to more than 260 million people, Indonesia is the fourth most populous country in the world and the largest economy in Southeast Asia. With GDP of about US$1 trillion, the country is the world's sixteenth largest economy and the seventh largest in purchasing-power-parity terms. It has played an increasingly prominent role in the global policy debate, including as a member of the Association of Southeast Asian Nations (ASEAN) and the Group of 20 (G20), an international forum bringing together 20 of the world's largest advanced and emerging market economies.

Indonesia economy has passed various conditions from different era. There were some obstacles and achievements that Indonesia got it. Indonesia economy activities have been started since from colonial era until now. Many steps and policies have been implemented.

In colonial times, Indonesia economy resource was only developed in the interest of colonizers through the concentration on agriculture, especially plantations, with most of product sold abroad. As a result, the structure of the Indonesia economy became unbalanced because of too great an emphasis on the heavily export-import oriented agriculture.

During the decade knows as Old Order Era (1945-1966), the economy was a servant to politics. Rational Economic principles were unacknowledged and ignored. Furthermore, domestic and foreign resources were squandered. The direct result of these conditions was a drastic decline in the economy, accompanied by hyperinflation which reached more than 600 per cent in 1966. During this period, food production did not keep pace with population growth. Export proceeds decreased significantly, while imports were paid for by increasing loans from abroad.

Monetary policy received greater attention when the New Order Government came into the power. A new Bank Indonesia Act was stipulated in 1968 with multiple objectives, namely, to achieve and maintain price stability, stimulate economic growth and create employment. The monetary policy focused on controlling inflation and coordinating with fiscal authority to achieve economy stability. Inflation could finally and drastically be controlled to below 10 per cent in 1969. Thereafter, between 1969 and 1981, economic growth averaged about 7.86 per cent, with high revenue coming mainly from oil exports.

The first financial liberalization took place in June 1983. At this time the direct monetary policy was replaced with an indirect monetary policy through an open market operation using Bank Indonesia Certificate (Sertifikat Bank Indonesia) as its main instrument and couple with intervention in money market when necessary. To achieve the multiple objectives stated before, Bank Indonesia implemented a base money (quantity) targeting framework. Further deregulation took place in October 1988, when the reserve requirement was significantly reduced from 15 per cent to 2 per cent and restrictions on permits to open new banks were eased. Since then, the banking sector has grown rapidly to participate as an agent of development. As a result, short-term capital could flow freely in and out of the country and exposure to foreign exchange risk increase while the financial sector and real sector decoupled. Consequently, controlling supply money become complex.

The 1997-1998 Asian Financial Crisis hit Indonesia through a contagion effect from the currency crisis in Thailand in July 1997. This crisis struck Indonesia's economy so hard that it led to both a triple financial crisis (currency, banking and foreign debt) and political crisis. As a monetary authority, Bank Indonesia initially responded by adopting a free floating exchange rate regime. Previously, Bank Indonesia had adopted a managed floating exchange rate regime. However, the government decided to turn to the IMF for help and entered into a Standby Arrangement with it on November 5th 1997. Later, on August 25th 1998, this was stepped up and became known as an Extended Fund Facility. The table below shows condition in some countries when Asian Financial Crisis happened:

Table 3: Asian Financial Crisis Outlook

Country	Year	Type Of Crisis	NPL (%)	Fiscal Cost (% GDP)	Output Loss (% GDP)	Growth (%)
Indonesia	1997	Banking, Currency, Debt	32.5	56.8	67.9	-13.1
Korea	1997	Banking, Currency	35.0	31.2	50.1	-6.9
Malaysia	1997	Banking, Currency	30.0	16.4	50.0	-7.4
Philippines	1997	Banking, Currency	20.0	13.2	0.0	-0.6
Thailand	1997	Banking, Currency	33.0	43.8	97.7	-10.5
Vietnam	1997	Banking, Debt	35.0	10.0	19.7	4.8

To tackle impact of Asian Financial Crisis, Indonesia's government implemented some policies. Period 1997-1999, monetary authority under Monetary Board chaired by Minister of Finance with Governor of Bank Indonesia took actions to handle this condition. In 1999, inflation dropped to 1.92 %, economic growth improved to positive 0.3 %. In 2000, inflation increased to 9.35 % and economic growth improved further to 4.9 %. The table below shows what Monetary Policies that launched by Indonesia Authority in 1997-1999:

Table 4: Indonesia Monetary Policy 1998

Economic Conditions	Monetary Policies
● Overheated economy ● Structural Weaknesses ● Foreign debt was not be hedged ● Contagion effect started from currency crisis In Thailand in July 1997 ● Banking distress : NPL increased, margin, ROA, and CAR became negative ● Bank runs in November 1997	● Tight money policy ● Closing of 16 hopeless ailing bank on November 1st 1997 (before implementing Blanket Guarantee) ● Letter of Intent with IMF: - Blanket Guarantee in January 1998 - Bailout other ailing banks - Aggressively raising interest rate ● Banking Act 1998 : Central Bank Act 1999
Economic Conditions	**Monetary Policies**
● Budget Deficits ● Public Debt US$ 60 billion	● Cutting back government spending ● Structural reform
Economic Conditions	**Monetary Policies**
● Speculation/rush in foreign exchange Market caused IDR to fall since August 1997	● Widen intervention band in July 1997 ● Floating exchange rate regime in August 1997

Indonesia's economy started to recover in 1999, indicated by declining inflation and stronger rupiah, which provided room for a phased reduction of interest rate. Significant progress was also recorded in the restructuring of bank and external debts, especially those of banks and government. With positive hindsight, it can be seen that the stock market was bullish, signaling an initial return of investor confidence in Indonesia's economy prospect. However, the process of economic stabilization and recovery in Indonesia was, in fact, slower than that in other Asian countries in crisis.

As a result, a new Central Bank act No. 23 of 1999 entered into force in 1999, when Bank Indonesia became an independent central bank, which focused on a single objective, which was to achieve and maintain IDR (Indonesia Rupiah) stability. The new Bank Indonesia Act of 1999 made a fundamental change in the conduct of monetary policy from multiple objectives using quantity targeting to single objective using price targeting, known as Inflation Targeting Framework (ITF). To further refine the efficacy of monetary management, the Bank Indonesia act of 1999 amended in 2004. Initially, Bank Indonesia implemented light ITF. Later, however, in July 2005, it implemented a full-fledged ITF, as a response to aftermath of structural changes where interest rates started to take on an increasingly important role (compared with money supply) in influencing inflation.

In July 2007, the global economy witnessed a financial crisis precipitated by the subprime mortgage crisis in the US banking system. The situation worsened in 2008, with oil price soaring up to more than US$ 100 per barrel, which further escalated to US$ 147 per barrel in July 2008 but soon after that. The crisis was first transmitted to Indonesia through the capital market. The composite stock index started around 2,700 in December 2007 become 1,241 in November 2008. The ownership share of foreign investor decreased significantly that started 66.3 % in December 2007 become 63.2 % in August 2008. In October 2008, Indonesia's currency also was depreciated by US dollar. Indonesia Rupiah (IDR) was brought down to IDR 10,995 to the US Dollar and continued to weaken further to IDR 12,151 in November 2008. As an independent monetary authority, Bank Indonesia has single objective for achieving and maintaining the stability of the rupiah by taking into account the general economic policies of the government. In 2009, the result of monetary policy were Inflation dropped to 2.78 %, GDP growth reached 4.4 %, Interest rate lowered to 6.5 %, strong exchange rate at IDR 9,300/US$ 1 and Unemployment decreased to 9.0 %.

Table 5:Indonesia Monetary Policy 2008

Economic Conditions	Monetary Policies
● Global Financial Crisis started in July 2007 ● Stock Market index started to slide since 03/2008; oil price continued to increase Drastically and reach US$ 147 in July 2008 ● Global banking systemic contagion Worsened in September 2008; tight liquidity Problem in the banking system ● Inflation pressure lessened in September 2008; many central banks started to lower their policy rates	● Tight monetary policy; gradual Bank Indonesia rate increase since May 2008 ● Eased statutory reserve requirement and Facilitating Short Term Financing for Banks That have low Capital Adequate Ratio ● BI rate increased 25 basis points in October 2008 and kept unchanged in November 2008 ● Bailout one troubled small bank in November 2008 ● Eased Monetary Policy aggressively from December 2008 until early 2010
Economic Conditions	**Monetary Policies**
● Fiscal sustainability pressure since early 2008; increased cost of subsidies	● Budget tightening by 10 % in 2008; Decreased subsidy; raised gas price in May 2008 ● Increased minimum deposit insurance 20 times ● Established Financial System Stability Committee (Finance Minister and Bank Central Governor) and necessary regulations ● Bilateral Currency Swap with China and Japan ● Lowered gas price in December 2008
Economic Conditions	**Monetary Policies**
● Capital outflow since early 2008 ● Depreciation to IDR 12, 150/US$ 1 in November 2008; increased volatility	● Stabilization policy in Foreign Exchange Market

The government responded to the crises of 1998 and 2008 in different ways. The IMF recommended that BI respond to the weakening of the rupiah by raising interest rates during the Asia Financial Crisis. Because NPLs were high, raising interest rates increased the probability of default, which led to the banking crisis. The banking crisis worsened the economy and encouraged capital outflows. This is consistent with Stiglitz and Greenwald's (2003) argument that as an economy enters a deep recession and contraction devaluation causes many firms to be distressed. In contrast with the AFC, during the global financial crisis, BI responded by lowering the interest rate and ensuring that there was enough liquidity in the financial system. As a result, the probability of default was relatively low in 2008, and the impact of NPLs on the banking sector was also relatively small.

Amid the positive momentum on multiple fronts, challenges emerged that hampered the pace of domestic economic recovery. These challenges were rooted in cyclical and structural problems, both global and domestic. To add to the complexity of the challenges, the Indonesian economy was simultaneously undergoing an adjustment phase in response to changes in the global and domestic environment. Taken together, these conditions held the domestic economy back from mounting a quick, robust recovery.

Indonesia's economic recovery progressed gradually and at the same time became more stable. Economic growth edged upwards and the structure of growth was seen in the second half of the year. Growth in 2017 was recorded at 5.07%, up slightly from 5.03% in 2016. Macroeconomic stability was also well in hand, with inflation remaining within the target range, a prudent current account deficit level and a sufficiently stable exchange rate. Financial system stability was also carefully maintained, despite unresolved challenges relating to the still-limited performance in banking intermediation.

Four main cyclical challenges impeded economic recovery in 2017. First, the normalization of monetary policy by some advanced nations presented a challenge. Global financial markets were influenced by the direction of this monetary policy normalization, most importantly that undertaken by the United States. Even though markets were generally prepared for it, pressure on global financial markets did intensify at the end of the third quarter of 2017 as the US dollar strengthened over nearly every other currency. This pressure exacerbated uncertainty on global financial markets and in capital flows and threatened to rein in a more rapid global recovery, including in Indonesia. This became a challenge which given the risk that normalization in advanced nations could cause instability by triggering a capital reversal from emerging markets, including Indonesia. Second, the limited domestic fiscal space posed a challenge. It limited the Government's capacity to create economic stimuli and to leverage positive momentum for the benefit of the domestic economy. The lack of a sizeable stimulus is explained in part by below-target taxation. In 2017, the tax ratio came to 9.9% of GDP, representing a decline compared to the preceding two years; the tax-to-GDP ratio in 2015 was 10.7% and in 2016 edged down to 10.4%. The capacity of fiscal stimulus to give a strong boost to the economic recovery was therefore limited, as evident in the dynamics of government financial operations during 2017. Third, domestic corporate consolidation had not yet fully run its course, though it is now winding down. During this period of consolidation, companies generally did not expand, but instead were focused on putting their house in order. Corporate behavior was also influenced by adverse global developments in 2016 that damaged corporate confidence and discouraged them from expanding. In addition, corporate expansion plans were stifled by the modest fiscal stimulus and the still-sluggish household consumption. At the same time, bank intermediation underperformed, hitting corporate business financing and in turn impacting on corporate expansion. These factors led to inadequate levels of domestic non-construction investment, particularly in the first half of 2017. This was cause for concern because incorrect handling could have hampered the recovery process. For these reasons, short-term measures were taken to boost the confidence of domestic economic actors at a time when Indonesia was receiving positive recognition from abroad for the improvement in its economic fundamentals. Fourth, as noted above, banking intermediation had not fully recovered, limiting the driving force of the economy. Slackness in credit growth was the result of both demand- and supply-side factors. On the demand side, the incomplete corporate consolidation slowed business expansion and therefore also demand for credit. At the same time, banks remained cautious and selective in extending new loans and continued to apply high lending standards.

II.1.1 Policy Response in 2017

Macroeconomic policy responses in 2017 aimed to optimize the momentum for recovery, while reinforcing the economy at a structural level. To this end, the policy synergy forged in 2017 by Bank Indonesia, the Government and the Financial Services Authority (OJK) targeted three key areas. First, policies sought to mitigate cyclical risks from the global and domestic environment in order to safeguard macroeconomic and financial system stability as a basis for building economic growth. Second, policies were aimed at accelerating the completion of the domestic economic consolidation process in order to promote economic recovery. Third, policies were designed to correct a range of structural problems in the domestic economy. At the national level, the macroeconomic policy management responses were pursued through synergy that brought together fiscal, monetary, macro and micro prudential and structural reform policies, including in the payment system and currency management.

The Government pursued a fiscal policy focused on stimulating the economy while safeguarding the fiscal sustainability outlook. In this regard, the thrust of the strategy for the state budget was threefold namely: optimizing revenues, improving the quality of expenditure and managing financing efficiently and sustainably. To this end, government spending was allocated to productive sectors, efficiencies were made in non-priority spending and a better fiscal balance between the central government and the regions was encouraged. This strategy was marked by increased infrastructure spending, which reached

19.4% of the state budget in 2017. This represents a twofold increase compared with 2013 –before state subsidies were reformed and infrastructure was accounted for only 9.4% of the state budget.

The strategy of increasing infrastructure expenditure was balanced with short-term stimuli that would immediately support the domestic economic recovery. The Government increased the budget for national priority and social safety net programs; social assistance was increased to IDR55.3 trillion, 11.5% higher than realized spending in 2016. At a practical level, more of the social assistance was disbursed during the second half of 2017, a factor that helped spur consumption during that period.

Efforts to create greater space for fiscal stimulus were, however, impeded by underperforming tax revenues. In 2017, tax revenues came in below the targets set in the 2017 Revised State Budget. Consequently, overall government spending was reined in to safeguard fiscal sustainability. This strategy ensured the 2017 fiscal deficit remained at a prudent and safe level of 2.5% of GDP, below the revised target of 2.9% of GDP. The deficit was financed by issuing government securities and by foreign debt. To improve the efficiency of financing, the Government carefully managed the denomination, timing and tenor of issuances of government securities. Accordingly, official debt was maintained at a low, prudent level of 29.2% of GDP.

Bank Indonesia’s exchange rate policy sought to keep movement in the rupiah in line with fundamentals by promoting the operation of market mechanisms. Exchange rate policy was reinforced by improvements in the foreign exchange supply and demand structure, mandatory use of the rupiah in Indonesian national territory and the Implementing Activities for Prudential Principles (KPPK) for external debt management. These principles include the obligation for non-bank corporate with external debt exposure to comply with the hedging ratio, the minimum liquidity ratio and the minimum credit rating. This regulation is intended to mitigate exchange rate risk, liquidity risk and over leverage risk relating to external debt obligations. Bank Indonesia also expanded the range of instruments available on the foreign exchange market by issuing financial instruments in non-US dollar currencies. In addition, Bank Indonesia also promoted the use of local currency settlement (LCS) in trading transactions in order to reduce dependence on one particular currency. Exchange rate policy was also bolstered by strengthening of external sector resilience through adequate levels of international reserves, the first line of defense. Further, the role of the international financial safety net as the second line of defense was expanded.

Indonesia’s economic growth improved gradually in 2017, but with recovery at a slow pace. In 2017, GDP growth was recorded at 5.07%, up slightly from the 2016 growth of 5.03%. GDP expansion was mainly evident in the second half of 2017, buoyed by exports and investment. Exports increased by a substantial margin, driven by the positive momentum in the world economy. This strengthening in external demand contributed to an easing of the corporate consolidation process and created space for corporations to expand. Brisk investment also received impetus from the fiscal stimulus, particularly in the second half of 2017 when work moved forward on various infrastructure projects. The increase in exports and investment, however, did not have an optimal effect in accelerating value creation in the domestic economy because, as in the past, some of this increase was offset by imports.table below shows Indonesia Domestic Indicators since 2015 until 2017

Table 6: Indonesia Domestic Indicators 2015-2017

Component	2015	2016	2017
Economic Growth (%, yoy)	4.88	5.03	5.07
Household Consumption (%, yoy)	4.96	5.01	4.95
Government Expenditure (%, yoy)	5.32	-0.14	2.14
Investment (%, yoy)	5.01	4.47	6.15
Building Investment (%, yoy)	6.11	5.18	6.24
Non-Building Investment (%, yoy)	1.93	2.43	5.9
Export (%, yoy)	-2.12	-1.57	9.09
Import (%, yoy)	-6.25	-2.45	8.06
CPI Inflation (%, yoy)	3.35	3.02	3.61
Core Inflation (%, yoy)	3.95	3.07	2.95
Volatile Food Inflation (%, yoy)	4.84	5.92	0.71
Administered Price Inflation (%, yoy)	0.39	0.21	8.70
Indonesia Balance of Payment			
Current Account Deficit (% GDP)	2.0	1.8	1.7
Overall Balance (Billion US$)	-1.1	12.1	11.6
Reserve Assets (Billion US$)	105.9	116.4	130.2
Exchange Rate (Average, Rp/US$)	13,392	13,305	13,385
Jakarta Composite Index (JCI)	4,593	5,297	6,356
Government Bond Yield 10 years (%)	8.76	7.97	6.32
Banking			
Total Credit (%, yoy)	10.4	7.9	8.2
CAR (end of period, %)	21.2	22.7	23.0
NPL (end of period, %)	2.5	2.9	2.6
State Budget			
Tax (%GDP)	10.7	10.4	9.9
State Budget Deficit (% GDP)	2.6	2.5	2.5

Source: Indonesia Statistic 2018, Bank Indonesia, Ministry of Finance, Financial Service Authority and Indonesia Stock Exchange

The recovery in the domestic economy had a positive impact on the quality of growth, which was accompanied by declining unemployment and a fall in poverty, albeit with a relatively flat Gini ratio. With the onset of improvement in the economy, unemployment eased slightly to 5.5% in August 2017 versus 5.6% in August 2016. The decline in unemployment is explained in part by advancements in digital technology. Its widespread use in economic activities created more job opportunities and provided a buffer against the downturn in formal employment in leading sectors, such as agriculture, mining and construction. This shift in employment also led to improvement in poverty figures. In 2017, the proportion of citizens living in poverty was recorded at 10.1%, representing an improvement over 10.7% in 2016. There was only limited amelioration of disparities, however, as evident from the Gini ratio that reached 0.391 or only slightly below the 2016 level of 0.394.

II.1.2 International Environment

In general, the policy responses of most countries were oriented towards accelerating the economic recovery and maintaining momentum, while taking into account local dynamics. In terms of monetary policy, several advanced economies gradually sought to normalize in response to the solid economic recovery and the rising inflation outlook. Meanwhile, most emerging market economies (EMEs) adopted monetary policy easing to support the economic recovery. The table below shows the World Economic Growth by Representative of Advanced Countries and Emerging Countries:

Table 7: World Economic Growth by Representative of Advanced and Emerging Countries

(%)

GROUP OF COUNTRIES	2015	2016	2017
Major Industrial Countries			
USA	2.90	1.60	2.20
Euro Area			
Germany	1.30	1.90	2.80
France	1.00	1.20	2.80
Italy	0.92	1.15	1.57
Japan	1.38	0.98	1.78
United Kingdom	2.30	1.80	1.70
Canada	1.01	1.41	3.05
Selected European Countries			
Russia	-2.50	-0.20	1.50
Turkey	5.92	3.22	7.36
Asia			
People's Republic of China	6.90	6.70	6.90
South Korea	2.80	2.90	3.10
Hong Kong SAR	2.40	2.20	3.80
Taiwan, Province of China	0.81	1.41	2.89
India	7.40	8.20	7.10
ASEAN-5 Countries			
Indonesia	4.88	5.03	5.07
Malaysia	5.10	4.20	5.90
Philippines	6.10	6.90	6.70
Singapore	-0.52	-0.53	0.59
Thailand	3.00	3.30	3.90
Australia	**2.48**	**2.58**	**2.23**
Central and South America			
Argentina	2.73	-1.82	2.85
Brazil	-3.54	-3.46	0.99
Mexico	2.60	2.30	2.00
South Africa	**1.35**	**0.55**	**1.30**

Source: Bank Indonesia, 2018

On the fiscal side, many advanced and EME governments played a dominant role in stimulating the economy, although some countries were unable to do this as they lacked the fiscal space. The global recovery also prompted structural reforms aimed at enhancing productivity, overcoming labor market constraints and increasing future economic growth. In addition, international cooperation played a key role in achieving robust, sustained, balanced, inclusive and resilient economic growth.

In the years before the Asian Financial Crisis, Indonesia appeared to be distinctly outward looking. Economic reforms accelerated in the 1980s—spurred by oil price volatility and the recognition of the economy's acute dependence on oil and other commodities—spanning trade, banking, investment, and capital account liberalization and the hallmarks of globalization. Foreign investors, attracted by strong fundamentals, including robust growth, low inflation, and the promise of commodity wealth, funded external deficits via long-term foreign direct investment (FDI) and banking flows. Growth was strong, averaging 7.3 percent per year in 1987–97. Cross-border trade and financial links, while not accelerating quite as rapidly as in the Asian Tigers, rose steadily through the 1990s.

With the onset of the Asia Financial Crisis in 1997, Indonesia began a striking turnaround.5 However, the country's trade and financial exposure did not follow the strong recovery and robust growth that occurred after the crisis. As a result, in relation to the size of its economy, Indonesia's trade and financial integration with the world steadily declined.

The strengthening pace of global economic recovery in 2017 saw global GDP growth rise to 3.7% in 2017 from 3.2% in 2016. A faster pace of recovery in the advanced economies and ongoing recovery in developing economies supported this global growth, with the sources of growth expanding from consumption to investment. This stronger investment stimulated growth in world trade volumes, which increased to 4.5% in 2017 from just 1.5% in 2016. This in turn prompted international commodity prices rise, particularly energy and metals. These positive global developments improved the dynamics of global financial markets, as did the reduction in risks in comparison with 2016.

Most policy responses were aimed at building momentum in the economic recovery and ensuring it was sustainable, while taking into account local dynamics and challenges. The majority of advanced economies, including Japan, maintained their accommodative monetary policies, underpinned by fiscal stimuli and structural reforms. Nonetheless, some advanced economies, including the United States, began to gradually normalize monetary policy. The role of fiscal stimulus in advanced economies has expanded, because there is little room to maneuver within the sphere of the accommodative monetary policy. On the other hand, emerging market economies maintained their accommodative monetary policies, bolstered by increasing fiscal stimulus. In addition, both advanced and developing economies continued to implement structural reforms to foster sustainable economic growth in the long term.

The policy responses in emerging economies included a mix of monetary, fiscal, and structural policies. In terms of monetary policy, emerging economies generally adopted an accommodative policy stance, with most reducing their policy rate in response to controlled inflation and restrained economic recoveries. This was seen in Brazil, Russia, Colombia, Peru, and Indonesia.In contrast, other emerging economies, including Mexico and Turkey, opted to raise their policy rates in response to inflationary pressures coming from exchange rate depreciation. On the fiscal front, emerging economies generally maintained an expansionary policy, while structural policies were aimed at boosting productivity in the medium to long term.

International cooperation strengthened in 2017 to optimize the global economic recovery and reinforce economic resilience. International cooperation was realized through the G20 Forum, International Monetary Fund (IMF) and Bank for International Settlements and Chiang Mai Initiative Multi lateralization (CMIM). At the G20, cooperation to build on the momentum in the global economic recovery manifested in a commitment to stimulate strong, sustained, balanced and inclusive growth. The IMF emphasized the importance of monetary policy, fiscal policy and structural reforms to maintain economic growth momentum. Meanwhile, efforts to strengthen economic resilience were realized through: agreement concerning the Note on Resilience Principles for G20 Economies, strengthening the Global Financial Safety Net (GFSN), including through the CMIM and increasing oversight of financial technology development at various international forums.

Economic and financial sector resilience has also been strengthened in ASEAN by the regional grouping’s ongoing financial sector integration. ASEAN aims for economic integration in 2025 – the ASEAN Economic Community – particularly in the financial channel, and has set a strategic action plan for financial integration in 2025. In 2017, ASEAN compiled key performance indicators to evaluate the progress towards financial integration. These indicators are divided into three sections – financial integration, financial inclusion, and financial stability.

The policy priorities for Indonesia and the other ASEAN-5 (Indonesia, Malaysia, Singapore, Philippines and Thailand) economies include enhancing resilience to external shocks, rebuilding or protecting policy buffers, and addressing bottlenecks to growth. To enhance resilience, these economies should diversify their exports and trading partners and reduce external vulnerabilities such as high current account deficits, large external debt, or currency and maturity mismatches in the domestic financial market. Policy buffers should be protected or rebuilt to increase the room for maneuver in response to external shocks. These adjustments include lowering fiscal deficits and public debt, enhancing the transmission of monetary policy, and modernizing the macro prudential framework. Countries should also tackle bottlenecks to growth by improving infrastructure and education quality and streamlining regulations to enhance the business climate and promote domestic sources of growth.

II.1.3 Indonesia Balance of Payment (BOP)

The balance of payments (BOP), also known as balance of international payments, summarizes all transactions that a country's individuals, companies and government bodies complete with individuals, companies and government bodies outside the country. These transactions consist of imports and exports of goods, services and capital, as well as transfer payments such as foreign aid and remittances. Balance of payments and international investment position data are critical in formulating national and international economic policy. Certain aspects of the balance of payments data, such as payment imbalances and foreign direct investment, are key issues that a nation's policymakers seek to address

The global economic recovery and growing optimism concerning the domestic economic outlook strengthened Indonesia’s balance of payments (BOP) in 2017. The BOP recorded another surplus in 2017, backed by a healthy current account and an influx of foreign capital flows in the form of a significant capital and financial account surplus. The current account deficit fell to 1.7% of GDP in 2017, down from 1.8% of GDP in 2016, as exports increased to meet global demand and international commodity prices rose. Nevertheless, the export gains still relied on commodity based exports, while manufacturing export growth was restrained. At the same time, rising imports were subdued given the slow nature of the domestic economic recovery. Meanwhile, the capital and financial account recorded a significant surplus, driven by a sharp increase of nonresident capital inflows in the form of direct investment and portfolio investment

Such dynamics confirmed the favorable perception of non-resident investors concerning the domestic economy, leading to an increase of placements in Indonesia. BOP performance has effectively reinforced external sector resilience, with several of the relevant indicators improving on their positions in the previous year. Furthermore, the BOP surplus nudged-up the position of international reserves to US$130.2 billion in 2017, representing an all-time high for Indonesia. This position of international reserves was equivalent to 8.6 months of imports or 8.3 months of imports and servicing of government external debt, well above the international standard of three months. The basic balance also registered a surplus in 2017, reversing the deficit recorded in 2016, in line with the controlled current account deficit and the increasing sources of long-term financing. External debt indicators were also sound, with the external debt-to-GDP ratio remaining within a safe threshold at 34.7%, relatively stable on the 34.3% posted in 2016 and consistent with other peer countries. The composition of external debt was also sound, with long-term external debt dominating at 86.1% of the total. The table below shows Indonesia’s Balance of Payment from 2015 until 2017:

Table 8: Indonesia’s Balance of Payment 2015-2017

(million US$)

ITEMS	2015	2016	2017
I. Current Account	**-17,519**	**-16,952**	**-17,307**
A. Goods	14,049	15,318	18,785
- Exports, fob	149,124	144,470	168,854
- Imports, fob	-135,076	-129,152	-150,069
1. General Merchandise	13,319	14,744	17,886
- Exports	147,725	143,105	166,973
- Imports	-134,406	-128,360	-149,087
a. Non-Oil and Gas	19,023	19,516	25,236
- Exports	130,541	130,188	151,400
- Imports	-111,518	-110,672	-126,164
b. Oil and Gas	-5,703	-4,772	-7,349
- Exports	17,184	12,916	15,573
- Imports	-22,887	-17,688	-22,922
2. Other Goods	730	574	899
- Exports	1,400	1,365	1,881
- Imports	-670	-792	-982
B. Services	-8,697	-7,084	-7,834
- Exports	22,221	23,324	24,794
- Imports	-30,918	-30,407	-32,628
C. Primary Income	-28,379	-29,647	-32,756
- Receipts	2,822	4,048	6,550
- Payments	-31,201	-33,695	-39,306
D. Secondary Income	5,508	4,460	4,498
- Receipts	10,362	9,832	9,990
- Payments	-4,853	-5,371	-5,493
II. Capital Account	**17**	**41**	**46**
- Receipts	17	41	46
- Payments	-	-	-
III. Financial Account	**16,843**	**29,306**	**29,356**
- Assets	-21,489	15,920	-18,236
- Liabilities	38,332	13,386	47,592

1. Direct Investment	10,704	16,136	19,285
a. Assets	-9,075	11,594	-2,134
b. Liabilities	19,779	4,542	21,419
2. Portfolio Investment	16,183	18,996	20,899
a. Assets	-1,268	2,218	-3,356
b. Liabilities	17,451	16,778	24,255
- Public Sector	17,386	16,835	21,880
- Private Sector	65	-57	2,375
3. Financial Derivatives	20	-9	-128
4. Other Investment	-10,064	-5,817	-10,700
a. Assets	-11,812	1,499	-13,187
b. Liabilities	1,748	-7,316	2,488
- Public Sector	-190	-2,369	-1,353
- Private Sector	1,938	-4,947	3,840
IV. Total (I + II + III)	**-659**	**12,394**	**12,095**
V. Net Error and Omissions	**-439**	**-305**	**-509**
VI. Overall Balance (IV + V)	**-1,098**	**12,089**	**11,586**
VII. Reserves and Related Items [3]	**1,098**	**-12,089**	**-11,586**
A. Reserve Asset Transactions	1,098	-12,089	-11,586
B. Credit and Loans with IMF	-	-	-
C. Exceptional Financing	-	-	-
Memorandum:			
- Reserve Assets Position	105,931	116,362	130,196
In Months of Imports & Official Debt Repayment	7.39	8.42	8.27
- Current Account (% GDP)	-2.03	-1.82	-1.7
- Debt Service Ratio (%)	-	-	-
O/w Government & Monetary Authority DSR (%)	-	-	-

Source: Bank Indonesia, 2018

Such dynamics confirmed the favorable perception of non-resident investors concerning the domestic economy, leading to an increase of placements in Indonesia. BOP performance has effectively reinforced external sector resilience, with several of the relevant indicators improving on their positions in the previous year. Furthermore, the BOP surplus nudged-up the position of international reserves to US$130.2 billion in 2017, representing an all-time high for Indonesia. This position of international reserves was equivalent to 8.6 months of imports or 8.3 months of imports and servicing of government external debt, well above the international standard of three months. The basic balance also registered a surplus in 2017, reversing the deficit recorded in 2016, in line with the controlled current account deficit and the increasing sources of long-term financing. External debt indicators were also sound, with the external debt-to-GDP ratio remaining within a safe threshold at 34.7%, relatively stable on the 34.3% posted in 2016 and consistent with other peer countries. The composition of external debt was also sound, with long-term external debt dominating at 86.1% of the total.

II.1.4 Current Account

In 2017, current account performance improved as the deficit narrowed, supported by commodity prices that have been rising since the middle of 2016. Consequently, the current account deficit stood at US$ 17.3 billion in 2017, or - 1.7% of GDP, the lowest level on record in the past six years. The healthy current account deficit was supported by a larger goods trade surplus, particularly non-oil and gas. The non-oil and gas trade surplus soared 30.4% in 2017 on increasing export value, as international commodity prices continued to rise and demand increased from Indonesia's major trading partners. However, the robust export gains were remained depend on commodity-based exports, although several manufacturing products did begin to show early signs of improvement.

The surge of non-oil and gas exports spurred a narrower current account deficit, countering the growth in non-oil and gas imports, a persistent oil and gas trade deficit, and deficits in the services and primary income accounts. Measured increases of non-oil and gas imports was reported, however these were predominantly raw materials and capital goods for investment purposes, needed to feed rising exports and growing domestic demand. The oil and gas deficit widened, due to the higher global oil price, rising fuel consumption, and declining domestic crude oil production. Meanwhile, the larger deficits recorded in the primary income and services trade accounts stemmed from high revenue payments on non-resident investments and freight services payments on imported goods.

II.1.5 Trade Balance

The non-oil and gas trade balance improved in 2017, underpinned by the ongoing global economic recovery and rising international commodity prices. Higher commodity prices strengthened the terms of trade and raised the value of non-oil and gas exports from Indonesia, as demand grew from the country's major trading partners. The non-oil and gas trade surplus stood at US$ 26.2 billion in 2017, up from US$ 20.1 billion in 2016.Dominated by crude palm oil (CPO), the increase of vegetable oil exports was triggered by stronger CPO demand, despite rising prices. Growing demand for CPO was heightened by lower production of soybean, which is a viable substitute for CPO, due to inclement weather. Demand mainly originated from the usual major export destinations for CPO, including India, China, Pakistan and the Netherlands. Vegetable oil exports to India went into the manufacturing sector, primarily as cooking oil, while in China, the Government sought to maintain domestic inventories of CPO, which it uses in part as a constituent of biodiesel.

The oil and gas trade balance declined on the rising global oil price due to Indonesia's status as a net importer. The oil and gas trade deficit stood at US$ 7.3 billion in 2017, up from US$ 4.8 billion in 2016 with the oil trade deficit the primary contributor. The higher global oil price pushed up the value of oil imports to Indonesia, and the growing gas trade surplus was insufficient to offset this. A wider oil trade deficit was a key driver of the growing oil and gas trade deficit. The oil trade deficit swelled to US$ 12.8 billion in 2017 from US$ 9.7 billion in 2016, as the value of oil imports increased due to stronger domestic demand and rising global oil prices. Oil imports were recorded at US$ 20.3 billion in 2017, up from US$ 15.9 billion in 2016. Furthermore, fuel consumption increased 4.1% on the previous year, primarily for transport and industry. In contrast, oil exports were subdued as lifting of crude oil fell to just 803,000 barrels per day from 829,000 barrels per day in 2016, and as a growing portion of domestic crude oil was used domestically by Indonesia's refineries. However, the larger gas trade surplus curbed the growing oil and gas trade deficit. The gas trade surplus stood at US$ 5.5 billion in 2017, up from US$ 4.9 billion in 2016; it was boosted by higher export values of liquefied natural gas and natural gas, as gas prices mirrored the rise in the oil price. The Table shows Indonesia's Trade Balance since 2015 until 2017 as below:

Table 9: Indonesia's Trade Balance 2015-2017

(million US$)

ITEMS	2015	2016	2017
Goods	14,049	15,318	18,785
- Exports	149,124	144,470	168,854
- Imports	-135,076	-129,152	-150,069
A. General merchandise	**13,319**	**14,744**	**17,886**
1. Non-oil and gas	**19,023**	**19,516**	**25,236**
a. Exports	130,541	130,188	151,400
b. Imports	-111,518	-110,672	-126,164
2. Oil	**-13,106**	**-9,680**	**-12,816**
a. Exports	7,833	6,267	7,503
b. Imports	-20,938	-15,947	-20,319
3. Gas	**7,402**	**4,908**	**5,467**
a. Exports	9,351	6,649	8,070
b. Imports	-1,949	-1,741	-2,604
B. Other goods	**730**	**574**	**899**
o/w Nonmonetary gold	730	574	899
a. Exports	1,400	1,365	1,881
b. Imports	-670	-792	-982
Memorandum:			
1. Nominal			
a. Total exports (fob)	149,124	144,470	168,854
- Non-oil and gas	131,941	131,554	153,281
- Oil and gas	17,184	12,916	15,573
b. Total imports (fob)	-135,076	-129,152	-150,069
- Non-oil and gas	-112,189	-111,464	-127,146
- Oil and gas	-22,887	-17,688	-22,922
2. Growth (%, yoy)			
a. Total exports (fob)	-14.93	-3.12	16.88
- Non-oil and gas	-9.96	-0.29	16.52
- Oil and gas	-40.24	-24.83	20.57
b. Total imports (fob)	-19.75	-4.39	16.20
- Non-oil and gas	-12.17	-0.65	14.07

- Oil and gas	-43.60	-22.72	29.59
3. Crude oil unit prices (USD/barrel)	48.79	39.27	51.12
4. Crude oil production (million barrels per day)	0.79	0.83	0.80

Source: Bank Indonesia, 2018

II.1.6 Service Account, Primary Income Account and Secondary Income Account

The positions of the services account and primary income account deteriorated in 2017, exacerbating pressures on the current account. The larger primary income account deficit had a larger impact on the current account deficit than other components, due to the high level of revenue payments on international direct investment. Pressures on the current account deficit also originated from a larger services account deficit compared with 2016, caused by freight services payments. On the other hand, the position of the secondary income account remained relatively stable in line with steady remittances.

The primary income account deficit increased in 2017, but the revenue payment structure improved. The primary income account deficit stood at US$ 32.8 billion in 2017, up from US$ 29.6 billion in 2016. An increase in the position of foreign financial liabilities to meet growing demand for financing contributed to the larger primary income account deficit. Foreign financial liabilities increased despite competitive domestic financial returns, culminating in an uptick of revenue payments on foreign investments. Notwithstanding the increase, the payment structure improved through an increase in reinvested earnings. Dividend payments continued to dominate the total primary income account deficit, albeit with a declining value on the previous period. Furthermore, increasing interest payments on government debt securities, primarily government debt securities (SUN) and global bonds also influenced primary income account performance.

The services account deficit increased 11.0% to US$ 7.9 billion in 2017 from US$ 7.1 billion in 2016. The larger deficit was attributed to a wider transport services trade deficit, primarily freight services payments that correlate positively with world trade activity. Nevertheless, a higher services trade deficit was countered by an increase in travel services receipts as the number of international travelers visiting the Indonesian archipelago continued to soar.

The persistent transport services trade deficit in Indonesia is linked to longstanding structural issues, in particular in freight services, which must rely on foreign modes of transport, especially sea transport, to facilitate international trade. Domestic freight services are unable to compete with their foreign counterparts, due to a lack of supporting infrastructure, in terms of the number and quality of ships and an underdeveloped domestic shipbuilding industry. Consequently, any increase in international trade – particularly of imports, which use mostly foreign freight services – exacerbates the freight services deficit. In 2017, goods imports grew 16.1% and freight services payments rose 13.2%. Consequently, the ratio of freight imports to imports remains high at around 5%, while the ratio of freight exports to exports is very small at around 1% or less. In contrast, the travel services trade surplus increased in 2017 as the number of international travelers visiting Indonesia increased sharply. Travel services receipts stood at USD4.2 million in 2017, up from USD3.6 million in 2016, backed by a steep 12.3% rise in the number of international travelers visiting Indonesia to 12.2 million. Most international travelers in 2017 originated from China, Singapore, Australia, and Malaysia.

The secondary income account surplus was relatively unchanged from 2016 to 2017 due to a stable surplus of remittances. While the number of Indonesian migrant workers (TKI) in the informal sector fell slightly, the number of TKI in the formal and professional sectors rose. The total number of TKI fell slightly to 3.50 million in 2017 from 3.51 million in 2016 as a result of a moratorium put in place in 2014. The decline affected Indonesian migrant workers (TKI) in the informal sector but, in contrast, increases were recorded in the formal and professional sectors. In addition, the average salary of professional TKI increased, particularly for those working in the Asia-Pacific region. Consequently, total remittances rose moderately to US$ 8.8 billion in 2017 from US$ 8.7 billion in 2016. However, remittances sent abroad from foreign workers placed in Indonesia also increased. Such dynamics sustained the secondary income account surplus at around US$ 4.5 billion in 2017, relatively unchanged on the previous period.

Table 10: Indonesia's Service Account 2015-2017

(million US$)

ITEMS	2015	2016	2017
Services			
- Exports	22,221	23,324	24,794
- Imports	-30,918	-30,407	-32,628
A. Manufacturing services	356	351	354
- Exports	356	351	354
- Imports	-	-	-
B. Maintenance and repair services	-340	-353	-178
- Exports	284	411	169
- Imports	-624	-764	-348
C. Transport	-6,146	-5,544	-6,864
- Exports	3,456	3,572	3,472
- Imports	-9,602	-9,116	-10,336
a. Passenger	-1,215	-1,006	-1,105
- Exports	1,293	1,360	1,552
- Imports	-2,508	-2,366	-2,656
b. Freight	-5,204	-4,387	-5,582
- Exports	1,406	1,676	1,283
- Imports	-6,610	-6,064	-6,865
c. Other	273	-151	-178
- Exports	758	536	637
- Imports	-484	-687	-815
D. Travel	3,469	3,639	4,242
- Exports	10,761	11,206	12,531
- Imports	-7,292	-7,566	-8,289
E. Construction	-74	93	183
- Exports	379	226	369
- Imports	-453	-133	-186
F. Insurance and pension services	-888	-661	-647
- Exports	54	80	83
- Imports	-942	-741	-730
G. Financial services	-497	-577	-442
- Exports	248	336	640
- Imports	-744	-913	-1,081
H. Charges for the use of intellectual property	-1,601	-1,686	-1,801
- Exports	52	47	50
- Imports	-1,653	-1,732	-1,851
I. Telecommunications, computer, and information services	-820	-1,175	-1,416
- Exports	971	970	1,012
- Imports	-1,791	-2,146	-2,428
J. Other business services	-2,670	-1,836	-1,947
- Exports	4,917	5,359	5,261
- Imports	-7,587	-7,194	-7,208
K. Personal, cultural, and recreational services	45	36	74
- Exports	111	89	131
- Imports	-67	-53	-57
L. Government goods and services	469	630	607
- Exports	632	678	723
- Imports	-163	-48	-115
Memorandum:			
Number of traveler (thousands of people)			
- Inbound	9,794	10,860	12,199
- Outbound	8,345	8,509	9,077

Source: Bank Indonesia. 2018

Table 11: Indonesia's Primary Income Account 2015-2017

(million US$)

ITEMS	2015	2016	2017
Primary Income	-28,379	-29,647	-32,756
- Receipts	2,822	4,048	6,550
- Payments	-31,201	-33,695	-39,306
A. Compensation of employees	-1,361	-1,553	-1,509
- Receipts	213	219	226
- Payments	-1,574	-1,772	-1,735
B. Investment income	-27,018	-28,094	-31,248
- Receipts	2,609	3,829	6,324
- Payments	-29,627	-31,923	-37,571
a. Direct investment income	-18,504	-17,593	-20,161
1) Income on equity capital	-17,081	-16,557	-19,203
- Receipts	72	1,101	2,976
- Payments	-17,153	-17,658	-22,179
2) Income on debt (interest)	-1,423	-1,036	-957
- Receipts	16	74	14
- Payments	-1,440	-1,109	-971
b. Portfolio investment income	-6,460	-8,318	-8,837
1) Income on equity capital	-1,936	-1,920	-2,457
- Receipts	283	828	395
- Payments	-2,219	-2,748	-2,852
2) Income on debt (interest)	-4,525	-6,398	-6,380
- Receipts	1,812	1,134	2,157
- Payments	-6,337	-7,532	-8,537
c. Other investment income	-2,053	-2,183	-2,250
- Receipts	426	694	782
- Payments	-2,479	-2,876	-3,032

Source: Bank Indonesia. 2018

Table 12: Indonesia's Secondary Income Account 2015-2017

(million US$)

ITEMS	2015	2016	2017
Secondary Income	5,508	4,460	4,498
- Receipts	10,362	9,832	9,990
- Payments	-4,853	-5,371	-5,493
A. General government	149	365	411
- Receipts	150	366	416
- Payments	-1	-1	-5
B. Other sectors	5,360	4,095	4,087
1. Personal transfers	6,415	5,309	5,316
- Receipts	9,447	8,687	8,785
- Payments	-3,031	-3,378	-3,468
2. Other current transfers	-1,056	-1,214	-1,230
- Receipts	765	778	790
- Payments	-1,821	-1,992	-2,019
Memorandum:			
- Number of Indonesian migrant worker/TKI (thousands of people)	3,686	3,511	3,496
- Number of foreign migrant worker/TKA (thousands of people)	86	97	96

Source: Bank Indonesia. 2018

II.1.7 Capital and Financial Account

The capital and financial account surplus increased in 2017, bolstered by the favorable investor perception of Indonesia's promising domestic economic outlook, coupled with milder global risks. The capital and financial account surplus stood at US$ 29.9 billion in 2017, up from

US$ 29.3 billion in 2016 and they were underpinned by growing direct investment and portfolio investment surpluses. Conversely, other investments recorded a larger deficit, which stifled further capital and financial account gains.

The improvement in the capital and financial account surplus was associated with the vibrant domestic economy, which in turn elevated investors' perception of the national economic outlook.

Domestic economic indicators boosted the upbeat mood of global investors, as reflected by the Standard & Poor’s affirmation of investment grade status for Indonesia in May 2017.

Furthermore, a climate increasingly conducive to investment was also evidenced by the latest World Bank survey on the ease of doing business, in which Indonesia climbed to 72 in 2018 from 91 in 2017. Moreover, the successful tax amnesty, the impact of which was still being felt in the latter half of 2017, also boosted capital and financial account performance. The influx of nonresident capital was maintained as a result of conducive external dynamics, while the impact of gradual monetary policy normalization, in line with market expectations, is expected to have only a limited impact on financial market volatility.

II.1.8 Investment

Investment is expected to continue expanding, mainly supported by building investment. Building investment posted solid gains on the back of the government inclination to spend, especially capital spending, which increased as of August 2017 on the same period last year. Private investment also increased in the form of electricity and road infrastructure projects by state owned enterprises as well as the development of affordable housing. Moreover, cement sales accelerated at the beginning of the third quarter of 2017, indicating stronger building investment in the reporting period. Investment was also buoyed by non-building investment. With China and India seeing unprecedented growth over the past decade, global trade has increasingly pivoted towards Asia, putting ASEAN in a favorable position to capitalize on new regional opportunities. Official integration of the ASEAN Economic Community (AEC) is set to have a dramatic impact on future trade growth, both within ASEAN and beyond. Indonesia’s population and economy are the largest in the AEC, creating opportunities as regional integration unfolds. Investment is expected to rise as foreign companies seek to access the domestic consumer base, while export revenues could benefit from easier access to new markets.

II.1.9 Direct Investment

Non-resident capital flows in the form of direct investment hit an all-time high in 2017. Net direct investment grew 24.9 % to US$ 20.2 billion, backed by a surge of nonresident capital inflows to Indonesia coupled with a low level of direct international investments by Indonesian residents.

The foreign direct investment (FDI) into Indonesia was drawn to acquisitions and global bond issuances through affiliate companies abroad. In 2017, FDI placements in Indonesia increased to US$ 22.1 billion, exceeding the average for the period from 2010 to 2015. The influx of direct investment was primarily drawn to the non-oil and gas sector, driven by acquisitions of several domestic e-commerce firms by non-resident investors. In total, four e-commerce firms were purchased by investors from China, the United States, and Singapore. In addition to acquisitions, global bond issuances through offshore special purpose vehicles also spurred an upswing of FDI to Indonesia. In contrast, direct investment in the oil and gas sector recorded a net outflow, with interest in investments in this sector muted.

By origin, Singapore, Europe, Japan, and China were the dominant FDI investors, with the total value in 2017 reaching US$ 22.8 billion. Conversely, direct investment from the United States recorded a net outflow totaling US$ 2.5 billion in 2017, a wider outflow than in 2016. By economic sector, the manufacturing, trade, fisheries, and financial sectors absorbed most FDI realization in 2017, accounting for 82.4% of total FDI entering Indonesia. Specifically, manufacturing absorbed USD$ .6 billion, trade US$ 4.9 billion, fisheries US$ 3.5 billion, and financial sectors US$ 1.0 billion.

On the asset side, the net direct investment outflow by Indonesian residents abroad was not significant. The latest developments pointed to a net outflow of just US$ 1.9 billion in 2017, reversing the net inflow recorded in 2016 and below the average outflow from 2010 to 2015 of US$ 8.5 billion. The 2017 flows were dominated by placements in the non-oil and gas sector. The table shows Indonesia’s Direct Investment from 2015 until 2017 as below:

Table 13: Indonesia's Direct Investment 2015-2017

(million US$)

ITEMS	2015	2016	2017
Direct Investment	**10,704**	**16,136**	**19,285**
A. Assets	-9,075	11,594	-2,134
1. Equity capital	-7,998	10,676	-2,729
2. Debt instruments	-1,076	919	595
B. Liabilities	19,779	4,542	21,419
1. Equity capital	18,822	4,684	19,738
2. Debt instruments	957	-142	1,681
a. Inflow	75,588	50,638	49,404
b. Outflow	-74,631	-50,780	-47,723
Memorandum:			
Direct investment based on directional principle	10,704	16,136	19,285
A. Direct investment abroad	-5,937	12,215	-2,642
1. Equity capital	-4,237	12,058	-2,698
2. Debt instruments	-1,700	156	56
B. Direct investment in Indonesia	16,641	3,921	21,927
1. Equity capital	15,060	3,301	19,706
2. Debt instruments	1,581	620	2,220

Source: Bank Indonesia, 2018

II.1.10 Portfolio Investment

Both domestic and external factors in 2017 led to a larger portfolio investment surplus than seen in 2016. The net portfolio investment surplus stood at USD20.7 billion in 2017, up from USD19 billion in 2016, pushed up by non-resident capital inflows to the public sector. The surplus was also prompted by an upbeat mood among economic participants concerning the promising domestic economic outlook, together with attractive returns and milder pressures in the global financial markets.

Long-term rupiah government debt securities and global bonds were the dominant instruments favored as nonresident portfolio investment. In 2017, all government portfolio instruments recorded a significant net inflow. Non-resident investors booked a net buy of SUN totaling US$ 10.4 billion, up from US$ 8.4 billion in 2016. Furthermore, non-resident holdings of government-issued global bonds reached US$ 10.2 billion, consisting of global *sukuk* issuances in March, samurai bonds in June, euro bonds in July and global bonds to prefund the 2018 fiscal budget in December. In addition, conventional treasury bills and Islamic treasury bills, as well as sharia-compliant government securities (SBSN) recorded a net inflow totaling US$ 2.4 billion. Conversely, Bank Indonesia Certificates (SBI) booked a net sell of US$ 0.1 billion in 2017.

In contrast to the surge in purchasing of government debtsecurities, private sector portfolio investment bookeda net outflow, due to fewer non-resident placements inthe stock market. Foreign holdings of Indonesian stockdeclined in 2017, evidenced by the US$ 2.5 billionoutflow in non-resident investments. Non-resident investorsbegan to release stocks in the third quarter of 2017,spurred by monetary policy normalization in the UnitedStates, coupled with the increases in the Federal FundsRate. Nevertheless, outflow pressures were eased as thecorporate sector issued US$ 5.4 billion in global bonds in2017, the highest level in recent years. Overall, privateportfolio investment recorded a net outflow of US$ 1.2billion in 2017, reversing the net inflow of 2016. The table shows Indonesia's Portfolio Investment from 2015 until 2017 as below:

Table 14: Indonesia's Portfolio Investment 2015-2017

(million US$)

ITEMS	2015	2016	2017
Portfolio Investment	**16,183**	**18,996**	**20,899**
A. Assets	-1,268	2,218	-3,356
1. Public Sector	392	1,795	-9
a. Equity capital	-	-	-
b. Debt securities	392	1,795	-9
2. Private Sector	-1,660	423	-3,346
a. Equity capital	-758	-210	-1,560
b. Debt securities	-903	633	-1,787
B. Liabilities	17,451	16,778	24,255
1. Public Sector	17,386	16,835	21,880
a. Equity capital	-	-	-
b. Debt securities	17,386	16,835	21,880
1) Central bank	-135	114	-105
2) Government	17,521	16,720	21,985
a) Short term	-38	-444	1,718
b) Long term	17,559	17,164	20,267
2. Private Sector	65	-57	2,375
a. Equity capital	-1,547	1,319	-2,538
b. Debt securities	1,612	-1,376	4,912
1) Short term	-2,335	-291	305
2) Long term	3,947	-1,085	4,607
Memorandum:			
Government's debt securities, liabilities	17,521	16,720	21,985
1. Denominated in Rupiah	7,518	8,047	12,797
2. Denominated in foreign currency	10,003	8,673	9,188

Source: Bank Indonesia, 2018

II.1.11 Other Investment

The deficit in other investment increased in 2017 to US$ 10.9 billion, nearly doubling the US$ 5.8 billion deficit recorded in 2016. The main contributor to the larger deficit was domestic private placements in offshore deposits on the asset side, as the impact of the tax amnesty gradually faded and private sector transactions returned to normal. In contrast, 2016 witnessed funds returning to Indonesia during the tax amnesty.

On the asset side, private other investment transactions recorded a deficit. In 2017, the other investment deficit on the asset side stood at US$ 13.2 billion, reversing the US$ 1.8 billion surplus posted in 2016. The reversal stemmed from an increase of placements in offshore deposits, loan disbursements abroad, and trade credit. In anticipation of a cyclical and transient spike in demand for foreign exchange prior to *IdulFitri*, the banking industry increased placements in offshore deposits, particularly in the second quarter of 2017.

On the liability side, private other investments recorded a surplus, while other investments by the public sector experienced a deficit. Other investment transactions in the private sector recorded a US$ 3.7 billion surplus in 2017, reversing the US$ 4.9 billion deficit of the previous year as the effect of corporate consolidation began to fade and the corporate sector resumed drawing on foreign loans. In this way, the private sector overturned the net payment recorded in 2016. The net withdrawal of foreign loans was attributed to non-state-owned enterprises and nonbank financial institutions, while banks and state-owned enterprises booked a net payment. Meanwhile, the other investment deficit of the public sector on the liability side declined to US$ 1.4 billion, primarily stemming from a net payment of government foreign loans in line with government policy to reduce financing through loans.

In the public sector, the Government was less inclined to draw on foreign loans. In 2017, the Government withdrew US$ 3.6 billion in foreign loans, the lowest level in the past 18 years. From the foreign loans withdrawn, 55.8 % were project loans and the remainders are program loans. These loans come from the Asian Development Bank and International Bank for Reconstruction and Development, as well as the governments of France, Japan, China, and South Korea. The Table shows Indonesia Other

Investment Account from 2015 until 2017 as bellow:

Table 15: Indonesia Other Investment Account 2015-2017

(million US$)

ITEMS	2015	2016	2017
Other Investment	**-10,064**	**-5,817**	**-10,700**
A. Assets	-11,812	1,499	-13,187
1. Public Sector	-	-269	-
2. Private Sector	-11,812	1,768	-13,187
a. Currency and deposits	-7,411	2,940	-7,893
b. Loans	-1,034	-480	-2,422
c. Trade credit and advances	-2,232	-725	-1,265
d. Other assets	-1,134	33	-1,607
B. Liabilities	1,748	-7,316	2,488
1. Public Sector	-190	-2,369	-1,353
a. Currency and deposits	-	-	-
b. Loans	202	-574	-1,362
1) Central bank 1)	-33	-48	-145
a) Drawings	-	-	-
b) Repayments	-33	-48	-145
2) Government	235	-525	-1,217
a) Drawings	5,139	4,619	3,645
(1) Program	3,891	2,772	1,612
(2) Project	1,248	1,847	2,033
(3) Other	-	-	-
b) Repayments	-4,904	-5,145	-4,862
c. Other liabilities	-392	-1,795	9
2. Private Sector	1,938	-4,947	3,840
a. Currency and deposits	768	-471	186
b. Loans	883	-5,282	1,817
1) Drawings	30,372	20,400	23,018
2) Repayments	-29,489	-25,683	-21,201
c. Trade credit and advances	401	998	1,621
d. Other liabilities	-114	-192	216

Source: Bank Indonesia, 2018

II.1.12 Export

Cumulatively, Indonesia's export value from January to December 2017 reaches US$ 168.73 billion or increased by 16.22 percent compared to the same period in 2016 whereas non-oil and gas export reaches US$ 152.99 billion or increased by 15.83 percent. The biggest non-oil and gas export in December 2017 is to China amounting US$ 2.19 billion, followed by Japan US$ 1.47 billion and the United States US$ 1.42 billion. Their contribution reaches 38.31 percent. In the meantime, export to European Union (28 countries) reaches US$ 1.33 billion. Based on the origin province of the goods, West Java contributes to Indonesia's biggest export from January to December 2017 with export value US$ 29.18 billion (17.29 percent), followed by East Java US$ 18.43 billion (10.92 percent), and East Kalimantan US$ 17.63 billion (10.45 percent).

Table 16: Export 2015-2017

(million US$)

ITEMS	2015	2016	2017
EXPORT	150.366,3	145.186,2	168.828,2
- OIL AND GAS	18.574,4	13.105,5	15.744,3
- NON OIL AND GAS	131.791,9	132.080,8	153.083,9

Source: Indonesia Trade Ministry, 2018

II.1.13 External Debt

Stronger external resilience was further confirmed by Indonesia's external debt performance and profile. External debt rose by 10.1% in 2017 compared with a 3.0% increase in 2016. At the end of 2017, it stood at US$ 352.2 billion, up from US$ 320 billion at the end of 2016. Despite the increase, the ratio of external debt to GDP remained in safe territory at the end of 2017 at 34.7%, relatively stable on the previous year’s 34.3%. This consistency is due to the external debt management efforts of the Offshore Commercial Loan Coordinating Team, which consists of Staff from the Ministry of Finance and Bank Indonesia.

The position of public external debt increased due to issuances of government securities (SBN). Public external debt, accounting for 51.3% of total external debt, rose 14.1% in 2017, up from an increase of 11% in 2016. Consequently, public external debt increased to US$ 180.6 billion in 2017 from US$ 158.3 billion in 2016. This increase was used by the Government to finance development, and most (98.7%) was long term. Furthermore, public external debt increased on all instruments, including short-term instruments such as conventional treasury bills, Islamic treasury bills and long-term instruments, including SUN, SBSN, and government global bonds.

The position of private external debt also increased. Accounting for 48.7% of the total, the private external debt grew 6.1% to US$ 171.6 billion in 2017 from US$ 161.7 billion in 2016. Similar to the public sector, private external debt was dominated by long-term debt, which accounted for 72.9% of the total. Loan agreements continued to dominate private external debt. Based on remaining maturity, the structure of external debt was sound, indicated by the dominance of long-term debt, which has reached 84.5% of the total and is now at an all-time high. The position of long-term external debt was more dominant than short-term debt in both the public and private sectors. The table below shows Indonesia’s Debt Burden Indicator in from 2015 until 2017:

Table 17: External Debt 2015-2017

(%)

Debt Burden Indicators	2015	2016	2017
Short Term Debt by Original Maturity to Total Debt Ratio	12.46	12.68	13.91
Short Term Debt by Remaining Maturity to Total Debt Ratio	17.86	17.10	15.54
Short Term Debt by Original to Reserve Ratio	36.55	34.88	37.63
Short Term Debt by Remaining Maturity to Reserve Ratio	52.39	47.02	42.06
Debt Service Ratio – Quarterly			-
- DSR Tier	30.57	35.35	25.16
- DSR Tier	62.95	61.56	52.42
Debt Service Ratio - Annualized			-
- DSR Tier	30.57	35.35	25.16
- DSR Tier	62.95	61.56	52.42
Debt to Export Ratio - Annualized	168.39	176.14	167.73
Debt to GDP Ratio	36.09	34.30	34.68

Source: Bank Indonesia, 2018

II.1.14 Exchange Rate

The rupiah exchange rate remained generally stable in 2017 and was supported by improvement in the fundamentals of the Indonesian economy, despite some pressure from external factors in the final quarter of the year. The steady level of the exchange rate was closely linked to the positive performance of the Indonesia balance of payments, which posted a surplus on the strength of brisk foreign capital inflows and a lower current account deficit. Capital inflows in Indonesia were stimulated not only by attractive yields, but also improvement in the nation’s economic outlook. On the external side, movement in the rupiah was affected by global dynamics throughout 2017, particularly factors driven by economic policy and political events in the United States and Europe. In general, external factors worked in favor of the rupiah exchange rate, although they did have a more adverse impact during the final quarter of 2017.

The year was marked by stable movement in the rupiah until near the end of the third quarter of 2017, followed by depreciation through to the end of 2017. The rupiah closed 2017 at a level of IDR 13,568 to the US dollar, not markedly different from the position at the end of 2016 of IDR 13,473 to the US dollar. Averaged over the year, the rupiah weakened fractionally by 0.6 % to IDR 13,385 to the US dollar in 2017 from IDR 13,305 in 2016. The general stability of the rupiah was evidenced by the declining exchange rate volatility; this fell to 3.0% in 2017 from 8.4% in 2016. The table shows middle US$ Middle Rate against IDR (Rupiah) from 2015 until 2017 as below:

Table 18: USD – IDR

			(Rupiah)
CURRENCY	**2015**	**2016**	**2017**
USD ($1)	13,795	13,436	13,548

Source: Bank Indonesia, 2018

II.1.15 Inflation

Consumer price index (CPI) inflation in 2017 remained under control and within the target range of 4.0±1%. The low CPI inflation figure of 3.61% in 2017 means inflation targets have been met for three consecutive years. Low inflation was prevalent evenly across Indonesia. The inflation developments of 2017 were reflected in monthly inflation, which was regularly recorded at a lower level than average monthly inflation over the last three years. Notably, in the second half, every individual month was lower than the average monthly inflation of the last three years. Breaking this down into the individual inflation components, controlled core inflation and low volatile food (VF) inflation contributed to these inflation successes, but administered prices (AP) inflation rose, driven by the policy of targeted electricity subsidies. However, the second-round effect of the electricity subsidy policy on other commodity prices was relatively limited. The inflation achievements of 2017 were supported by Bank Indonesia's consistent monetary policies, as well as by policy coordination with the Government. Bank Indonesia's consistent monetary policy on macroeconomic stability pushed inflation expectations downwards; they were anchored in the 4.0±1% target range. Policy coordination between Bank Indonesia and the Government was particularly relevant in terms of supply chains. Government policy was aimed at maintaining the availability of supplies, ensuring distribution efficiency, and stabilizing food prices to support controlled inflation. Strengthened policy coordination between Bank Indonesia and the Government on inflation control was achieved through Central and Regional Inflation Control Team (TPID) forums.

Table 19: Inflation Rate from 2015 until 2017

			(%)
Month	**2015**	**2016**	**2017**
January	-0.24	0.51	0.97
February	-0.36	-0.09	0.23
March	0.17	0.19	-0.02
April	0.36	-0.45	0.09
May	0.5	0.24	0.39
June	0.54	0.66	0.69
July	0.93	0.69	0.22
August	0.39	-0.02	-0.07
September	-0.05	0.22	0.13
October	-0.08	0.14	0.01
November	0.21	0.47	0.20
December	0.96	0.42	0.71
Inflation Rate	3.35	3.02	3.61

Source: Indonesia Statistics, 2018

II.1.16 Financial System

Macro prudential policy in 2017 was aimed at supporting the intermediation function of banks by continuing touphold financial system stability. By safeguarding thisstability, Bank Indonesia gives itself room to continuepursuing its accommodative macro prudential policy.An accommodative macro prudential stance will reversethe downward direction of the financial cycle andsupport the ongoing economic recovery process. In2017, Bank Indonesia continued its accommodativepolicy stance towards the loan-to-value (LTV), financing-to-value (FTV) and loan-to-funding ratios (LFR), as it hasdone since 2015. Efforts to support improvements in thefinancial cycle were also strengthened by safeguardingbanks' capacity to provide loans by reaffirming thecountercyclical capital buffer (CCB) at 0%. In addition,Bank Indonesia has also continued to encourage loangrowth for the development of micro, small, and mediumenterprises (MSME), both from the side of loans supplyby raising the minimum limit of the lending ratio forMSME, and from the angle of loan demand by raisingthe capacity of MSME players. From the perspective offinancial system stability risk management, Bank

Indonesiaconsistently undertakes macro prudential surveillance andsupervision and has established closer coordination withrelated authorities, particularly around preventing andhandling a financial system crisis. The table shows Indonesia's Banking Operation from 2015 until 2017 as below:

Table 20: Indonesia's Banking Operation 2015-2017

(Billion rupiah)

Indicator	2015	2016	2017
Distribution of Funds			
Commercial Banks	5,952,279	6,570,903	7,177,051
Rural Banks	98,604	109,389	121,296
SBI and SBIS [1)]	53,567	96,103	19,901
Source of Funds			
Commercial Banks	4,909,707	5,399,210	5,921,000
Rural Banks	84,728	93,622	103,874
Total Assets			
Commercial Banks	6,095,908	6,729,799	7,387,144
Rural Banks	101,713	113,501	125,945

1)Sharia based Bank Indonesia Securities
Source: Bank Indonesia, 2018

Indicator	2015	2016	2017
Total Banks			
Commercial Banks	118	116	115
Rural Banks	1,636	1,633	1,619
Total Bank Offices			
Commercial Banks	32,949	32,730	32,285
Rural Banks	5,982	6,075	6,192

1)Sharia based Bank Indonesia Securities
Source: Bank Indonesia, 2018

Bank Indonesia has coordinated with other authorities to strengthen the effectiveness of macro prudential policy in maintaining financial system stability. The coordination on subjects including macro-micro prudential policy and MSME (Micro, Small and Medium Enterprises) development was conducted either bilaterally or in one coordinating pool and was done through the Financial System Stability Committee (KSSK).

To maintain financial system stability, Bank Indonesia worked together with other institutions, most notably the Ministry of Finance, the Financial Services Authority (OJK), and the Deposits Insurance Agency (LPS). Coordination between these four institutions takes place through the Financial System Stability Committee (KSSK) forum, as mandated in the Law concerning the Prevention and Handling of Financial System Crises (PPKSK). The role of KSSK is to: coordinate the monitoring and maintenance of financial system stability, handle financial system crises and handle systemic bank problems, when the banking system is both normal or in crisis. The members of KSSK are the Bank Indonesia Governor, the Minister of Finance, OJK's Chairman of the Board of Commissioners and LPS's Chairman of the Board of Commissioners. The table shows Indonesia's Common Banking Performance from 2015 until 2017:

Table 21: Indonesia's Common Banking Performance 2015-2017

(Billion Rupiah)

Items	2015	2016	2017
Capital Adequacy Ratio (%)	**21.39**	**22.93**	**23.18**
- Capital	914,657	1,052,597	1,166,002
- Risk Weighted Assets	4,276,555	4,589,611	5,029,816
Core Capital Ratio to ATMR (%)	**19.00**	**21.19**	**21.50**
- Core Capital (Tier I)	812,590	972,350	1,081,234
- Risk Weighted Assets	4,276,555	4,589,611	5,029,816
Return On Assets Ratio (%)	**2.32**	**2.23**	**2.45**
- Profit	132,601	136,048	165,196
- Average total assets	5,703,813	6,106,959	6,730,350
Operating Expenses/Operating Income (%)	**81.49**	**82.22**	**78.64**
- Operating Expenses	569,141	624,173	603,178
- Operating Income	698,404	759,146	766,975
Net Interest Margin Ratio (%)	**5.39**	**5.63**	**5.32**
- Interest income net	293,824	329,913	342,731
- Average total earning assets	5,449,642	5,854,786	6,445,076
Loan to Deposits Ratio (%)	**92.11**	**90.70**	**90.04**
- Total Credit to third party	3,903,936	4,199,713	4,548,155
- Total Third Party Funds	4,238,349	4,630,352	5,050,984
Liquid Assets Ratio (%)	**16.70**	**17.50**	**18.56**
- Primary Liquid Asset	736,720	837,433	963,833
- Secondary Liquid assets	251,623	296,098	353,504
- Total Assets	5,919,390	6,475,602	7,099,564

Source: Bank Indonesia, 2018

II.2 Domestic Environment

II.2.1 Economic Overview as of December 2017

On the one hand it is positive that Indonesia's GDP growth is continuing to accelerate. In fact, the 5.07 percent growth figure is the nation's fastest full-year GDP growth figure since 2013. Moreover, the 5.19 percent (y/y) growth figure in Q4-2017 is the best Q4 GDP growth figure since 2013. Also positive is that Indonesia's nominal GDP reached IDR 13,558 trillion, or US$ 1 trillion using the 2017 exchange rate. This puts Indonesia in the US$ 1 trillion economy group of nations.

Household consumption is an important component to watch because it accounts for about 56 percent of Indonesia's economic growth. Meanwhile, investment growth picked up in Q4-2017. Gross domestic fixed capital formation grew by 7.27 percent (y/y) in the last quarter of 2017. Amid bleak household consumption Indonesian President JokoWidodo has high hopes for investment realization. Therefore, the government has been opening several sectors to foreign direct investment in recent years and has been eager to improve the nation's investment climate (for example through deregulation). Another positive development is that Indonesia's export performance has improved on the back of rising commodity prices and improving global demand.

II.2.2 Economic Growth

Indonesia's economy continued to recover in 2017, with momentum garnered from supportive global dynamics and maintained macroeconomic stability at home. Solid global economic growth in advanced economies and developing economies, including major trade partners of Indonesia, combined with rising commodity prices, boosted Indonesia's export performance, particularly exports of commodities. These export gains and government spending on infrastructure has restored corporate confidence in investing. Consequently, corporate sector consolidation began to tail off, replaced by stronger corporate investment in the second half of the year. Investment gains and an increase in exports helped to drive Indonesia's economic growth to 5.07% in 2017 from 5.03% in 2016, but these improvements have not yet significantly lifted household consumption.

The ongoing economic recovery has benefitted public welfare and prosperity. Unemployment, poverty and inequality all declined in 2017, although the number of informal workers remained high. Low inflation and stable prices for staple foods, as well as a slight increase in incomes, helped to alleviate poverty. Furthermore, indicators in 2017 demonstrated a moderate decrease in inequality, as spending by the top 20% of the population fell.

II.2.3 GDP – By Expenditure

Export and investment gains drove the gradual domestic economic recovery in 2017. Economic growth dynamics show Indonesia has recovered from its lowest growth level – 4.74% –recorded in the second quarter of 2015. Since then, the national economy has steadily improved, with GDP growth recorded at 5.07% in 2017, up from 5.03% in 2016. This recovery is based on stronger export and investment growth in 2017, in line with a favorable global economic climate and steady economic fundamentals. Both exports and investment made a greater contribution to economic growth in 2017 versus 2016. The table shows GDP Growth by expenditure in Indonesia from 2015 until 2017 as below:

Table 22: GDP Growth by Expenditure in Indonesia 2015-2017

percent, yoy

Component of GDP	2015	2016	2017
Domestic Demand	4.94	4.39	5.13
Private Consumption	4.84	5.04	4.98
Household Consumption	4.96	5.01	4.95
Non-Profit Institution Serving Household Consumption	-0.62	6.64	6.91
Government Expenditure	5.31	-0.14	2.14
Gross Fixed Capital Formation	5.01	4.47	6.15
Building	6.11	5.18	6.24
Non-Building	1.93	2.43	5.9
Change of Inventory	-0.59	0.23	-0.19
Net Export	0.94	0.16	0.35
Export	-2.12	-1.57	9.09
Import	-6.25	-2.45	8.06
Gross Domestic Product	4.88	5.03	5.07

Source: Indonesia Statistic, 2018

Indonesia experienced domestic economic improvement in the second half of 2017. This was driven by an increasingly solid global economic recovery and resulted in a significant 9.09% increase in exports for 2017, the highest level posted in five years and a sharp contrast to the 1.57% contraction in 2016. Consolidation in the corporate sector lessened and the Government ramped up several infrastructure projects, which boosted investment primarily in the second half of the year. Gross fixed capital formation growth stood at 6.15%, easily surpassing the 4.47% posted in 2016. However, this improving export and investment performance has thus far failed to significantly stimulate private consumption, particularly household consumption.

II.2.4 GDP – By Industrial Origin

Indonesia's main economic drivers in 2017 were the agricultural, forestry, and fisheries sector, plus certain mining and quarrying subsectors. Coal was a key driver, and exports rose. The government decision to speed up infrastructure projects strengthened the construction sector, while a shift in household spending boosted the accommodation, food and beverages, transportation and warehousing, as well as information and communications sectors. In contrast, financial services, corporate services, and other services experienced slower growth. The Table shows GDP Growth in Indonesia by Industrial Origin from 2015 until 2017

Table 23: GDP Growth in Indonesia by Industrial Origin 2015-2017

percent, yoy

Component of GDP	2015	2016	2017
Agriculture, Forestry and Fishery	3.75	3.36	3.81
Mining and Quarrying	-3.42	0.95	0.69
Manufacturing	4.33	4.26	4.27
Electricity	0.9	5.39	1.54
Water Supply, Garbage, Waste Management and Remediation Activities	7.07	3.6	4.61
Construction	6.36	5.22	6.79
Wholesale and Retail Trade, Repair of Car and Motorcycle	2.54	4.03	4.44
Accommodation, Food and Beverage Supply	6.71	7.45	8.49
Transportation and Storage	4.31	5.17	5.55
Information and Communication	9.7	8.88	9.81
Financial Service	8.58	8.9	5.48
Real Estate	4.11	4.69	3.68
Business Service	7.69	7.36	8.44
Government, Administration, Defense and Compulsory Social Security	4.63	3.19	2.06
Education Service	7.33	3.8	3.66
Health Service and Other Activities	6.69	5.15	6.79
Other Activities	8.08	8.02	8.66
Taxes Less Subsidies on Product	32.55	19.2	13.38
Gross Domestic Product	4.88	5.03	5.07

Source: Indonesia Statistics, 2018

Strong production from plantations and fisheries lifted the agriculture, forestry, and fisheries sector and accounted for half the sector's growth. The plantation subsector grew 4.46% in 2017, up from 3.47% in the previous year, while the fisheries sector expanded by 5.95% from 5.15%. This increase in both plantation and fisheries production is attributed to favorable weather conditions in 2017, after severe disruptions in 2016 caused by La Niña, and a larger fishing fleet. Furthermore, incidences of land clearance fires were minimized in 2017 by more stringent supervision. Land expansion for plantations was also restricted by an extension to the moratorium on new licenses for palm oil on virgin forest and peat land. Rising exports and prices for plantation commodities, particularly CPO, buoyed producers of fresh fruit bunches of oil palm.

II.2.5 Domestic Demand

Stronger domestic demand combined with a growing need to boost exports fed into import dynamics in various regions. Robust import growth was observed in the regions of Sumatra, Java, Sulawesi, and Papua. A need for transportation equipment to support plantation and mining operations outside Java prompted imports of capital goods. Furthermore, several natural resources companies in Sumatra and Sulawesi enhanced their CPO processing capacity and increased their fishing catch. Also in Sulawesi, some manufacturing imports rose, particularly wheat for processing into flour. Imports also increased into Papua; this primarily affected iron and steel for infrastructure projects. Meanwhile, the construction of electricity projects in Sumatra, Kalimantan, and West Nusa Tenggara triggered imports of machinery and equipment. On Java, imports of capital goods picked up, particularly in the second half, relating to investments in transport and textiles, as well as downstream industries.

II.2.6 Growth of Household Consumption

Household consumption across Indonesia's regions was also inextricably linked to the production of commodities. Solid increases in household consumption were recorded in the producing areas of Kalimantan and Sulawesi as CPO, coal, and other mining commodity prices soared Growth in household consumption was not, however, balanced across all regions rich in natural resources, because job creation was limited. For example, corporations continued to utilize rising export proceeds to maintain equipment. Furthermore, total workers employed in the primary sector declined as the expansion of agricultural land slowed, which impeded job creation. Household consumption growth was also somewhat muted on Java, Indonesia's dominant region, due to a smaller increase in the minimum provincial wage (UMP) than had been seen in previous years, following changes to the way it is calculated. The impact of the annual increase in the UMP was also limited on Sumatra, a region dominated by industry. The UMP was raised by 8.25% in 2017 but down from more than 10% in 2016.14 In addition, a decline in remittances from Eastern Indonesia also impacted incomes and consumption in several regions, particularly Java.

II.2.7 Government Consumption

Policies introduced in 2015 and 2016 to enhance expenditure quality and accelerate regional transfers – transfers of money from central to local or provincial governments – and disbursements under the Village Fund – central government money for welfare and village development – were intended to foster regional economic growth. In addition to capital spending for investment purposes, government consumption was another form of regional fiscal stimulus. In 2017, the Government managed to increase its own consumption in all regions, except Kalimantan. Central Government measures to improve the disbursement system for regional transfers and village funds through State Treasury Services Offices (KPPN) helped to accelerate regional government spending. The significant larger allocation of village funds is in 2017, increasing from IDR47 trillion in 2016 to IDR60 trillion, also nurtured regional economic activities. Regional transfers and village fund realization reached IDR742 trillion in 2017, up 4.5% on 2016. Furthermore, the absorption of government spending increased to 91% in 2017 from 85.5% in 2016.

II.2.8 Employment, Welfare, Poverty and Inequality

The manufacturing industry also contributed to a sound employment market, particularly on Java. Labor-intensive industries, such as electronics and food and beverages, added new jobs, and more labor was absorbed by manufacturing in West Java and Banten. Outside of Java, more labor was absorbed in 2017 by the development of industrial zones, including the Morowali Industrial Park in Central Sulawesi, Bantaeng Industrial Park in South Sulawesi, Konawe Industrial Park in Southeast Sulawesi, and Mandalika Special Industrial Zone in West Nusa Tenggara. As part of the Government's strategic program, these industrial zones developed outside Java were not only complemented with physical infrastructure networks, but also with vocational education centers to support the absorption of newly-skilled local labor.

Table 24: The unemployment rate in by province 2015-2017:

(%)

Province	2015		2016		2017	
	February	August	February	August	February	August
Aceh	7.73	9.93	8.13	7.57	7.39	6.57
Sumatera Utara	6.39	6.71	6.49	5.84	6.41	5.60
Sumatera Barat	5.99	6.89	5.81	5.09	5.80	5.58
Riau	6.72	7.83	5.94	7.43	5.76	6.22
Jambi	2.73	4.34	4.66	4.00	3.67	3.87
Sumatera Selatan	5.03	6.07	3.94	4.31	3.80	4.39
Bengkulu	3.21	4.91	3.84	3.30	2.81	3.74
Lampung	3.44	5.14	4.54	4.62	4.43	4.33
Kepulauan Bangka Belitung	3.35	6.29	6.17	2.60	4.46	3.78
Kepulauan Riau	9.05	6.20	9.03	7.69	6.44	7.16
DKI Jakarta	8.36	7.23	5.77	6.12	5.36	7.14
Jawa Barat	8.40	8.72	8.57	8.89	8.49	8.22
Jawa Tengah	5.31	4.99	4.20	4.63	4.15	4.57
DI Yogyakarta	4.07	4.07	2.81	2.72	2.84	3.02
Jawa Timur	4.31	4.47	4.14	4.21	4.10	4.00
Banten	8.58	9.55	7.95	8.92	7.75	9.28
Bali	1.37	1.99	2.12	1.89	1.28	1.48
Nusa Tenggara Barat	4.98	5.69	3.66	3.94	3.86	3.32
Nusa Tengggara Timur	3.12	3.83	3.59	3.25	3.21	3.27
Kalimantan Barat	4.78	5.15	4.58	4.23	4.22	4.36
Kalimantan Tengah	3.14	4.54	3.67	4.82	3.13	4.23
Kalimantan Selatan	4.83	4.92	3.63	5.45	3.53	4.77
Kalimantan Timur	7.17	7.50	8.86	7.95	8.55	6.91
Kalimantan Utara	5.79	5.68	3.92	5.23	5.17	5.54
Sulawesi Utara	8.69	9.03	7.82	6.18	6.12	7.18

Sulawesi Tengah	2.99	4.10	3.46	3.29	2.97	3.81
Sulawesi Selatan	5.81	5.95	5.11	4.80	4.77	5.61
Sulawesi Tenggara	3.62	5.55	3.78	2.72	3.14	3.30
Gorontalo	3.06	4.65	3.88	2.76	3.65	4.28
Sulawesi Barat	1.81	3.35	2.72	3.33	2.98	3.21
Maluku	6.72	9.93	6.98	7.05	7.77	9.29
Maluku Utara	5.56	6.05	3.43	4.01	4.82	5.33
Papua Barat	4.61	8.08	5.73	7.46	7.52	6.49
Papua	3.72	3.99	2.97	3.35	3.96	3.62
Indonesia	**5.81**	**6.18**	**5.50**	**5.61**	**5.33**	**5.50**

Source: Indonesia Statistic, 2018

Table 25: The average of wages/salary by Education Attainment in 2017

Rupiah

Educational Attainment	February 2017	August 2017
No Schooling	1,196,831	1,274,562
Not/Not Yet Completed Primary School	1,396,636	1,434,207
Elementary School	1,633,614	1,666,573
Junior High School	1,847,374	1,918,092
High School (General)	2,537,845	2,666,627
High School (Vocational)	2,613,633	2,678,607
Diploma I/II/III/Academy	3,432,911	3,543,796
University	4,551,988	4,515,054
Average	2,702,590	2,742,621

Source: Indonesia Statistic, 2018

Table 26: The Percentage of People Living in Poverty by Province in 2015-2017

(%)

Province	2015		2016		2017	
	Semester 1	Semester 2	Semester 1	Semester 2	Semester 1	Semester 2
ACEH	17.08	17.11	16.73	16.43	16.89	15.92
SUMATERA UTARA	10.53	10.79	10.35	10.27	10.22	9.28
SUMATERA BARAT	7.31	6.71	7.09	7.14	6.87	6.75
RIAU	8.42	8.82	7.98	7.67	7.78	7.41
JAMBI	8.86	9.12	8.41	8.37	8.19	7.9
SUMATERA SELATAN	14.25	13.77	13.54	13.39	13.19	13.1
BENGKULU	17.88	17.16	17.32	17.03	16.45	15.59
LAMPUNG	14.35	13.53	14.29	13.86	13.69	13.04
KEP. BANGKA BELITUNG	5.4	4.83	5.22	5.04	5.2	5.3
KEP. RIAU	6.24	5.78	5.98	5.84	6.06	6.13
DKI JAKARTA	3.93	3.61	3.75	3.75	3.77	3.78
JAWA BARAT	9.53	9.57	8.95	8.77	8.71	7.83
JAWA TENGAH	13.58	13.32	13.27	13.19	13.01	12.23
DI YOGYAKARTA	14.91	13.16	13.34	13.1	13.02	12.36
JAWA TIMUR	12.34	12.28	12.05	11.85	11.77	11.2
BANTEN	5.9	5.75	5.42	5.36	5.45	5.59
BALI	4.74	5.25	4.25	4.15	4.25	4.14
NUSA TENGGARA BARAT	17.1	16.54	16.48	16.02	16.07	15.05
NUSA TENGGARA TIMUR	22.61	22.58	22.19	22.01	21.85	21.38
KALIMANTAN BARAT	8.03	8.44	7.87	8	7.88	7.86
KALIMANTAN TENGAH	5.94	5.91	5.66	5.36	5.37	5.26
KALIMANTAN SELATAN	4.99	4.72	4.85	4.52	4.73	4.7
KALIMANTAN TIMUR	6.23	6.1	6.11	6	6.19	6.08
KALIMANTAN UTARA	6.24	6.32	6.23	6.99	7.22	6.96
SULAWESI UTARA	8.65	8.98	8.34	8.2	8.1	7.9
SULAWESI TENGAH	14.66	14.07	14.45	14.09	14.14	14.22
SULAWESI SELATAN	9.39	10.12	9.4	9.24	9.38	9.48
SULAWESI TENGGARA	12.9	13.74	12.88	12.77	12.81	11.97
GORONTALO	18.32	18.16	17.72	17.63	17.65	17.14
SULAWESI BARAT	12.4	11.9	11.74	11.19	11.3	11.18
MALUKU	19.51	19.36	19.18	19.26	18.45	18.29
MALUKU UTARA	6.84	6.22	6.33	6.41	6.35	6.44
PAPUA BARAT	25.82	25.73	25.43	24.88	25.1	23.12
PAPUA	28.17	28.4	28.54	28.4	27.62	27.76
INDONESIA	**11.22**	**11.13**	**10.86**	**10.7**	**10.64**	**10.12**

Source: Indonesia Statistics, 2018

Table 27:Gini Ratio by Province 2015-2017

%

Province	2015		2016		2017	
	Semester 1	Semester 2	Semester 1	Semester 2	Semester 1	Semester 2
ACEH	0.334	0.339	0.333	0.341	0.329	0.329
SUMATERA UTARA	0.336	0.326	0.319	0.312	0.315	0.335
SUMATERA BARAT	0.342	0.319	0.331	0.312	0.318	0.312
RIAU	0.364	0.366	0.347	0.347	0.325	0.325
JAMBI	0.361	0.344	0.349	0.346	0.335	0.334
SUMATERA SELATAN	0.36	0.334	0.348	0.362	0.361	0.365
BENGKULU	0.376	0.371	0.357	0.354	0.351	0.349
LAMPUNG	0.376	0.352	0.364	0.358	0.334	0.333
KEP. BANGKA BELITUNG	0.283	0.275	0.275	0.288	0.282	0.276
KEP. RIAU	0.364	0.339	0.354	0.352	0.334	0.359
DKI JAKARTA	0.431	0.421	0.411	0.397	0.413	0.409
JAWA BARAT	0.415	0.426	0.413	0.402	0.403	0.393
JAWA TENGAH	0.382	0.382	0.366	0.357	0.365	0.365
DI YOGYAKARTA	0.433	0.42	0.42	0.425	0.432	0.44
JAWA TIMUR	0.415	0.403	0.402	0.402	0.396	0.415
BANTEN	0.401	0.386	0.394	0.392	0.382	0.379
BALI	0.377	0.399	0.366	0.374	0.384	0.379
NUSA TENGGARA BARAT	0.368	0.36	0.359	0.365	0.371	0.378
NUSA TENGGARA TIMUR	0.339	0.348	0.336	0.362	0.359	0.359
KALIMANTAN BARAT	0.334	0.33	0.341	0.331	0.327	0.329
KALIMANTAN TENGAH	0.326	0.3	0.33	0.347	0.343	0.327
KALIMANTAN SELATAN	0.353	0.334	0.332	0.351	0.347	0.347
KALIMANTAN TIMUR	0.316	0.315	0.315	0.328	0.33	0.333
KALIMANTAN UTARA	0.294	0.314	0.3	0.305	0.308	0.313
SULAWESI UTARA	0.368	0.366	0.386	0.379	0.396	0.394
SULAWESI TENGAH	0.374	0.37	0.362	0.347	0.355	0.345
SULAWESI SELATAN	0.424	0.404	0.426	0.4	0.407	0.429
SULAWESI TENGGARA	0.399	0.381	0.402	0.388	0.394	0.404
GORONTALO	0.42	0.401	0.419	0.41	0.43	0.405
SULAWESI BARAT	0.363	0.362	0.364	0.371	0.354	0.339
MALUKU	0.34	0.338	0.348	0.344	0.343	0.321
MALUKU UTARA	0.28	0.286	0.286	0.309	0.317	0.33
PAPUA BARAT	0.44	0.428	0.373	0.401	0.39	0.387
PAPUA	0.421	0.392	0.39	0.399	0.397	0.398
INDONESIA	**0.408**	**0.402**	**0.397**	**0.394**	**0.393**	**0.391**

Source: Indonesia Statistic, 2018

Infrastructure development also created local job opportunities in areas with large-scale projects, such as Java. Nevertheless, increasing mechanization, particularly on urban public transportation projects, limited the number of job openings for construction workers. Innovative government policies to stimulate regional economies through greater connectivity also played an important role in nurturingemployment. Approval for a new direct international flight to North Sulawesi catalyzed tourism development in the province and beyond, which created new jobs and offset rising local unemployment.

Conversely, labor absorption in the mineral and oil and gas mining subsectors declined in 2017, and layoffs made by mining corporations in Papua had a deleterious effect on rising open unemployment in the region. Corporate rationalization was necessary to adjust to new mining license policies, which stoked uncertainty regarding investment and production.

The economic recovery also lifted welfare. The poverty rate edged down to 10.1% in 2017, from 10.7% in 2016. This can be attributed to low and stable inflation, especially food inflation, which has reduced poverty line inflation sharply over the past few years. The number of urban poor people remains well below that of rural poor, but several challenges specific to the urban poor persist. Notably, census data from 2015 points to accelerating urbanization – driven by limited job availability and stagnant income growth in rural areas – but urban job creation is growing at a slow pace.

Reduced economic inequality is indicative of improving welfare conditions. The Gini ratio stood at

0.391 in September 2017, down slightly from 0.394 in September 2016. Nevertheless, the apparent improvement was due to reduced spending by the uppermost 20% percentile. By location, the lower Gini ratio stemmed from urban areas, contrasting the moderate increase recorded in rural areas

II.3. Fiscal Situation

Fiscal policy in 2017 aimed to speed up economic recovery in order to achieve sustainable and equitable economic growth. The 2017 State Budget (APBN) balanced stimulus needs over the short and long term, while also maintaining fiscal resilience. On the income side, the Government continued to widen the taxpayer database and increase tax compliance, which contributed to higher tax revenues in 2017 versus 2016. The increase in 2017 income was also supported by rising commodity prices, including for oil and gas. However, the tax-to-GDP ratio fell, highlighting the ongoing challenges Indonesia faces in generating income, particularly tax revenues. On the expenditure side, the Government made efforts to improve the quality of spending and to balance short- and long term stimulus. In this context, spending on non-priority goods was reduced and on energy subsidies flattened, while spending on social assistance and infrastructure increased. The Government was able to keep the 2017 fiscal deficit at a healthy level of 2.5% of GDP and the government debt ratio at a safe 29.2%.

Fiscal Policy in 2017 had some objectives namely: Stimulus, Endurance and Sustainability. From stimulus side, Fiscal policy provided fiscal incentive for strategic economy activity, spending for improving the quality of infrastructures, and debt for productive activities. On the other hands, Endurance in fiscal policy aimed for fiscal buffer, flexibility and fiscal vulnerability. To achieve sustainability, Fiscal policy had be able to control primary balance, control debt ratio and control budget deficit.

The direction of regional fiscal policy in 2017 was consistent with central policy; the goal was to accelerate economic recovery. Policy strategy was pursued by reducing the dependence of regional funding on central sources of funding and by channeling expenditure toward productive sectors such as infrastructure development. The Government boosted the role of the regions in stimulating the economy by increasing funding transfers to the regions and village funds (TKDD); this funding was used optimally, including that portion spent on infrastructure development.

Both global and domestic economic developments affected policy formulation and the fiscal realization of the central government in 2017. The APBN was set in November 2016 and assumed higher economic growth in 2017 of 5.3%, up from 5.0% realized growth in 2016. In turn, the assumption of higher economic growth influenced the inflation assumption; inflation was expected to increase to 4.7%. However, economic dynamics prompted changes to these macroeconomic assumptions, and the Government's financial achievements up to mid-2017 were not as expected. Consequently, it issued the 2017 Revised State Budget.

The fiscal policy strategy of accelerating economic growth is seen in the original 2017 State Budget. Domestic income was targeted at IDR 1,750.3 trillion, up 12.5% on the realized 2016 figure. State spending was set at IDR 2,080.5 trillion, up 11% versus the actual 2016 figure. These estimates gave rise to a 2017 budget deficit of approximately 2.5% of GDP, in line with the 2016 figure. The 2017 State Budget was to be funded in part through a net issuance of state securities (SBN) at IDR 400 trillion, slightly lower than the IDR407.3 trillion realized in 2016.

As 2017 unfolded, the fiscal management strategy resulted in better budget performance. Revenues and expenditure grew and the fiscal deficit remained below 3% of GDP. Revenues in 2017 grew by 7.0%, up from 3.2% growth in 2016, mainly lifted by contributions from oil, gas and natural resources, but non-oil and gas revenues – especially income tax – were below target. Spending in 2017 grew by 7.4%, up from 3.2% growth in 2016, while the absorption rate of spending set out in the 2017 Revised State Budget increased to 93.9% in 2017 from 89.5% in 2016. Acceleration in both government consumption spending and government investment began in the third quarter of 2017 following the revisions, which were approved in July 2017. Higher government consumption spending was supported by social assistance payments, which rose 11.5% in 2017 versus 2016, while infrastructure spending rose 44.3%. Overall, the 2017 fiscal deficit was maintained at a safe 2.5% of GDP, with a government debt ratio at a healthy 29.2% of GDP.

II.3.1 State Revenue

State income rose in 2017, driven by increased growth of both tax and non-tax revenues. Domestic income was recorded at IDR 1,655.5 trillion, up 7.0% from 2016 – and higher than the 3.2% growth recorded in 2016 – lifted by increases in the prices of oil, gas and other commodities. A strong domestic economic recovery in the second half of 2017 also supported tax revenues, especially VAT. Revenues were also boosted by the tax amnesty program, which widened the tax database and the tax compliance of taxpayers, both bodies and individuals.The Table shows budgeted and actual Indonesia's State Revenue from 2015 until 2017 as below:

Table 28: State Revenue 2015-2017

(billion Rupiah)

ITEMS	2015	2016	2017
Budget			
Government Revenues and Grants	1,761,643	1,786,225	1,736,060
Domestic Revenues	1,758,331	1,784,250	1,732,952
Tax Revenues	1,489,255	1,539,166	1,472,710
Domestic Taxes	1,439,999	1,503,295	1,436,731
Income Tax	679,370	855,843	783,970
i. Non-Oil and Gas	629,835	819,497	742,200
ii.Oil and Gas	49,535	36,346	41,770
Value Added Tax	576,469	474,235	475,483
Land and Building Tax	26,690	17,711	15,412
Duties on Land and Building Transfers	0	0	0
Exercise Duties	145,740	148,091	153,165
Others Domestic Taxes	11,729	7,415	8,700
International Trade Taxes	49,257	35,872	35,979
Import	37,204	33,372	33,279
Export	12,053	2,500	2,700
Non Taxes Revenues	269,075	245,084	260,242
Natural Resources	118,919	90,524	95,643
Oil Revenues	61,584	51,328	57,407
Gas Revenues	19,781	17,360	14,801
Other Natural Resources	37,554	21,836	23,435
Profit Transfers From SOE's	36,957	34,164	41,000
Bank Indonesia Surplus	0	0	0
Revenue from Public Service Institution	23,090	36,271	38,541
Other Non-Tax Revenues	90,110	84,124	85,058
Grants	3,312	1,975	3,108
Actual			
Government Revenues and Grants	1,508,020	1,555,934	1,666,376
Domestic Revenues	1,496,047	1,546,946	1,654,746
Tax Revenues	1,240,419	1,284,970	1,343,530
Domestic Taxes	1,205,479	1,249,499	1,304,316
Income Tax	602,308	666,212	646,793
i. Non-Oil and Gas	552,637	630,114	596,478
ii. Oil and Gas	49,672	36,099	50,316
Value Added Tax	423,711	412,213	480,725
Land and Building Tax	29,250	19,443	16,770
Duties on Land and Building Transfers	0	0	1
Exercise Duties	144,641	143,525	153,288
Others Domestic Taxes	5,568	8,105	6,738
International Trade Taxes	34,940	35,471	39,214
Import	31,213	32,472	35,066
Export	3,727	2,999	4,147
Non Taxes Revenues	255,628	261,976	311,216
Natural Resources	100,972	64,902	111,132
Oil Revenues	47,987	31,448	58,203
Gas Revenues	30,183	12,646	23,640
Other Natural Resources	22,801	20,808	29,289

Profit Transfers From SOE's	37,644	37,133	43,904
Bank Indonesia Surplus	0	0	0
Revenue from Public Service Institution	35,315	41,946	47,345
Other Non-Tax Revenues	81,697	117,995	108,835
Grants	11,973	8,988	11,630

Source: Ministry Of Finance, 2018

The increase in revenues from oil and gas income tax, VAT, excise tax and international trade tax minimized the impact of the weaker performance of other tax components, including the land and property tax and nonoil and gas income tax. The lower growth in revenues from the property tax reflects the impact of a tariff reduction policy to ease the issuance of real estate investment funds and changes in the regulations governing the use of forest lands. The decline in the performance of non-oil and gas income tax in 2017 was owed more to the base effect of Indonesia's tax amnesty program, which began in July 2016 and brought in IDR 135 trillion in total. In 2016, the high non-oil and gas income tax receipts were supported by relatively high income of IDR114 trillion from phases I and II of the tax amnesty program. Phase III took place over the first quarter of 2017 and brought in IDR21 trillion. If receipts from the tax amnesty program are stripped from non-oil and gas income tax receipts for 2016 and 2017, non-oil and gas income tax receipts grew faster in 2017 than 2016.

Amid higher state revenues in 2017, the challenge to increase tax revenues remained at the fore, given the decline in the tax-to-GDP ratio to 9.9% in 2017 from 10.4% in 2016. This issue warrants greater attention, because it threatens Indonesia's fiscal sustainability. The Table shows budgeted and actual Indonesia's State Revenue from 2015 until 2017 as below:

II.3.2 State Expenditure

Various fiscal spending strategies have been pursued to accelerate economic recovery. The quality of spending was improved, while the balance between short-term and long-term fiscal stimulus was maintained. Both central government spending and transfers to TKDD (Transfer To Region and Village Fund) have been improved, with energy subsidies better targeted and efficiencies made in spending on goods, thereby providing space for increased spending on social protection, education, health and infrastructure.

As a consequence, government spending in 2017 reached IDR 2,002.8 trillion, up 7.4% compared to 2016. This increase was also accompanied by better absorption of spending in 2017 compared to 2016 meaning that the realization of state spending in relation to the 2017 Revised State Budget target was also higher. This condition was reflected in higher central government spending, which grew by 9.2% and higher transfers to TKDD, which grew 4.5% in 2017.

The stimulus to support sustainable long-term economic growth was achieved through a productive capital expenditure policy and by increasing local involvement in infrastructure development. For central government spending, actual capital expenditure rose by 21.1%, as the continuing fiscal reforms shifted spending from energy subsidies to infrastructure.

The role of the regions in supporting fiscal stimulus was also encouraging, though further improvement is needed. Actual transfers to TKDD in 2017 came to IDR742 trillion, although growth slowed to 4.5% versus 14% in 2016. The slowing TKDD growth owed, at least in part, to a delay in the transfer of DBH (Profit Sharing Fund) funds and slower growth in physical DAK (Special Allocation Fund) for spending on facilities and physical infrastructure. This latter point is related to a new regulation requiring local governments to submit a proposal first. Meanwhile, 2017 non-physical DAK – used for operational purposes – grew by a brisk 19% and village funds by 28%, in line with the increase in the social protection budget, which is partly channeled through the regions, and the intention to empower and strengthen the villages. The table shows Indonesia's Expenditure Budget from 2015 until 2017 as below:

Table 29: Expenditure Budget 2015-2017

(billion Rupiah)

ITEMS	2015	2016	2017
Budget			
Government Expenditures	1,984,150	2,082,949	2,133,296
Central Government Expenditures	1,319,549	1,306,696	1,366,957
Current Expenditures	0	0	0
Personnel	293,129	342,447	343,656
Goods and Services	238,818	304,242	294,716
Capital	275,788	206,567	226,144
Interest payment	155,731	191,218	219,196
Domestic Interest	141,204	174,016	202,878
External Interest	14,527	17,202	16,318
Additional Interest	0	0	0
Subsidies	212,104	177,754	168,877
Oil Subsidies	64,675	43,687	44,489
Non-Oil Subsidies	147,430	134,068	124,388
Grant Expenditures	4,644	8,537	5,532
Social Assistance	107,670	53,404	58,962
Others Current Expenditures/Others Expenditures	31,664	22,525	49,874
Development Expenditures	0	0	0
Rupiah Financing	0	0	0
Project aid	0	0	0
Regional Budget Expenditures	664,601	776,253	766,339
Balance Budget	521,761	705,459	678,596
Revenue Sharing Funds	110,052	109,076	95,377
General Allocation Funds	352,888	385,361	398,582
Special Allocation Funds	58,821	211,022	184,637
Special Autonomy	122,074	23,812	27,743
Rural Fund	20,766	46,982	60,000
Actual			
Government Expenditures	1,806,515	1,864,275	2,007,352
Central Government Expenditures	1,183,304	1,154,018	1,265,359
Current Expenditures	0	0	0
Personnel	281,143	305,142	312,729
Goods and Services	233,281	259,647	291,459
Capital	215,434	169,474	208,657
Interest payment	156,010	182,761	216,568
Domestic Interest	141,904	167,753	199,977
External Interest	14,106	15,008	16,591
Additional Interest	0	0	0
Subsidies	185,971	174,227	166,401
Oil Subsidies	60,759	44,620	47,047
Non-Oil Subsidies	125,212	129,607	119,354
Grant Expenditures	4,262	7,130	5,446
Social Assistance	97,151	49,614	55,297
Others Current Expenditures/Others Expenditures	10,052	6,024	8,803
Development Expenditures	0	0	0
Rupiah Financing	0	0	0
Project aid	0	0	0
Regional Budget Expenditures	623,140	710,257	741,992
Balance Budget	485,818	639,766	654,483
Revenue Sharing Funds	78,053	90,535	88,232
General Allocation Funds	352,888	385,361	398,582
Special Allocation Funds	54,877	163,870	167,668
Special Autonomy	116,555	23,812	27,743
Rural Fund	20,766	46,679	59,767
Suspend	72	0	0

Source: Ministry Of Finance, 2018

II.3.3 Budget Financing

The increase in state revenues and controlled spending helped to maintain the 2017 fiscal deficit at a healthy level. The actual 2017 deficit was IDR 337.6 trillion or 2.5% of GDP, below the 2.9% deficit targeted in the revised budget and at a safe and healthy level to maintain fiscal sustainability. The healthy fiscal conditions were also supported by a decline in the primary balance deficit to 0.9% of GDP, down from 1.0% of GDP in 2016.

The gap in the budget that appeared following the July revisions was plugged by foreign loans and the issuance of SBN (Indonesia Government Bond). In 2017, the gross issuance of these state securities in rupiah and other currencies reached IDR 708.9 trillion, while net issuances reached IDR 463.8 trillion. Meanwhile, the drawdown of gross foreign loans in 2017 was IDR 52.8 trillion and it was slightly lower than the IDR 54.3 trillion seen in 2016.

The issuance of SBN was split by denomination, timing and tenor, and was made in both in rupiah and foreign currency denominations, namely the US dollar, euro and yen. This strategy was undertaken in the framework of safeguarding the stability of the money market and domestic liquidity. Concerning timing, the issuance of foreign currency SBN began at the beginning of 2017 with US$ 3 billion, equivalent to IDR 40 trillion. This was done to raise the potential for spending at the beginning of the year and minimize instability in the domestic market. SBN were issued in tenors of three years, five years, up to 15 years, with this variation in tenors chosen to deepen the market and divide the risk on maturing SBN.

Overall, the financing through SBN and foreign loans kept government debt at a healthy level. The Government's debt ratio in 2017 was also maintained at a low level and in a safe corridor at 29.2% of GDP, little changed from 2016's level of 27.8% of GDP. Government debt sourced from SBN reached 23.1% of GDP, while the remainder came from foreign loans. This ratio remains lower than that of other countries in the region, including Malaysia, Thailand and the Philippines. The table below shows Indonesia's Budget Financing Position from 2015 until 2017:

Table 30: Budget Financing Position 2015-2017

(Billion Rp)

ITEMS	2015	2016	2017
Budget APBN			
Surplus / Deficit	-222,507	-296,724	-397,236
Financing, Net	222,507	296,724	397,236
Domestic Financing	242,515	299,251	412,656
Domestic Bank Financing	0	19,011	0
Government Account	0	0	0
Moratorium Funds	0	0	0
Domestic Non-Bank Financing	242,515	280,240	412,656
Privatization	350	325	300
Asset Management	0	0	0
Government Bonds, Net	297,698	364,867	467,314
Issuance of Government Bonds	0	0	0
Bonds Redemption and buyback	0	0	0
Domestic Loan	1,691	3,389	1,733
Gov. Capital Participation & Investment Fund	-58,844	-88,985	-49,234
Aid Channeling	0	0	0
Infrastructure Funds	0	0	0
National Education Development Fund	0	-5,000	-10,500
Others	1,620	5,644	3,042
Foreign Financing (net)	-20,008	-2,527	-15,420
Gross Drawing	48,647	72,959	57,500
Program Aid	7,500	35,775	20,100
Project Aid	41,147	37,184	37,400
Aid Channeling	-4,472	-5,834	-7,716
Amortization	-64,183	-69,652	-65,204
Financing Surplus/Deficit	0	0	0
Additional Debt Financing/Two Step Loan	0	0	0
Actual			
Surplus / Deficit	-298,495	-308,341	-340,976
Financing, Net	323,108	334,503	366,624
Domestic Financing	307,858	344,923	386,891
Domestic Bank Financing	0	19,011	0
Government Account	0	19,011	0

Moratorium Funds	0	0	0
Domestic Non-Bank Financing	307,858	325,912	386,891
Privatization	342	552	359
Asset Management	0	0	0
Government Bonds, Net	362,257	407,259	441,826
Issuance of Government Bonds	0	0	0
Bonds Redemption and buyback	0	0	0
Domestic Loan	832	1,052	648
Capital	-59,655	-84,080	-49,254
Aid Channeling	0	0	0
Infrastructure Funds	0	0	0
National Education Development Fund	0	-5,000	-10,500
Investment Funds	0	0	0
Others	4,081	6,129	3,811
Foreign Financing (net)	15,250	-10,420	-20,267
Gross Drawing	83,821	63,424	51,727
Program Aid	55,085	35,325	20,948
Project Aid	28,737	28,099	30,779
Aid Channeling	-2,576	-5,118	-6,869
Amortization	-65,995	-68,726	-65,125
Financing Surplus/Deficit	24,613	26,162	25,648
Additional Debt Financing/Two Step Loan	0	0	0

Source: Ministry Of Finance, 2018

III. Tax Structure: Institution and Reality

III.1 Historical Background

In 1600s, The Dutch government underThe VOC (*VereenigdeOost-IndischeCompagnie*) as the delegating authority, issued policies to increase colonies revenue by raising some taxes fromagricultural products tax. From early 1811 until late 1816, Sir Thomas Stamford Raffles of The Britainacted as a governor changed the structure of land tax which had been applied by The Dutch into a new land tax*landrent* (land tax). Only in 1836 when The Dutch ruled the country for the second chance, Governor Van Den Bosch began enforcing the *cultuurstelsel* (a so-called forced cultivation system) aimed to increasing production of various commodities which had relatively strong demand in the world's market. Under such*cultuurstelsel*, villagers/inhabitants were enforcedto sell their commodities only to the Dutch Government with fixed price so that earnings from sales could be used to pay the land tax as well as farm tax. But, export fell due to worldwide economic depression in 1930s, henceThe Dutch revenues began to depend largely on taxes upon income and expenditure whereby the revenue was intended to enhance the development of The Dutch.

In 1967, a new system of tax collection called *MenghitungPajakSendiri*translated as"to calculate your own taxes" was introduced. Under this mechanism,not only couldtaxpayers calculate their tax liabilities but also they could calculate the amount of tax payable reassessed by the tax authority by the end of the fiscal year – it was the pioneer of self-assessment system in Indonesia taxation system.

Fundamental yet comprehensive changes in Indonesia tax administration occurred in January 1, 1984: The first tax reform. Since then, laws wereregularly amended in order to address the rapidly changing business environment within the country as well as to support the objectives of the government in improving the investment climate while increasing tax revenues at the same time.

The first tax reform came into force with the implementation of three primary tax laws i.e.Law of General Tax Provisions and Procedures, Law of Income Tax as well asThe Law of Value-Added Tax (VAT) and Luxury-goods Sales Tax (LST). The reform continued the next year with the enactment of Law of Land and Building Tax and Law of The Stamp Duty.

The year of 1994 was the commencement of the second tax reform whereby some regulations were amended such are General Tax Provisions and Procedures, VAT and LST, Income Tax and Land and Building Tax. The second reform came into effect on January 1, 1995, with changes, additions and deletions of several articles from previous legislation.

The third tax reform was in 1997 with the enactment of three tax laws. First,the Law of Tax Dispute Settlement Agency under whicha new agency was established whilereplacing the legacy from Dutch Law. Previously, provisions concerning appeal in Indonesia law systemwerementioned in*Regeling van het Beroep in Belastingzaken*, lastly amended in 1959. Second, Law of Tax Collection with Distress Warrant and third, Law of Acquisition Duty of Rights on Land and Building. Besides, the new Tax Court law was also enacted as a revision toLaw of Tax Dispute Settlement Agency. Based on Tax Court Law, the administrative appeal body was no longer a part of the tax institution butbecame an institution under Tax Court Secretary, Ministry of Finance where trialsare conducted in Jakarta, Yogyakarta, and Surabaya.

III.2 Tax System

III.2.1 Introduction

Tax is a compulsory contribution to the state which is payable by any individual or entity that is enforced based on the law, without any direct benefit in return and is used for the maximum welfare of the people. Tax payments constitute the realization of the citizen obligation and the role of the taxpayer to the state financing and national development. Such responsibility is in accordance with the *self-assessment* system implemented in the Indonesian.

Taxesin Indonesia are divided into two parts: Central Taxes and Local Taxes.Central Taxes areadministered by the central Government which in this case is mostly managed by the Ministry of Finance Directorate General of Taxes (DGT) as well as Ministry of Finance Directorate General of Customs and Excise responsible for import duty, export duty, and excise. DGT administers taxes as follows:

1. Income Tax
   Income tax is imposed on anytaxable individual, entity or permanent establishmentupon the income received or accrued within a taxable year comprises both resident and non-resident.
2. VAT
   VAT is imposed on the consumption of taxable goods and/or taxable services within the territory of Indonesia. Persons, corporations, or governments who consume taxable goods and/or taxable services are subject to VAT. Basically, any goods and services are taxable goods and/or taxable services, unless otherwise provided by the Laws.
3. LST
   In addition to VAT, the consumption of certain taxable goods classified luxuries, are also subject to LST. Classified as luxury are:
   a. It is not a basic necessity; or
   b. Goods are consumed by certain communities; or
   c. In general, goods are consumed by high-income people; or
   d. It is consumed to show status; or
   e. If consumed can damage the health and morale of society, and disturb the public order.
4. Stamp Duty
   Stamp duty shall be imposed on the use of documents, such as letters of agreement, notarial deeds, and receipts of payments, securities and securities, containing the amount of money or nominal amount above a certain amount in accordance with the provisions.
5. Land and Building Tax Other Than Urban and Rural Sector
   Separate regulations are applied to plantation, forestry, and mining which consists of mineral and coal mining, oil, gas and geothermal mining, as well as other industries located in national waters outside territory of regional area.

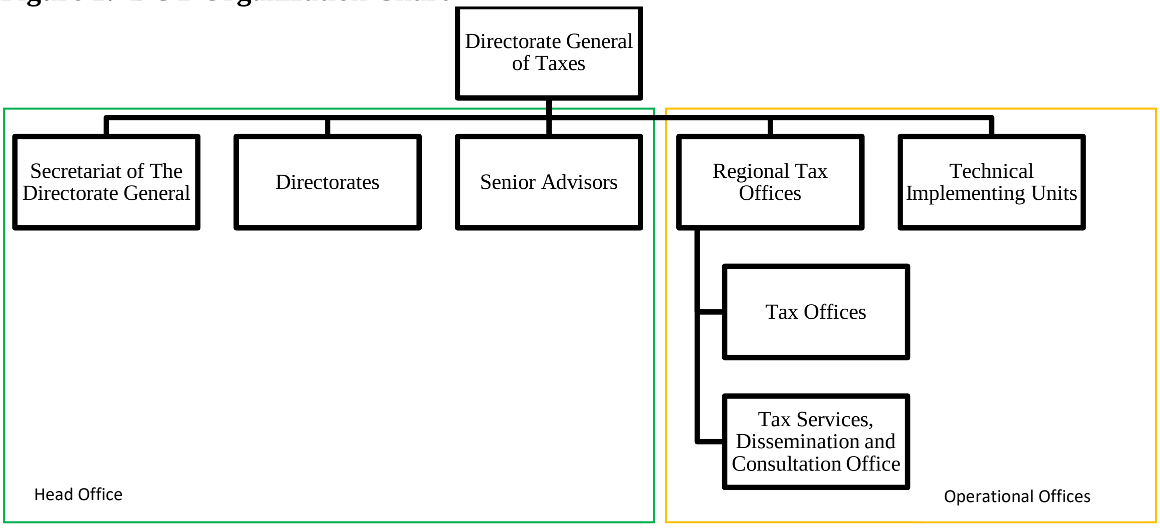
Local taxes administered by the regional Government are mainly structured as follows:

1. Provincial taxes:
   a. Vehicle tax;
   b. Transfer of Motor Vehicle Title;
   c. Motor Vehicle Fuel Tax;
   d. Surface Water Tax;
   e. Cigarette Tax.
2. District/City taxes:
   a. Hotel Tax;
   b. Restaurant tax;
   c. Entertainment Tax;
   d. Advertisement tax;
   e. Street lighting tax;
   f. Non-metallic and rock mineral taxes;
   g. Parking Tax;
   h. Groundwater Tax;
   i. Swallow's nest tax;
   j. Land and Building Tax on Urban and Rural Sector;
   k. Acquisition of Land and/or Building Rights.

III.2.2 Profile of Directorate General of Taxes

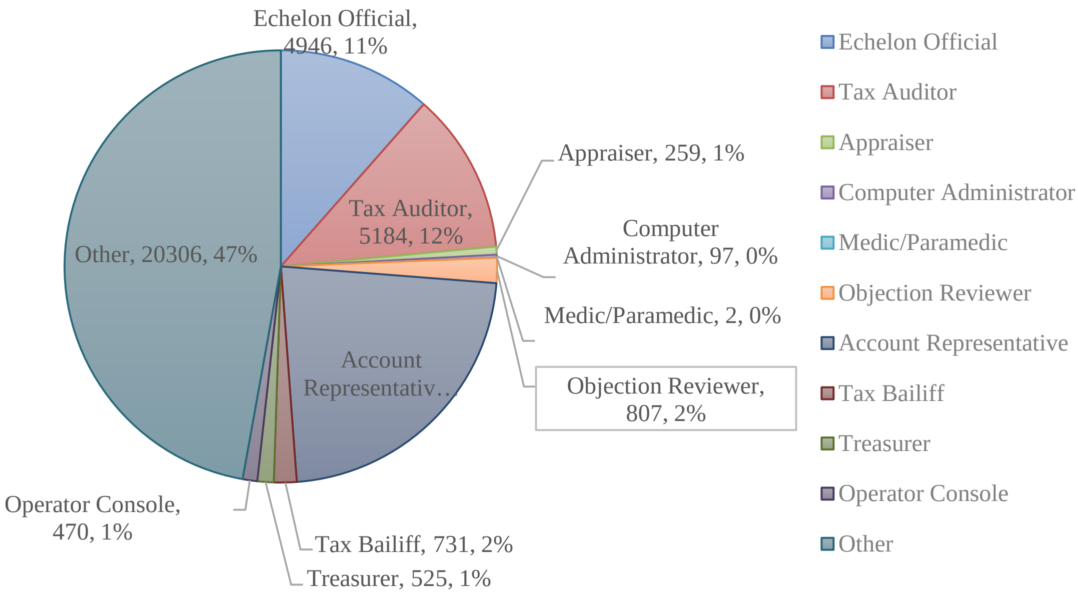
DGT is the responsible Echelon-I institution under Ministry of Finance to collect revenue with the vision is to become the best state tax administrator to ensure state sovereignty and autonomy by collecting tax revenue based on a high level of voluntary tax compliance and just law enforcement, providing modern technology-based services to ease tax obligation fulfilment, building tax officers who are competent, professional, and possessing high level of integrity, and providing competitive rewards based on performance management system. DGT vertical units encompassesThe Secretariat of DGT, 4 Senior Advisors, 14 Directorates, 33 Regional Tax Offices (RTO), 341 Tax Offices (TO), 207 Tax Service, Dissemination, and Consultation Offices (TSDCO), and 5 Technical Implementing Units (TIU) all over Indonesia.

Figure 1: DGT Organization Chart



The total number of personnel as of December 2017accounted for43,052 comprises 68% men and 32% women respectively.By age, most personnel (7,809 personnel) are at their 31-35 of age while 1,624 others aged 16-20 as the least group in population. Moreover, by educational level, 15,820 are undergraduate, 5,637 are graduate, and 43 are post-graduate.Further, based on job position, the distribution of personnel is depicted in the following graph.

Figure 2: Number of personnel by job position



Source: DGT, annual report 2017

III.2.3 Tax Revenue

Realized net tax revenue in 2017accounted for IDR 1,151.03 trillion which comprises 89.67%of the target. It saw growth of4.07% for income tax including oil and gas and 2.88% for income tax excluding oil and gas respectively. More details as follow:

Table31:DGT Net Tax Revenue

(Trillion IDR)

Year	Non-Oil & Gas Income Tax	VAT &LST	Land & Building Tax	Other Taxes	Oil & Gas Income Taxes	Total	
						Excluding Oil & Gas Income Tax	Including Oil & Gas Income Tax
2013	417.69	384.72	25.3	4.94	88.75	832.65	921.4
2014	459.08	408.83	23.48	6.29	87.44	897.68	985.13
2015	552.22	423.71	29.25	5.57	50.11	1,010.75	1,060.86
2016	630.12	412.21	19.44	8.10	36.10	1,069.87	1,105.97
2017	596.48	480.72	16.77	6.74	50.32	1,100.71	1,151.03

Source: DGT Financial Statement 2013-2017 (audited), annual report 2017

III.2.4 Taxpayer Compliance: A Tax Return Submission Outlook

Tax compliance is fundamental to increase tax revenue.Regarding this matter, DGT performs a number of efforts in achieving a high level of compliance. First, in order to be registered, a taxpayer is able to perform registration either using “e-registration” mechanism or simply visit the service counter in every tax office. E-registration is the tool intended to increase the number of registered taxpayer. As seen on following table 32, there are three types of taxpayers: individual, corporate, and treasurer. A treasurer defines as a person acted as a state treasurer who runs the treasury in any unit of government institution – they also have to register themselves to get a Tax Identification Number (TIN).

Table 32: Registered Taxpayers

Type	2017	2016	2015	2014	2013
Individual	35,540,985	33,005,315	30,184,682	27,421,041	24,821,429
Corporate	3,110,887	2,912,882	2,674,406	2,463,878	2,276,876
Treasurer	499,731	479,892	454,567	413,819	390,013
Total	39,151,603	36,398,089	33,313,655	30,298,738	27,488,318

Source: ODS Taxpayer Master File accessed on March 15, 2018, annual report 2017

However, DGT also performs another effort to the awareness of the unregistered taxpayer by intensifying tax education.Tax education program ranges from face-to-face formto various workshops, disseminations, seminars, sports events, car free day and other outdoor activities or in the form of indirect contact viawww.pajak.go.idwebsite, television and radio, or in the form of printed media such as newspapers, school text books, booklets, and or by using online and social media. Those are intensively conducted by every unit in DGT. Hence, the goal is to increase the number of tax return submission as shown on the table 33 below.

Table 33: Ratio of Annual Income Tax Return Submission

Description	2017	2016	2015	2014	2013
Taxpayers Obliged to Submit Tax Return	16,598,887	20,165,718	18,159,840	18,357,833	17,731,736
Annual Income Tax Return	12,057,400	12,256,401	10,975,909	10,854,819	9,967,904
Compliance Ratio	72.64%	60.78 %	60.44%	59.13%	56.22%

Source: DGT Compliance Dashboard accessed on July 17, 2018, annual report 2017

III.3 Current Tax Law and Regulation

III.3.1 Corporate Income Tax

III.3.1.1 Overview

Anentity is considered taxable if it has a presence and conducts business within the country. Such definition includes a place of management, branch, representative office, office building, agent, factory or workshop, construction or mining site. Such entity is required to register at the relevant DGT office for their location/status at the time or shortly after establishment thereafter an annual income tax return should be filed including its worldwide income. In addition, tax paid offshore in relation to foreign source income can be credited in the same tax year subject to certain limitations.

III.3.1.2 Tax Rates

A single flat rate of 25% has been applied since 2010. Public enterprises that satisfy a minimum listing requirement of 40% and other conditions are entitled to a tax discount of 5% of the standard rate, giving an effective tax rate of 20%. To be eligible, a public enterprise must have at least 40% of the outstanding shares owned by at least 300 persons, each holding less than 5% of the paid-in shares, and this condition must be maintained for at least 183 days in a taxable year. Small enterprises, i.e. corporate taxpayers with an annual turnover of not more than IDR 50 billion, are entitled to a tax discount of 50% of the standard rate for taxable income of up to IDR 4.8 billion.

III.3.1.3 Tax Residence

An entity is treated as a resident of Indonesia for tax purposes by virtue of having its establishment or its place of management in Indonesia. A foreign company carrying out business activities through a permanent establishment (PE) in Indonesia will generally have to assume the same tax obligations as a resident taxpayer.

III.3.1.4 Taxable Income

The object of tax is income, which is defined as any economic benefit received or accrued by a taxpayer, whether originating from within or outside of Indonesia, which is used for consumption, or which increases the wealth of the taxpayer, in whatever name or form. A company income can be defined as follows:

1. Gross profits from business;
2. Gains upon the sale or transfer of property (realized capital gains);
3. Interest, dividends, and royalties (subject to certain exceptions);
4. Rents;
5. Income from debt forgiveness and;
6. Surplus on revaluation of assets (favorable tax rate may apply).

Exchange gains or losses resulting from normal movements in currency exchange rates are, in most cases, included in taxable income in the current fiscal year irrespective of whether they are realized or unrealized. Gains or losses arising from a change in currency rates resulting from a government regulation or decree (revaluation or devaluation) may be subject to special concessions.

III.3.1.5 Exempted Income

Excluded from the definition of taxable income are, among others:

1. Gifts or donations that are not related to the business or profession of the parties involved;

2. Dividends received by a resident company from another resident company, provided:
   a. The dividend is sourced from retained earnings, the recipient owns at least 25 percent of paid up capital.
   b. The holding companies no longer need to undertake any other business activities due to removal of the ”active business” criteria for holding companies. Therefore any interest expense incurred in relation to the holding company’s investment will not be deductible since the dividends received are not taxable.
3. Income received by venture capital companies in the form of profits or dividends, as long as the investee companies meet certain requirements and the companies are not listed on the stock exchange and.
4. Income From The capital invested by the Pension Fund, in the fields of certain specified by regulation of the Minister of Finance.

III.3.1.6 Capital Gains Tax

Capital gains or losses may come from sales of a company’s assets. It is calculated as the difference between the sales proceeds and the tax written down value of the assets concerned. Capital gains are assessable while a capital loss is tax-deductible only if the asset concerned is used in the running of the business, i.e. for obtaining, collecting, and securing assessable income. The exemptions are for transactions in stock on the Indonesian stock market and on private property. The gain or loss is ignored and tax is instead charged on the transaction value. The tax rate is 0.1% of transaction value of stock, except for founder shares sold by founder 0.5% of transaction value. For Land and building, tax rate is 5 % of transfer value – final tax for individuals, foundations and corporations.

III.3.1.7 Dividend

Tax is withheld from dividends as follows:

1. Resident recipients. Dividends received from an Indonesian company by a limited liability company incorporated in Indonesia as *Perseroan Terbatas*(PT), a cooperative, or a state-owned company (BUMN/BUMD), are exempt from income tax if the following conditions are met: the dividends are paid out of retained earnings; and the company earning the dividends holds at least 25% of the paid-in capital in the company distributing the dividends;
2. Non-resident recipients: 20% (lower for treaty countries) final withholding tax is due on dividends paid to a non-resident recipient.

If these conditions are not met, the dividends are assessable to the company earning the dividends at the ordinary tax rates alongside the company’s other income. Upon declaration, dividends are subject to Article 23 income tax at 15%, which constitutes a prepayment of the corporate tax liability for the company earning the dividends. Dividends received by firma, commanditaires, foundations and similar organizations are always subject to 15% withholding tax. Dividends received by resident individual taxpayers are subject to final income tax at a maximum rate of 10%.

III.3.1.8 Deductions

The taxable income is determined after deducting allowable deduction cost from gross income. The list of allowable deduction costsis as follows:

1. The costs of deriving, recovering and conserving such income including, the costs of materials, wages, salaries of employees, employee bonuses, honoraria, cash allowances, interest, rent, royalties, travel expenses, waste treatment costs, insurance premiums, administrative costs, and taxes other than income tax;
2. Promotional and sales costs;
3. Bad debts, provided strict conditions are fulfilled;
4. Depreciation of the acquisition cost of property and amortization of costs incurred in obtaining

rights and other costs that have a useful life of more than one year;
5. “Zakat” donations if paid to an approved body by a Moslem individual or Moslem-owned business;
6. Losses from the sale or transfer of assets;
7. Foreign exchange losses;
8. Costs of research and development performed in Indonesia;
9. Scholarships, apprenticeships and training costs;
10. Donations (as regulated by Government Decree) in relation to: National disasters, Research and development in Indonesia, The provision of educational facilities, and Development of sports;
11. The provisioning of reserves for re-forestation and closure/maintenance of industrial waste storage locations are deductible for these business sectors (as further regulated by Minister of Finance Decree);
12. Goodwill can be capitalized and amortized;
13. Office refreshments;
14. Prior year losses;
15. Contributions to a pension fund approved by The Ministry of Finance (MoF).

Additionally, entertainment costs are an allowable deduction where they relate to securing, acquiring and collecting income, but substantiation requirements exist. Full details of each expense are required to be lodged with the annual tax return. Moreover, there are also some non-allowable deductions cost from gross income as follows:

1. Benefits-in-kind (BIK) for instance, free housing, 50% of the acquisition and maintenance costs of certain company provided cars, except food and drink provided to employees in the workplace, employee benefits required for job performance, such as protective clothing and uniforms, transportation costs to and from the place of work, accommodation for ship crews and the likes, the cost of providing BIKs in remote areas, and 50% of the acquisition and maintenance costs of cellular phones;
2. Private expenses;
3. Non-business gifts and aid, except Islamic alms (“Zakat”);
4. Provisions: However, certain types of provision d. are claimable as deductible expenses: provision for doubtful accounts for banking and financing companies, insurance claims provision for insurance companies, deposit security provision for the Deposit Security Blanket Institution (LPS), reclamation provision for mining companies, forestation provision for forestry companies, and area closure and maintenance provision for industrial waste processing businesses;
5. Income tax payments;
6. Tax penalties;
7. Profit distributions;
8. Employer contributions for life, health and accident insurance and contributions to unapproved pension funds, unless the contributions are treated as part of the taxable income of employees;
9. Expenses relating to income which is taxed at a final rate, e.g., interest on loans relating to time deposits;
10. Expenses relating to income which is exempt from tax, e.g., interest on loans used to buy shares where dividends to be received are not subject to income tax;
11. Salaries or compensation received by partnership or firm as members where their participation is not divided into shares.

III.3.1.9 Losses

Losses may be carried forward for a maximum of 5 years. However, for a limited category of businesses in certain regions or businesses subject to certain concessions, the period can be extended for up to ten years. The carrying-back of losses is not allowed whiletax consolidation also is not applicable.

III.3.1.10 Capital Allowances

Expenditure incurred in relation to assets with a beneficial life of more than one year are categorized and depreciated from the month of acquisition by the consistent use of either the straight-line or the declining-balance method, as follows:

1. Category 1: 50% (declining-balance) or 25% (straight-line) on assets with a beneficial life of four years. Examples of assets in this category are computers, printers, scanners, furniture and equipment constructed of wood/rattan, office equipment, motorcycles, special tools for specific industries/services, kitchen equipment, manual equipment for agriculture, farming, forestry and fishery industries, light machinery for the food and drink industries, motor vehicles for public transportation, and equipment for the semi-conductor industry.
2. Category 2: 25% (declining-balance) or 12.5% (straight-line) on assets with a beneficial life of eight years. Examples of assets in this category are furniture and equipment constructed of metal, air conditioners, cars, buses, trucks, speed-boats, containers and the like. The category also covers machinery for agriculture, plantations, forestry activity, fisheries, and for food and drink, and light machinery, logging equipment, equipment for construction, heavy vehicles for transportation, warehousing, and communication, telecommunications equipment, and equipment for the semi-conductor industry.
3. Category 3: 12.5% (declining-balance) or 6.25% (straight-line) on assets with a beneficial life of 16 years. Examples of assets in this category are machines for general mining other than in the oil and gas sector, machines for the textile, timber, chemical, and machinery industries, heavy equipment, docks and vessels for transportation and communication, and other assets not included in the other categories.
4. Category 4: 10% (declining-balance) or 5% (straight-line) on assets with a beneficial life of twenty years. Examples of assets in this category are heavy construction machinery, locomotives, railway coaches, heavy vessels, and docks.
5. Building: 5% (straight-line) on assets in the permanent building category with a useful life of 20 years; or 10% (straight-line) on assets in the non-permanent building category with a useful life of ten years. Included in the cost of the buildings is the land and building transfer duty (DAL&BR) on building rights.

Intangible property or costs, including the cost of extending building use rights, rights for business use, rights for use and DAL&BR on land rights with a useful life of more than one year, should be amortized on the following bases, as appropriate:

1. By using the straight-line or the declining-balance method at the rates specified in categories 1, 2, 3, and 4 under Depreciation, based on the useful life of the property:
   Category 1: 4 years; Category 2: 8
   years; Category 3: 16 years;
   Category 4: 20 years.
   Membership of the category is determined on the basis of the nearest useful life (e.g., an intangible asset with a useful life of six years may fall under Category 1 or Category 2, while an intangible asset with a useful life of five years is under Category 1).
2. The costs of incorporation and expansion of the capital of an enterprise are claimed in full in the year in which the expenditure is incurred or are amortized using either the declining-balance or straight-line method at the following rates:
   Category 1: 50% declining-balance; 25% straight-line
   Category 2: 25% declining-balance; 12.5% straight-line
   Category 3: 12.5% declining-balance; 6.25% straight-line
   Category 4:10% declining-balance; 5% straight-line
3. Costs incurred for acquiring the right to oil and natural gas concessions with a beneficial life of longer than one year are amortized using the production-unit method.
4. Costs incurred in the acquisition of mining rights, forest concessions, and other rights to exploit natural resources and natural products with a beneficial life of longer than one year are amortized using the production-unit method but not may not exceed 20% per annum.
5. Costs incurred before the commencement of commercial operations with a useful life of longer than one year are capitalized and amortized according to the rates set out.

Subject to DGT approval, corporate taxpayers and PEs who maintain Rupiah accounting may undertake a revaluation of their non-current tangible assets for tax purposes. This may be carried out once every 5 years. Each revaluation must include all business-related assets which are owned by the company and located in Indonesia, except for land and buildings (these may be omitted). Before requesting the DGT's approval, the company concerned must determine that it has settled all of its outstanding tax liabilities

The revaluation must be conducted on a market or fair value basis. The market values must be determined by a government-approved appraiser. These are subject to DGT adjustments if the values, in DGT's view, do not represent the fair or market values of the assets. Once approved, the depreciation applied to depreciable assets must be based on the new tax book values (approved values) on the basis of a full useful life (in other words, as if the assets were new). The excess of the fair market value over the old tax book value of the revalued assets is subject to final income tax at a rate of 10%. Subject to DGT approval, taxpayers facing financial difficulties may pay this tax in installments over 12 months.

Fixed assets falling under categories 1 and 2 must be retained at least to the end of their useful life. Land, buildings, and assets falling under categories 3 and 4 must be retained for at least 10 years of the revaluation date. Additional final income tax at a rate of 10% is imposed on the original revaluation gains if the revalued assets are sold or transferred before the end of this minimum retention period (this does not apply to assets transferred because of *forcemajeure*, assets transferred based on government decision/policy/court decision or assets transferred in the course of a tax-neutral business merger, a consolidation, or a business split and fixed asset withdrawal because of irreparable damage).

III.3.1.11 Tax Payments

Resident taxpayer and PE of foreign companies have to settle their tax liabilities either by direct payments, third party withholdings, or a combination of both. Foreign companies without a PE in Indonesia have to settle their tax liabilities for their Indonesian-sourced income through withholding of the tax by the Indonesian party paying the income.

1. Monthly tax installments (Article 25income tax) constitute the first part of tax payments to be made by resident taxpayers and Indonesian PEs. As a prepayment of their current year corporate income tax liability, a monthly tax installment is generally calculated using the most recent corporate tax return. Special installment calculations apply for new taxpayers, finance lease companies, banks and state-owned companies, listed companies and other taxpayers with periodical reporting requirements;
2. The tax withheld by third parties on certain income (Article 23 income tax) or tax to be paid in advance on certain transactions (e.g., Article 22 income tax on imports) constitute other prepayments for the current year corporate tax liability of the income recipient or the party conducting the import;
3. If the total amounts of tax paid in advance through the year (Articles 22, 23, and 25 income taxes) and the tax paid abroad (Article 24 income tax) are less than the total corporate tax due, the company concerned has to settle the shortfall before filing its corporate income tax return. Such a payment is referred to as Article 29 income tax.
4. Certain types of income earned by resident taxpayer and Indonesian PE are subject to final income tax. In this respect, the tax withheld by third parties (referred to as Article 4.2 income tax) constitutes the final settlement of the income tax for that particular income;
5. For foreign companies without a PE in Indonesia, the tax withheld from their Indonesia-sourced income by the Indonesian party paying the income (Article 26 income tax) constitutes a final settlement of their income tax due.

III.3.2 Individual Income Tax

III.3.2.1 Overview

The extent of the Indonesian income tax liability depends upon the individual's residence status in Indonesia. Resident individuals are taxed on their worldwide income, regardless of where such income arises from or for whom work or service is performed. For Indonesian-source income, there is an extensive framework of withholding taxes so that income tax is often collected by deduction at source, for example in relation to employment income, interest, dividends, royalties, rent and income from sales of property, and listed shares.

Non-resident individuals are exempted from the worldwide income reporting obligation and tax is imposed only on income derived in Indonesia. Deductions are limited to individual personal allowances. Resident individual taxpayer who receive or earn annual income exceeding the income threshold must register with the tax office and file annual income tax returns. The tax return should state the individual's income, including compensation from employment, investment income, capital gains, overseas income, and other income. Tax return also provides a summary of the individual's assets and liabilities.

A family is generally regarded as a single tax reporting unit with only a single TIN in the name of the head of the family (typically the husband). His wife and his dependent children's income must be reported on the same tax return in his name. A married woman has two options. She can choose to have her own tax identification number and report her own income tax return separately from her husband. Otherwise, she can merge her income to her husband's tax return.

III.3.2.2 Tax Rates

Most income earned by individual tax residents is subject to income tax at the normal tax rates:

Table 34: Individual Income Tax Rate

Taxable Income	Rate
Up to IDR 50,000,000	5%
Above IDR 50,000,000 up to IDR 250,000,000	15%
Above IDR 250,000,000 up to IDR 500,000,000	25%
Above IDR 500,000,000	30%

Source: Law of Income Tax.

III.3.2.3 Main Personal Relief

The amount of annual non-taxable income (PTKP) for resident individualsfirstly implemented on June 27 2016 are as follows:

Table35: Individual Main Personal Relief

Amount (IDR)	
Taxpayer	54,000,000
Spouse	4,500,000
Each dependent (max of 3)	4,500,000
Occupational expenses (5% of gross income, max Rp.500,000/month)	6,000,000
Employee contribution to *Jamsostek* for pension fund (2% of gross income)	Full amount
Pension maintenance expenses (5% of gross income, max Rp.200,000/month)	2,400,000

Source:Law of Income Tax.

III.3.2.4 Tax Residence

Indonesian tax law distinguishes between resident and nonresident taxpayers. Residents are defined as individual if he/she fulfills any of the following conditions:

a. resides in Indonesia;
b. presents in Indonesia for 183 days or more in any continuous 12-month period;
c. Presents and resides in Indonesia during the fiscal years and intend to remain in Indonesia.

Nonresident taxpayers are individuals present in Indonesia for fewer than 183 days with no intention to reside. Nonresidents need not register for tax purposes. Resident individual taxpayers are taxed on their worldwide gross income less allowable deductions and nontaxable income. Non-resident employees in the oil and gas sectors are taxed on deemed salaries based on job titles. The provisions of tax treaties may override these rules.

III.3.2.5 Taxable Income

Income is defined as any economic benefit received or accrued by a taxpayer that is used for consumption or that increases the wealth of the taxpayer, in whatever name or form. The following types of income are subject to tax:

1. Compensation or payments received or earned in connection with work or services;
2. Lottery, prizes, and awards;
3. Gross profits from individual business activities;
4. Gains from the sale or transfer of assets;
5. Refunds of tax payments already deducted as expenses;
6. Interest;
7. Dividends, in whatever name or form, paid by a corporation, payments of dividends by an insurance company to policy holders.

III.3.2.6 Benefits-in-kind

Benefits in kind received by employees, including discounted or free housing, are not taxable to the employee nor deductible to the provider/employer. However, company cars and cellular phones provided to the employee are deductible at 50% of the acquisition cost by way of depreciating those assets over their useful lives (8 years and 4 years), while cellular phone refill vouchers and repair expenses can be claimed as deduction at 50%. A full deduction however applies to food and drinks provided to employees in the workplace and employee benefits required for job performance such as protective clothing and uniforms, transportation costs to and from the place of work, accommodation for ship crews and the like, and also for housing provided in remote areas approved by the Minister of Finance.

III.3.2.7 Tax Payments

A substantial part of individual income is collected through withholding by third parties. Employers are required to Withhold Article 21/26 income tax on a monthly basis from the salaries and other compensation payable to their employees. If an employee is a resident taxpayer, the amount of tax withheld should be based on the normal tax rates (as set out above). If he/she is a non-resident taxpayer, the withholding tax is 20 percent of the gross amount (and may be set at a lower rate under a tax treaty). Various other payments to individuals also call for withholding tax obligations from the payers. These include, among others: pension payments made by government-approved pension funds; severance payments; old-age security saving payments from Jamsostek; scholarships; fees for services; prizes/awards. Typically the amount of tax withheld from this income is based on normal tax rates. Fees for certain professionals, such as lawyers, notaries, accountants, architects, doctors, actuaries and appraisers, are required to be calculated based on 50% of the gross income.

III.3.3 Tax rate for Small and Medium Enterprises and Individual Business

Government Regulation Number23of 2018 concerning Income Tax on Income from Business Received/Earned by Taxpayer with Certain Gross Turnover has been enactedon 8 June 2018 and come into effectbeginning from 1 July 2018 – it revoked the lastly applied Government Regulation Number 46 of 2013. The regulation stipulates that individual(individual businesses with small to medium range trading and services activities other than professional services, such as lawyers, accountants, translators, insurance agents, etc.)as well as corporate taxpayers other than permanent establishments having annual income up to IDR 4.8 billion are subject to final tax at 0.5%. However, taxpayers can only benefit from such new regulation only for some time limitations: 7 years for individual; 4 years for cooperative, limited partnership, or firm; and 3 years for Limited Liability Company. Excluded also on the basis of types of taxpayers among others are taxpayers who choose to apply normal tax rate based on Article 17 or 31E Law of Income Tax, individual taxpayers in the form of limited partnerships/firms delivering services categorized as freelance business activities, taxpayers who benefit from tax holiday or tax allowance, and as already mentioned, taxpayers in the form of PEs.

III.3.4 Withholding Tax

Income tax collection is mainly conducted through withholding taxes system whereby a particular income item is subject to withholding tax, the payer is generally held responsible for collection by withholding the tax.

III.3.4.1 Article 21 – Salaries and Other Payments to Individuals

Employer is required to withhold Article 21 income tax from the salaries payable to their employees and pay the tax to the State Treasury on their behalf. The same withholding tax is applicable to other payments to non-employee individuals (e.g., fees payable to individual consultants or service providers). Resident individual taxpayers without TIN are subject to a surcharge of 20% in addition to the standard withholding tax.

III.3.4.2 Article 22 - Imports

Article 22 income tax is typically applicable in the following events:

1. Importation of goods;
2. Sale of goods to the government calling for payments from the State Treasury, the State Budget General Directorate, or certain state-owned companies;
3. Sale/purchase transactions of steel, automotive, cigarettes, cement, and paper products.
4. Sale/purchase of luxurious goods.

III.3.4.3 Article 4 (2) – Final Income Tax

Resident companies, PEs, representative of foreign companies, organizations, and appointed individuals are required to withhold final tax from the following gross payments to resident taxpayers and PEs:

Table 36: Final Income Tax Rate

Description	Tax Rate
Rental of land and/or buildings	10%
Proceeds from transfer of land and building right	5%
Fees for constructions work performance	2/3/4%
Fees for constructions work planning	4/6%
Fees for constructions work supervision	4/6%
Interest on time or saving deposits and on Bank Indonesia Certificates (SBIs) other than that payable to bank operating in Indonesia and to government-approved pension funds	20%
Interest on bonds other than that payable to banks operating in Indonesia and government- approved pension funds	15%
Proceeds from sale of shares on Indonesian stock exchanges. Founder shareholders may opt to pay tax at 0.5% of the market price of their shares upon listing, otherwise, gains on subsequent sales are taxed under normal rules	0.1%
Income from lottery prizes	25%
Certain income received by individuals and corporates (except PEs) with gross turnover of not more than IDR 4.8 billion in one fiscal year.	0.5%

III.3.4.4 Article 23 – Residents

Certain types of income paid or payable to resident taxpayer are subject to Article 23 income tax at a rate of either 15% or 2% of the gross amount. Income Tax Article 23 sets 15% rate of the gross amount on dividends, interest (including premiums, discounts and loan guarantees fees), royalties, prizes and awards.

III.3.4.5 Article 26 – Non-Residents

Resident taxpayers, organizations, and representatives of foreign companies are required to withhold 20% tax from the following payments to non-residents:

1. On Estimated Net Income (ENI), being a specified percentage of the gross amount:

Table 37: Non Resident Estimated Net Income

Description	ENI	Effective Tax Rate
Insurance premiums paid to non-resident insurance companies:		
By the insured	50%	20%
By Indonesian insurance companies	10%	2%
By Indonesian reinsurance companies	5%	1%
Sale of non-listed shares by non-residents	25%	5%
Sale for by the non-residents holding of Indonesian of a conduit company companies hares/where PE serves as an intermediary	25%	5%

2. On gross amount, the object of tax would be in the form of dividend; interest including premiums, discounts (interest), swap premiums, and guarantee fees; royalties, rents and payments for the use of assets; fees for services, work, and activities; prizes and awards; and pensions and any other periodic payments. After-tax profit of a PE is exempted from withholding tax if it reinvest in Indonesia in the form of equity participation in a company established and domiciled in Indonesia for which such PE acts as the founder or one of the founders.

III.3.5 Income Tax on Certain Income in the Form of Net Assets

To provide legal certainty and simplicity while improving taxpayer's compliance after Tax Amnesty Program, Government Regulation Number 36 of 2017 concerning Imposition of Income Tax on Certain Income in the form of Net Assets Treated/Deemed as Income, Minister of Finance Regulation Number 165 of 2017 Tax Amnesty and Regulation Implementation, and Director General of Taxes Regulation Number 23 of 2017 concerning Procedures for Submission of Monthly Final Income Tax Return on Disclosure of Net Asset have been enacted, further known as Voluntary Asset Disclosure – Final Tax Rate policy.

Final rate of 25% applies for corporate taxpayer, 30% for individual taxpayer, and 12.5% for certain taxpayer. Meanwhile, types of income belong to this category are:

1. Additional net assets as referred to Article 13 par. (4) of Tax Amnesty Law;
2. Net assets owned by the end of preceding tax year which had not been disclosed or less disclosed as referred to Article 18 par. (1) of Tax Amnesty Law;
3. Net assets owned by the end of preceding tax year which had not been disclosed in Income Tax Return as referred to Article 18 par. (2) Of Tax Amnesty Law.

III.3.6 Income Tax on Land/Building Rent

Based on Government Regulation Number 34 of 2017 concerning Income Tax on Income from Rent of Land and/or Building, enacted on 2 January 2018, income derived from rental activity of land and/or building either by individual or corporation that holds land rights from related investors through the implementation of Build-Operate-Transfer (BOT) agreement is subject to 10% final tax rate.

III.3.7 Value Added Tax and Luxury-Goods Sales Tax

Eitherentity or individual, in any form, which in the course of his operationsconsisting production, import or exportof taxable goods, trading activities or taxable services, is required to register as a

Taxable Entrepreneur to DGT,however, registration by non-resident is not allowed.

III.3.7.1 Taxable Goods and Services

VAT is typically due to events involving transfers of taxable goods or provisions of taxable services in the Customs Area. Such taxable events include:

1. Deliveries of taxable goods in the Customs Area by an enterprise;
2. Importation of taxable goods;
3. Deliveries of taxable services in the Customs Area;
4. Use or consumption of taxable intangible goods originating from outside the Customs Area in the Customs Area;
5. Use or consumption of taxable services originating from outside the Customs Area in the Customs Area;
6. Export of taxable goods (tangible and intangible) by an enterprise;
7. Export of taxable services by an enterprise.

Delivery of taxable goods are defined broadly and include the following: deliveries of a title to taxable goods according to an agreement; transfers of taxable goods according to a leasing-with-option or finance-lease agreement; deliveries of taxable goods to an intermediary trader or an auction official; own-use and/or free gift of taxable goods; remaining taxable goods and certain assets originally not for sale at a company's dissolution; deliveries of taxable goods within a company (e.g., between branches, or between the head office and its branches) unless the company, at the DGT's approval, centralizes its VAT reporting; deliveries of taxable goods on consignment; deliveries of taxable goods by a taxable entrepreneur in the framework of *sharia-based* financing, whereby the deliveries are deemed to take place directly from the taxable entrepreneur to the party in need of the taxable goods.

Several exemptions apply on goods for basic necessities, mining taken from natural resources, food served in hotels and restaurants including food and drinks provided by catering services, money, gold and securities. Some other exemptions on broad area of services are medical, social and religious services, postal and account transfer services, banking, insurance and non-banking financial leasing, educational services, finance leasing, art and entertainment services, radio and television broadcasting services other than advertisements, public transportation services in land, sea and domestic air transportation, manpower and recruitment services, hotel and boarding house services, services provided by the government related to public administration and formality requirements, parking services, public telephone (by coin) services, food and catering services.

III.3.7.2 Tax Rates and Tax Base

Normal rate of 10% is imposed on importers, manufacturers, wholesalers and retailers as well as on the provision of services. While VAT law and regulation permit amendments of the rates for individual items, products with rate other than 10% are cigarettes and used cars. Services such as package deliveries and travel agents are taxed at 1%. Export of taxable goods are effectively excluded from VAT by being subject to the tax at a 0% rate.

VAT for a particular taxable event is calculated by applying the VAT rate to the relevant tax base. In most cases, the tax base is the transaction value agreed between the parties concerned. For certain events or situations, other parameters must be used as the tax base, including:

1. Market value for transactions between related parties, remaining inventories of taxable goods at a company's dissolution, and sales of (non-inventorial) assets originally not for sale;
2. Cost of sales for own-use or free gifts and internal deliveries of taxable goods (e.g., between branches, from the head office to branches);
3. Auction price for deliveries of taxable goods to an intermediary trader of an auction officer;
4. Agreed price for deliveries of taxable goods through an intermediary trader;

5. Average result per film for movies;
6. IDR 12 million per copy of imported movies;
7. 20% of total costs incurred or paid, exclusive of the acquisition price of land, for the self-construction of a building;
8. Retail selling prices for deliveries or imports of tobacco products;
9. 10% of the actual billing for package shipment services;
10. 10% of the actual billing for tour and tourism agency services whose deliveries are not based on commissions;
11. 20% of selling price on the deliveries of gold jewelry, including services carried out by the factory in relation to gold jewelry;
12. 10% of actual billing on the deliveries of freight forwarding services in which billing includes freight charges.

III.3.7.3 Relief for Export Manufacturers

A number of relief schemes allows export manufacturers to operate on a virtually VAT and duty-free basis including bonded zones, economic development zones (KAPET) and free trade zones. For example, free trade zones (Sabang, Batam, Bintan, and Karimun)as well as free ports are located in Indonesia but are considered outside the customs area thereby goods brought into these areas are exempted from import duties, VAT and LST. Business activities whichare able to be carried out in a free trade zone, among others, are trade, services, mining, transportation, banking and manufacturing.

III.3.7.4 VAT Reporting

A company carrying out business activities through a number of business units/branches in the working areas of different tax offices must have its units/branches registeredto relevant tax offices depending on the location/domicile. Such mechanism applied is in accordance with the context that internal deliveries of taxable goods within a company line of business are subject to VAT. Hence, corporation and individual as taxable entrepreneurs are obliged to report their business activities as well asto settle their VAT liabilities on a monthly basis.

Upon approval from DGT, a company is permitted to centralize its VAT reporting and thereby is allowed to exclude internal deliveries of taxable goods from VAT. In order to obtain such approval, several conditions must be met including centralization of sales administration,however, such company is also allowed whether to choose to centralize their VAT reporting without fulfilling other conditions if it files e-tax returns. Also, companies registered to Special Tax Office, Large Tax Office, and Medium Tax Office are required to centralize their VAT reporting.

III.3.7.5 Input-Output Mechanism

VAT liabilities are settled by an input-output mechanism. First,a vendor of taxable goods or a taxable service typically charges VAT to its buyer. From the vendor's perspective, it is regarded as an output tax. Second, the buyer has to pay VAT to the vendor as an input tax. In such input-output mechanism, both vendor and buyer must be registered as taxable entrepreneurs.

Input tax can be credited against output tax. A vendor isallowed to offset the output tax against its input tax on the acquisition of taxable goods or taxable services, and so is the buyer. If the amount of accumulated output tax (output tax derived from many transactions) for a particular month exceeds the amount of accumulated input tax for the same period, taxable entrepreneur has to settle the amount difference by the following month. On the contrary, if the amount of accumulated input tax for a particular month exceeds the amount of accumulated output tax, such taxable entrepreneur may ask for a refund at the end of tax year or else he could carry over excess amount oftax paid (input tax)for following months.

With regards to invoice used for the input-output mechanism, DGT has begun implementing the use of electronic VAT invoices (e-VAT invoice) for all registered entrepreneurs since 1 July 2016. It is regarded the samelegal invoice withpaper-based invoice and taxable entrepreneur shall use IDR currency and apply hisdigital signature.

III.3.7.6 VAT Refund

Refund application can be filled and submitted at the end of an accounting year. DGT then woulddetermine on a refund application within 12 months by conducting a VAT audit. Relevant supporting documents for a VAT refund must be submitted to DGT within a month after the date of application. In addition, an early VAT refund is applicable to certain taxpayers regarded obedient.

III.3.8 Luxury-Goods Sales Tax (LST)

The VAT law also imposes LST on delivery of luxury goods by foreign manufacturers into Indonesia as well as on the importation of luxury goods by residents. Rates vary depending on the category of the goods (up to 200% rate) and suchLST is imposed only once by multiplying the applicable rate by the sales/import price excluding VAT.

Similar to VAT, no LST is imposed on the export of luxury goods, hence, purchase of luxury goods cannot be credited against the collectable VAT when suchluxuries are subsequently sold. In broad terms, some of the main types of goods are subject to LST includes passenger vehicles, alcoholic beverages, certain food and non-alcoholic beverage products, household appliances and electronic goods, cosmetics, luxury homes and apartments, and so forth.

III.3.9 Stamp Duty

Under Law Number 13 of 1985, stamp duty is nominal and payable as a fixed amount of either IDR 6,000 or IDR 3,000 on certain documents. Examples of documents subject to stamp duty are as follows:

1. Letters of agreement and other letters (such as authorization letters, letters bestowing gifts, or declarations) which are prepared for the purpose of being used as evidence of act, fact, or condition of a civil nature.
2. Notary’s deeds and their copies.
3. Deeds prepared by a designated land notary (“PejabatPembuatAkta Tanah”).
4. All documents bearing a sum of money which:
    a. State the receipt of money;
    b. State the recording or deposit of money in a bank;
    c. Contain notification of a bank balance;
    d. Contain the acknowledgement of debt wholly or partly paid or compensated;
    e. Are in the form of valuable documents such as drafts, promissory notes, or acceptances;
    f. Are in the form of securities, in whatever name or form;
    g. Are in the form of cheque.
5. Documents to be used as instruments of evidence before a court:
    a. Ordinary letters or internal papers
    b. Paper 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.

The IDR 6,000 rate is applicable to (a), (b), (c), and (e). For (d), the rate is IDR 6,000 when the money value stated in the document is more than IDR 1 million, and IDR 3,000 when the value is between IDR 250,000 and Rp1 million. Values below IDR 250,000 are not subject to stamp duty. For cheque, the rate is IDR 3,000 regardless of the monetary value stated.

III.3.10 Land and Building Tax Other than Urban and Rural Sectors

Minister of Finance Regulation Number 131 of 2017 concerning Administration on Land and Building

Tax on Mining Sectors for Petroleum, Natural Gas, and Geothermal regulates the payment procedure and its adjustment of terminology to provision of Geothermal Law. Moreover, Minister of Finance Regulation Number 81 of 2017 and Number 82 of 2017 regulate deduction of administration fines of land and building tax along with deduction/cancellation of tax assessment/collection and criteria for granting deduction of land and building tax respectively. As depicted on the following table, there were 10,179 objects registered on respective land and building tax.

Table 38: Object of Land and Building Tax

Sector	2017	2016	2015	2014	2013
Plantation	4,401	4,275	8,637	13,663	14,115
Forestry	683	647	562	569	517
Mining	5,095	4,760	4,803	4,252	2,533
Total	10,179	9,682	14,002	18,484	17,165

Source: Directorate of Extensification and Valuation, annual report 2017

III.3.10 Tax Assessment

Indonesian taxation relies on a self-assessment system under which taxpayers are trusted to calculate, pay, and report their own taxes by themselves in accordance with prevailing tax laws and regulations. However, the DGT may issue tax assessment letters to a particular taxpayer if it finds that, based on a tax audit or other information the taxpayer has not fully paid its tax liabilities. A tax assessment letter may also be issued by the DGT to a taxpayer who ignores a warning letter to file a tax return in a specified period. Failure to maintain books in accordance with the prescribed standards is another condition that may lead the DGT to perform an official tax assessment.

III.3.9.1 Notice of Tax Assessment

A notice of tax assessment pertains only to one specific tax for one particular tax period or year which includes:

1. Notice of Tax Collection (NTC) which is a form of a notice for the collection of tax and oradministrative penalties in the form of interest and or fines;
2. Notice of Tax Underpayment Assessment (NTUA) which specifies a principle amount of tax payable, amount of tax credit, a principle amount of underpayment tax payable, amount of administrative penalties, and total of tax due;
3. Notice of Additional Tax Underpayment Assessment (NATUA) which specifies an additional amount of tax payable over previously issued tax assessment;
4. Notice of Nil Tax Assessment (NNTA) which specifies the principle amount of tax payable is as much as the amount of tax credit, or, there is no tax payable and no tax credit;
5. Notice of Tax Overpayment Assessment (NTOA) which specifies an amount of tax overpayment as a result of the amount of tax credit is greater than the tax payable, or the tax paid should not have been payable.

III.3.11 Tax Audit

According to Article 29 Law of General Provisions and Tax Procedures, DGT is authorized to perform audit to assess tax compliance, in the form of risk-based audit and routine audit, and for other purposes with respect to the implementation of tax laws and regulations. Tax compliance audit is generated by 2 condition of cases. The first condition is mandatory requirement by tax law with regards to the taxpayer’s rights and obligations, and the second condition is that DGT detectssome risks or tax gaps from the business sector or specific tax payer as a result of either bottom-up risk analysis or top-down risk analysis.

III.3.11.1 Objectives of Tax Audit

In the framework of exercising administrative supervision, DGT shall undertake audit for the purpose of assessing tax compliance and for other purposes in respect of the implementation of the tax laws and regulations as structured below.

1. Audit for the purpose of assessing taxpayer's compliance:
   a. overpayment tax return including those that have been granted preliminary tax returns;
   b. loss-reported tax return;
   c. overdue or not-submitted tax return (beyond the time period specified in the Letter of Reprimand) delivered;
   d. performing a merger, consolidation, division, liquidation, dissolution, or having intention to leave Indonesia permanently;
   e. Tax return which meet the selection criteria based on the results of the analysis (risk-based selection) is regarded as non-compliant.
2. Audit for other purposes:
   a. To issueTIN ex-officio;
   b. To terminatea taxpayer's TIN;
   c. To confirm or revoke taxable person for VAT purposes;
   d. Taxpayer lodges objection;
   e. To collect material for determination of net deemed-profit;
   f. To verify data and/or information;
   g. To determine whether taxpayer is located at remote area;
   h. To designate one or more places where VAT is payable;
   i. Audit is in the framework of tax collection;
   j. To determine the commencement of production or extending the time period of loss compensation relating to granting tax incentives; and or
   k. To fulfill information request from treaty partner country with respect to the implementation of exchange of information of the tax treaty.

III.3.11.2 Closing-Conference

In the final stage of tax audit, tax auditors will provide the taxpayer a written notification of the findings containing a proposed tax audit corrections. Then, taxpayer shall respond within 7 days – in some cases, as auditor's discretion, time limit can be extended up to 21 days. Within 3 weeks, a final discussion about the tax audit findings (closing-conference) will be held between tax auditors and the taxpayer.

A closing-conference serves as the last opportunity for the taxpayer to reassert its position with regards to the tax audit corrections by presenting relevant supporting documents. Tax auditors may change some of proposed corrections in light of the taxpayer's response to audit findings notification and the closing-conference discussion. The results of such final discussion are then summarized into a closing-conference document which states agreement or disagreement from the taxpayer. By the end of the closing conference, tax auditors and the taxpayer have to sign the closing-conference document.

III.3.12 Tax Investigation

Tax investigation is the ultimate tax enforcement method conducted when other approaches e.g. reminder, counseling, and audit are considered to be ineffective. It can only be conducted by Certified Tax Officers with technical support from the Police. In details, tax crime is regulated on article no. 38, 39, and 39A of the General Law.

Generally, tax crime can be divided into 2 categories:

1. Pure tax crime case.It is mostly related to invoice based on fictitious transaction and other fictitious tax documents.A clear proof of crime usually detected within tax administration. For such cases, tax investigation takes the first place to conduct a covered preliminary-investigation;
2. Escalated tax fraud case.It is the kind of fraud conducted by evading tax amount or tax obligation. Such crime requires tax investigation to be preceded by other enforcements, yet in a preliminary-

investigation, tax payer can avoid investigation by declaring a self-correction or an adjustment related to data or information in accordance with tax regulations.

As stated in the law, there are four major *modus operandi* of tax crime, as follows:

1. By issuing or using tax invoice which is not based on real transactions;
2. By withholding tax, but do not pay such withheld amount;
3. By submitting incorrect or incomplete information Tax Return;
4. Not submitting the Tax Return.

III.3.13 Tax Dispute Settlement

Judicial process of tax administration can be divided into 2 main categories: administration of impartial justice in DGT and Partial Justice in Tax Court and Supreme Courtas shown in the following table. Impartial Justice in DGT covers Objection, Correction, Deduction, Annulment, and Cancellation of Tax Assessment, while Partial Justice in Tax Court and Supreme Court covers Appeal, Lawsuit and Review.

III.3.13.1 Impartial Justice in DGT

In the implementation of the provisions of the tax law and regulations, there are several legal measures which could be taken by taxpayers if they disagree with the tax assessment, namely:

1. Tax objection over NTUA, NATUA, NNTA, and NTOA, Notice of Land and Building Tax Payable, Notice of Land and Building Tax Assessment, Notice of Acquisition Duty of Right on Land and Building Assessment Underpayment, Notice of Additional Acquisition Duty of Right on Land and Building Assessment Underpayment, Notice of Acquisition Duty of Right on Land and Building Assessment Overpayment, Notice of Nil Acquisition Duty of Right on Land and Building Assessment, and other withholding tax by third parties;
2. Correction of notice of tax assessment, Notice of Tax Collection (NTC), and decrees for any error in writing, miscalculations, and mistake in the application of certain provisions of tax law and regulations;
3. Deduction or annulment of administrative penalties either due to the negligence of taxpayers or not;
4. Deduction or cancellation of incorrect tax assessment notice;
5. Deduction or cancellation of incorrect NTC;
6. Deduction of administrative penalty for Land and Building Tax;
7. Deduction of payable for Land and Building Tax and Duty of Rights on Land and Building Acquisition; and
8. Cancellation of tax audit result or Notice of Tax Assessment resulted from audit thatconducted without notification of tax audit finding or without closing-conference with taxpayers.

III.3.13.2 Partial Justice in Tax Court and Supreme Court

III.3.13.2.1 Appeal and Lawsuit

In relation to tax disputes in the partial administrative court process, taxpayers can only file appeals and lawsuit to Tax Court. Appeals is submitted based on the Decree of Objection, while the lawsuit is submitted by taxpayers against:

1. Execution of Distress Warrant, Notice of Seizure, or Auction Announcement;
2. Decision on prevention in framework of tax collection;
3. Decision pertaining to the execution of tax;
4. Decision, other than those stipulated in Article 25 par. (1) And Article 26 Law of GeneralProvisions and Tax Procedures; or
5. Issuance of notice of tax assessment or decision on tax objection that is not in accordance with the procedures set out in tax law provisions.

III.3.13.2.2 Judicial Review

Both taxpayers and DGT have the rights to take extraordinary legal attempts to the Supreme Court, known as Review. Review can be submitted within a maximum period of three months since a decision has been delivered by a Tax Court**.**Further**,** Review is filed by DGT to the Supreme Court in form of Memory of Review. Upon the Review filed by taxpayers to theSupreme Court, DGT shall be obliged to respond in the form of Counter Memory of Review.

Appeal decisions or claim from Tax Court could be filed for Review by taxpayers and DGT for several reasons, namely:

1. The Tax Court verdicts are based on falsity or deceit of the counterparty which is revealed after the cases have been ruled or based on evidence which then declared as false by the judges;
2. There is new and decisive written evidence, which if presented at the trial in the Tax Court may result in different verdict;
3. Some issues, that were not charged or more than what have been charged, have been granted except that issues have been terminated under the Article 80 paragraph (1) letter b and c of Tax Court Law;
4. Concerning a part of the lawsuit which is yet to be decided without being given duly consideration; and
5. There is a verdict which clearly is not in accordance with the provisions of prevailing law and regulations.

III.3.13.3 Other Dispute Settlements and Granting of Legal Assistance

III.3.13.3.1 Case Handling

Case handled by DGT includes lawsuit, bankruptcy, state property disputes, state administrative lawsuit, and those related to information dispute resolution to the Public Information Commission. In general, types of lawsuit filed by taxpayers are:

1. Investigation, preliminary investigation, and tax crime investigation, with several case examples, namely:
   a. Audit period exceeds the standard audit period stated in the provisions of tax law and regulations;
   b. Understanding of tax crime as *ultimumremedium*, in which taxpayers believe that audit must be conducted prior to preliminary investigation, and correspondingly, investigations must be preceded by a preliminary investigation;
   c. taxpayers raise the issues on tax stipulation expiration (Article 13 Law onGeneral Provisions and Tax Procedures) and prosecution of tax crimes (Article 40 Law on General Provisions and Tax Procedures), in which taxpayers consider that if an annual tax return is not disputed for five years, then it is regarded legal, thus consequently cannot be audited or investigated;
   d. Related to the granting of power of attorney by taxpayers to tax consultants to represent them in investigation process, in which the tax consultants consider themselves could properly represent the taxpayers without obtaining tax consultant permit;
   e. Pre-trial request by taxpayers who are under investigation or suspected of committing tax crime.
2. Tax debt collection related to confiscation, hostage-taking/*gijzeling*, and bankruptcy, with several cases as follows:
   a. Tax offices are late in collecting tax arrears, for example, being late in carrying out auction for confiscated assets;
   b. Schemes where company management structure are strategically changed in an attempt to escape responsibility as tax bearers;

c. Wrongful confiscation of taxpayers' assets by tax offices;
d. Resistance from Taxpayers subject to hostile-taking/*gijzeling* by submitting pretrial requests;
e. Taxpayers use bankruptcy scheme as an effort to avoid the obligation to pay tax debt. This is made possible due to different opinion between DGT, curator, and judge in determining preferential creditor.

3. Dispute on state properties, for example:
   a. Procurement process;
   b. Documentation of ownership; and
   c. Insufficient maintenance.

III.3.13.3.2 Legal Assistance

DGT actively provides legal assistance for its employees, retired employees, or former employees who are summoned by law enforcement officials as witnesses and experts related to their duties as DGT employees. Additionally, DGT also monitors lawsuit process in which its employees, retired employees, or former employees is a suspect. In general, DGT provide legal assistance in 2017 in its capacity as a witness, both in the investigation and trial process.

III.3.13.3.3 Legal Opinion

DGT provides legal opinion to tax offices classified as follows:

1. Implementation of Tax Amnesty Law;
2. Tax collection and tax crimes investigation;
3. Preparation of memorandum of understanding, contracts and cooperation agreements between DGT and other institutions;
4. Legislative drafting of Law, Government Regulation in Lieu of Law, Government Regulation, Minister of Finance Regulation, andDirector General of Taxes Regulation;
5. Mitigation of legal risk for tasks implementation, particularly related to strategic programs such as the development of DGT information technology systems, urgent regulations preparation, plans for *gijzeling* and preliminary investigation, as well as procurement of goods and services.

III.3.13.3.4 Test Material

Overall, the handling of judicial review conducted by DGT in 2017 is explained in the following table.

Table 39: Dispute Material Tests 2017

Case Number	Subject Matter of Request	Status
22/PER/III/22P/HUM/2017 dated 17 March 2017	Director Generalof Taxes Regulation Number 32 of 2012 as amended by Number 47 of 2015 concerning Procedure for Imposing Land and Building Tax on Mineral and Coal Mining in Mining Sector	Won
27/PUU-XV/2017 dated 19 May 2017	Article 32 paragraph (3a) of Law on General Provisions and Tax Procedures concerning Requirements and Implementation of Rights and Obligations of Taxpayer Representatives Stipulated by Minister of Finance Regulation	Revoked
63/PUU-XV/2017 dated 5 September 2017	Article 32 paragraph (3a) of Law on GeneralProvisions and Tax Procedures concerningThe Authority of Minister of Finance to Establish Requirements forTaxpayerRepresentatives	Ongoing

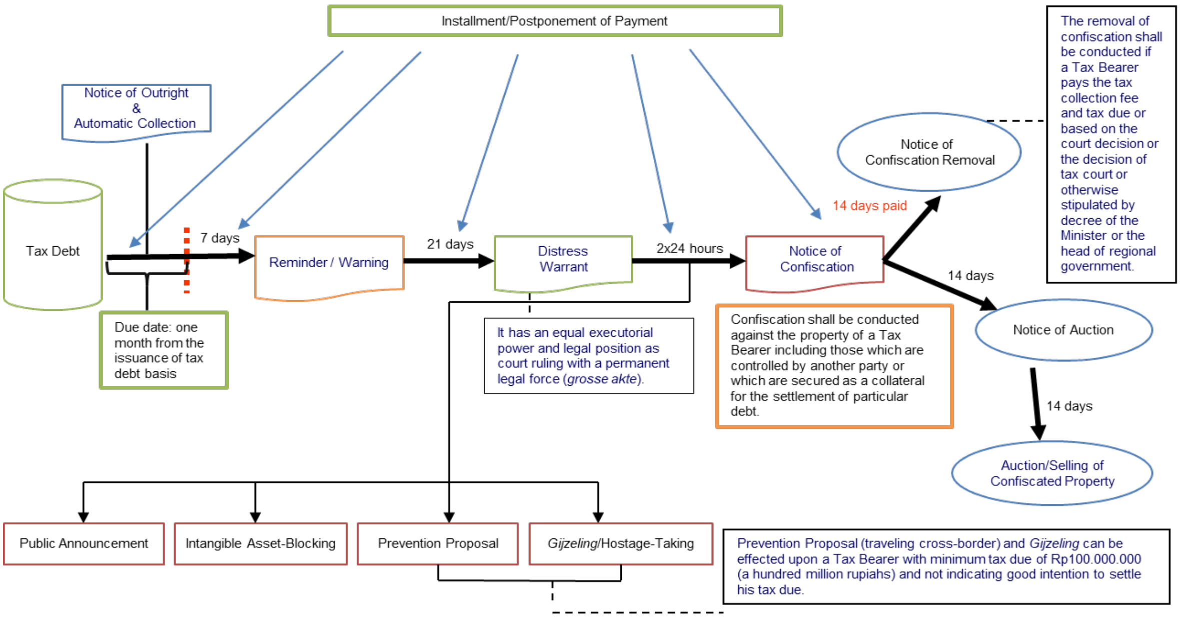
Source: DGT, annual report 2017

III.3.14 Tax Collection

Law Number 19 of 2000 concerning Tax Collection With Distress Warrants definesTax Collection as a series of measures intended to make a tax bearer settle his/its tax debts and tax collection fees by serving him/it a reminder/a warning, implementing outright and automatic collection, notifying distress warrants, proposing prevention, implementing confiscation, implementing hostage-taking and selling confiscated property. For more detailed collection enforcement mechanism, see figure 1 below.

A distress warrant shall have at its heading the words of "FOR THE SAKE OF JUSTICE ON THE BASIS OF GOD THE ALMIGHTY" and shall have an equal executorial power and legal position as a court ruling with a permanent legal force. Thus, tax collection with distress warrants shall be performed without assistance fromany court ruling, even more, it could not be effected by any appeal. However, a lawsuit could be regarded a legal effort only against the implementation of tax collection procedure and ownership of property as regulated in the prevailing laws.

Figure 3: Tax Collection Enforcement



The basis for tax collection which contribute to the formation of tax debt, among others are: NTC, NTUA, NATUA, Decision on Objection (DO), Notice of Tax Correction (NTCR), Decision on Appeal (DA),and Decision on Review (DR) as well. In particular, NTCR is notice for correcting errors in writing, calculation, and or errors in the application of particular provisions of the tax laws found in a notice of tax assessment, NTC, DO, Decision on Deduction or Annulment of Administrative Penalties, Decision on Deduction or Cancellation of Inaccurate Tax Assessment, or Decision on Pre-audit Refund of Tax Overpayment, tax assessment notices issued by the Directorate General of Customs and Excise, as well as tax assessment notices issued by Regional Taxes authorities (including official assessment notices of Land and Building for Urban and Rural Area Tax which previously issued by DGT).

Thus, there are two key unique issuesregarding Law Number 19 of 2000. First, Tax Collection Law applies to both Central and Regional collection of taxes. In the meantime, the implementation of the law is performed by Central Taxes Authorities i.e. DGT and Directorate General of Customs and Excise – the implementation by Regional Taxes authorities is undergoing mostly on regional regulations enactment phase.Second, the executor who is assigned to perform tax collection measures by such Law is Tax Bailiff who acts as prosecutor of the Law.All Tax Bailiff's tasks i.e.implementing a letter of instruction for outright and automatic collection, notifying a distress warrant, implementing the confiscation of the property of a tax bearer on the basis of a letter of instruction for the implementation of confiscation, and implementing hostage-taking on the basis of a letter of instruction for hostage takingis supported by the authorization to enter and examine all rooms including opening cupboards, drawers and other places in order to find the objects of confiscation at a business place of the tax bearer and conduct confiscation at his domicile or at his residence, or at other places which may alleged as places where the objects of confiscation are kept.

III.3.15 International Taxation

III.3.15.1 Tax Treaties

Tax treaties provide tax benefits in the form of withholding tax exemptions for service fees as well as in the form of reduced withholding tax rates on dividends, interest, royalties, and branch profits received by resident of a country with which Indonesia signed a tax treaty. Such tax exemption on the service fees is typically granted only if the foreign party earning the income from Indonesia does not have any PE in Indonesia. Hence, to claim the reduced rates, foreign partyshall present its certificate of residence (CoR) to DGT through itsrelated Indonesian party. Failure submittingsuch document, itis not entitled to tax benefit therein tax is withheld at a rate of 20%.

Regarding interest, dividends, and royalties, it is the beneficial owner acknowledged as the party entitled to the tax treaty benefits.In order to benefit from tax treaties, such following criteria should be met:

1. An individual whodoes not receive income as an agent or nominee;
2. An institution that is explicitly named in the tax treaty or one that has been agreed by the Competent Authority in Indonesia and its treaty partner;
3. An offshore company that earns income through a custodian from share or bond transactions in Indonesian Stock Exchange (except interest and dividends), that is not an agent or nominee.
4. A company whose shares are listed on the stock exchange and traded regularly;
5. A bank; or
6. Any other company that meets specific requirements:
    a. The company is established in the tax treaty partner country and the way transactionsconductedare not merely to enjoy tax treaty benefits – business activities are managed by the company’s own management thatpossesses sufficient authority to carry out transactions;
    b. The company has employee(s);
    c. The company has activities or an active business;
    d. Income derived from Indonesia is taxable in the recipient’s country;
    e. The company does not allocate more than 50% of its total income to fulfill its obligationssuch as interest, royalty, or other payments to other parties.

In addition, the withholding tax rates applicable under tax treaties are summarized as below.

Table 40: Indonesia Tax Treaty Networks and Its Withholding Tax Rates

No	Country	Dividends		Interest	Royalties	Branch Profit Tax
		Portfolio	Substantial Holdings			
1	Algeria	15%	15%	15%	15%	10%
2	Armenia	15%	10%	10%	10%	10%
3	Australia	15%	15%	10%	15% / 10%	15%
4	Austria	15%	10%	10%	10%	12%
5	Bangladesh	15%	10%	10%	10%	10%
6	Belgium	15%	10%	10%	10%	10%
7	Brunei	15%	15%	15%	15%	10%
8	Bulgaria	15%	15%	10%	10%	15%
9	Canada	15%	10%	10%	10%	15%
10	China	10%	10%	10%	10%	10%
11	Croatia	10%	10%	10%	10%	10%
12	Czech Republic	15%	10%	12.5%	12.5%	12.5%
13	Denmark	20%	10%	10%	15%	15%
14	Egypt	15%	15%	15%	15%	15%
15	Finland	15%	10%	10%	15% / 10%	15%
16	France	15%	10%	15%/10%	10%	10%
17	Germany	15%	10%	10%	10%	10%
18	Hong Kong	10%	5%	10%	5%	5%
19	Hungary	15%	15%	15%	15%	20%
20	India	10%	10%	10%	10%	15%
21	Iran	7%	7%	10%	12%	7%
22	Italy	15%	10%	10%	15% / 10%	12%
23	Japan	15%	10%	10%	10%	10%
24	Jordan	10%	10%	10%	10%	20%
25	North Korea	10%	10%	10%	10%	10%
26	South Korea	15%	10%	10%	15%	10%
27	Kuwait	10%	10%	5%	20%	10%
28	Laos	15%	10%	10%	10%	10%
29	Luxembourg	15%	10%	10%	12.5%	10%
30	Malaysia	10%	10%	10%	12.5%	10%
31	Mexico	10%	10%	10%	10%	10%
32	Mongolia	10%	10%	10%	10%	10%
33	Morocco	10%	10%	10%	10%	10%
34	Netherlands	10%	10%	10%	10%	10%
35	New Zealand	15%	15%	10%	15%	20%
36	Norway	15%	15%	10%	15% / 10%	15%
37	Pakistan	15%	10%	15%	15%	10%
38	Papua New Guinea	15%	15%	10%	10%	15%
39	Philippines	20%	15%	15%	15%	20%
40	Poland	15%	10%	10%	15%	10%
41	Portugal	10%	10%	10%	10%	10%
42	Qatar	10%	10%	10%	5%	10%
43	Romania	15%	12.5%	12.5%	15% / 12.5%	12.5%
44	Russia	15%	15%	15%	15%	12.5%
45	Saudi Arabia[1]	-	-	-	-	-
46	Seychelles	10%	10%	10%	10%	20%
47	Singapore	15%	10%	10%	15%	15%
48	Slovakia	10%	10%	10%	15% / 10%	10%
49	South Africa	15%	10%	10%	10%	20%
50	Spain	15%	10%	10%	10%	10%
51	Sri Lanka	15%	15%	15%	15%	20%
52	Sudan	10%	10%	15%	10%	10%
53	Surinam	15%	15%	15%	15%	15%
54	Sweden	15%	10%	10%	15% / 10%	15%
55	Switzerland	15%	10%	10%	10%	10%
56	Syria	10%	10%	10%	20 % / 15%	10%
57	Taiwan	10%	10%	10%	10%	5%
58	Thailand	20%	15%	15%	15%	20%
59	Tunisia	12%	12%	12%	15%	12%
60	Turkey	15%	10%	10%	10%	10%
61	Ukraine	15%	10%	10%	10%	10%
62	United Arab Emirates	10%	10%	5%	5%	5%
63	United Kingdom	15%	10%	10%	15% / 10%	10%
64	United States	15%	10%	10%	10%	10%
65	Uzbekistan	10%	10%	10%	10%	10%
66	Venezuela	15%	10%	10%	20%	10%
67	Vietnam	15%	15%	15%	15%	10%
68	Zimbabwe[2]	20%	10%	10%	15%	10%

Notes:
1. Limited to both countries airline companies
2. A protocol amending tax treaty has been signed, pending the ratification of the protocol and the exchange of ratification documents.

III.3.15.2 Thin Capitalization

Based on Minister of Finance Regulation number 169 of 2015 (PMK-169), the ratio of debt to equity (DER) has been set to 4:1. Any borrowing cost on debt which exceeds this ratio will not be tax-deductible for corporate income tax purpose.The ratio is used to limit the amount of deductible interest expense related to income tax calculation in order to meet the arm's length principle.

Some sectors are exempted from this regulation, such as banks, financial institutions, insurance and re-insurance companies, mining, oil and gas enterprises that are bound by production sharing contract (PSC), Contract of Work or Coal Contract of Work which itself governs the DER. In case a contract does not mention any provision for the DER or the contract has come to its expiry, PMK-169 will prevail and those exempted companies are subject to final income tax and infrastructure companies.

The implementation of PMK-169 is clarified under Director General of Taxes Regulation Number 25 of 2017 (PER-25) enacted on 28 November 2017. Not only does it provide details on thin capitalization implementation but also it includes the obligation to report DER calculation and private loan details as part of a corporate income tax return to DGT.

III.3.15.3 Controlled Foreign Company (CFC) Rules

Under Minister of Finance Regulation Number 107 of 2017 which revoked PMK-256/2008 and partially Minister of Finance Decree Number 164 of 2002 concerning Foreign Tax Credit (FTC) for dividend paid by a CFC, a dividend is deemed to be derived from a CFClocated in certain countries ifone or more Indonesian resident taxpayers hold at least 50% of the paid-up capital in such foreign company. Such measure is established in order to curb tax avoidance by resident taxpayers through offshore investments. This condition applies if onlya CFC does not trade its share on the stock exchange.

In case there is no dividend derived from offshore company, the resident taxpayer must calculate and report the deemed dividend on its corporate tax return. Otherwise, the Ministry of Finance would do so – the dividend is deemed to be derived either within 4 months following the deadline for filling the tax return in the offshore country, or seven months after the offshore company's tax year ends.

In brief, key aspects to such new regime encompasses detail definition of CFC which captures not only a non-listed foreign entity but also captures indirect CFC, introduction of "deemed dividend" concept, taxable dividend calculation, CFC income exemption, carried forward "deemed dividend", unrecognized CFC's loss, no distinction either on CFC's active or passive income, and FTC. Particularly, FTC limitation is based on under following limits whichever is the lowest:

1. The effective tax treaty rate that is payable;
2. Foreign income tax;
3. An amount which is calculated based on the proportion of dividend received from a direct CFC and the deemed dividend multiplied by the income tax due on such deemed dividend.

In order to claim the FTC, a taxpayer shall submit documents among others are financial statements, copy of corporate income tax return, calculation of after-tax profit for past five years, and a tax payment slip on actual dividend paid. Nevertheless, in case dividends are derived from several countries, a per-country limitation applies.

III.3.15.4 Transfer Pricing

Detailed transfer pricing guidelines has been issued which in principle is in-line with The Organization for Economic Co-operation and Development (OECD) guidelines i.e. Director General of Taxes Regulation number 43 of 2010 and number 32 of 2011 concerning The Application of The Arm's Length

Principle within Related Party Transactions. Subsequently, The Minister of Finance Regulation number 213 of 2016 has been enacted for the implementation of the three-tiered transfer pricing documentation approach regarding master file, local file, and country-by-country report.

Based on the above-mentioned Minister of Finance Regulation, any taxpayer having related-party transactions shall prepare the master file and the local file when it satisfies several conditions, among others are, having preceding tax year gross revenue exceeding IDR 50 billion, having preceding tax year tangible transactions exceeding IDR 20 billion, having preceding tax year intangible transactions exceeding IDR 5 billion, and such related party transactions is conducted with the affiliated party located in lower tax rate jurisdiction at any amount.

III.3.15.5 Base Erosion and Profit Shifting (BEPS) Measures

BEPS is a tax avoidance strategy generally carried out by multinational companies by seeking loopholes in tax regulation of a country. In order to minimize the impact of BEPS, tax authorities participating in BEPS Project initiated by G20 and OECD have stated their readiness to implement BEPS action plans. Regarding this issue, Indonesia has implemented Action 5, Action 6, Action 7, Action 13, Action 14, and Action 15.

First, Forum in Harmful Tax Practices (FHTP) has assessed several regulations concerning tax incentives and facilities in Indonesia and it has been stated that the applicable provisions are not harmful and are outside the scope of FHTP area as the implementation of Action 5. Second, the adoption of Preamble, Simplified Limitation on Benefit, and Principal Purpose Test in Multilateral Instrument (MLI) as well as improved provisions in Director General of Taxes Regulation number 10 of 2017 concerning Procedures for Implementation of Tax Treaty are actions to implement Action 6 and Action 7 respectively.

Third, the issuance of Transfer Pricing Documentation and Management of Country-by-Country Reporting regulations under Minister of Finance Regulation number 213 of 2016 and Director General of Taxes Regulation Number 29 of 2017 respectively are implemented with regard to Action 13. Fourth, to address Action 14, Minister of Finance Regulation number 240 of 2014 concerning Mutual Agreement Procedure (MAP) has been amended and it is prepared to be assessed in December 2018. Lastly, Indonesia has submitted 33 tax treaties to be modified through MLI to address the implementation of Action 15.

III.3.15.6 Mutual Agreement Procedure (MAP)

Statistically, as of 31 December 2016, the outstanding request for MAP was 49. The number then increased by 12 new requests during 2017 while during the year there were also 20 settlement of request submitted, hence, the outstanding request as of 31 December 2017 remained 41, lower that previous year. Such settlement of request is a sort of trade-off for taxpayers since MAP request can be submitted simultaneously with objection and appeal process, however, if the appeal hearing is to be settled, then the MAP request is not be able to be submitted.

III.3.15.7 Advance Pricing Agreement (APA)

DGT implements both unilateral and bilateral APA which are valid for 3 years and 4 years upon approval. Taxpayers who have transactions with affiliated parties can submit APA application within 6 months prior to the tax year in which APA will cover. As of 31 December 2017, the outstanding request was 15 and 20 for bilateral and unilateral respectively. In comparison with the previous year, there was a decrease by 1 unilateral request while bilateral number remained the same. Also, 3 settlement of requests have been submitted during 2017.

III.3.15.8 Exchange of Information (EOI)

As of 2017, Indonesia has cooperated with 65 partner countries in implementing EOI. Currently, Indonesia has Tax Information Exchange Agreement (TIEA) with 4 jurisdictions: Guernsey, Jersey, Isle of Man, and Bermuda. Besides, Indonesia is one among the 116 signatories of Convention on Mutual Administrative Assistance in Tax Matters (MAC).

During 2017, DGT has settled 196 EOI issues: 160 EOI on requests, 16 Spontaneous EOIs, and 20 Automatic EOIs on withholding tax for non-resident taxpayers. In addition, several attempts have been conducted for the participation in Exchange of Financial Account Information (AEOI) and in Automatic EOI for Country-by-Country Reporting (CbCR), among others are:

1. The Enactment of Law Number 9 of 2017 for the implementation of AEOI followed by Minister of Finance Regulation Number 70 of 2017 and its amendments as the implementing regulation of AEOI as well as Director General of Taxes Regulation Number 29 of 2017 as a guidance for CbCR;
2. Signing international agreements carried out through Multilateral Competent Authority Agreement (MCAA) for the exchange of CbCR on 26 January 2017 as well as Bilateral Competent Authority Agreement (BCAA) with Hong Kong on 16 June 2017;
3. Establishment of Common Transmission System (CTS) as a medium for transmitting AEOI data; and
4. Ensuring data confidentiality and information security by improving data and information security in DGT and complying with international Global Forum on Transparency and Exchange of Information for Tax Purposes standards.

III.3.16 Tax Incentives

The meaning and purposes of granting tax incentives are primarily to promote the direct investment in Indonesia either foreign investment or domestic investment in certain business sectors or certain areas which have the highest national priority covering the possibility of agreements with another country or countries in the field of trade, investment and other areas as also mentioned earlier on BEPS Action Plan 5. Moreover, DGT has set one of its performance target 2018 to arrange a selective tax incentive provision to support competitiveness of national industries.

III.3.16.1 Corporate Tax Benefit and Tax Allowances

Corporate taxpayers investing in certain approved industry sectors (stipulated by the government and/or geographical areas may benefit form income tax benefit in the form of:

1. An additional reduction in net income up to 30% of the amount invested in tangible assets allocated for six years;
2. Accelerated depreciation;
3. Extension of loss carry forward for up to 10 years; and
4. A reduced 10% withholding tax rate on dividend paid to non-resident.

III.3.16.2 Tax Holiday

It is intended to new domestic/foreign investment in specific pioneer industries. Such regime grants beneficial treatment to projects in high priority sectors such re upstream metals, crude oil refining and infrastructure, basic organic chemicals, industrial machinery, agriculture, forestry and fishery-based processing, telecommunication, information, communication, and economic infrastructure other than government cooperation scheme i.e. a corporate income tax reduction from 10% to 100% for the minimum investment of IDR 1 trillion and a corporate tax reduction up to 50% for taxpayers in telecommunication, information, and communication sectors with a minimum investment value IDR 500 billion at least yet not more than IDR 1 trillion. Further, the period of tax holiday normally lasts from 5 years to 15 years, however, extension up to 20 years shall apply depending on the competitiveness and strategic value of the industry – depends on discretion of The Ministry of Finance.

III.3.16.3 Upstream Oil and Gas Business Activities

In order to increase national oil and gas reserve, to promote investment climate, and to provide legal certainty for the business, Government Regulation Number 27 of 2017 regulates tax incentive for upstream oil and gas business activities, among others are:

1. exemption from import duty, VAT/LST, Article 22 Income Tax of import, and 100% deduction on Land and Building Tax during exploration and exploitation phase;
2. exemption from income tax and VAT for cost-sharing charges and indirect expenditure of head office cost allocation;
3. Easing of non-cost recoverable into cost recoverable e.g. environment and local community cost during exploitation phase, employee income tax paid as income tax incentive, and interest recovery as incentive cost.

In addition, to enhance investment, Government Regulation Number 53 of 2017 targeted oil and gas upstream business activities with "gross split" PSC without mechanism for operating cost recovery. Under such PSC regime, taxpayer can benefit from following tax incentives:

1. exemption from import duty, VAT/LST, Article 22 Income Tax of import, and 100% deduction on Land and Building Tax during exploration and exploitation phase;
2. exemption for VAT for cost-sharing charges; and
3. Fiscal loss compensation starts from subsequent tax year up to ten years.

IV. Country Specific Fiscal Issues

IV.1 Medium Term Revenue Strategy (MTRS)

Indonesia needs to substantially increase its government revenue level in a sustainable manner to finance additional expenditures that are critical for economic growth and development. With a ratio of general government tax revenue to GDP of just over 11 percent, Indonesia is the lowest among the Group of Twenty (G20) countries and trails other emerging market economies. Empirical evidence suggests that countries with a tax-to-GDP ratio of less than 15 percent tend to grow significantly more slowly than countries beyond this tipping point because it impedes opportunities for productive government spending. Therefore, adopting a medium-term approach to raising revenue will be critical to achieving the revenue-level change that Indonesia needs.

The approach was developed for the G20 by the Platform for Collaboration on Tax and frames the tax system reform in a comprehensive and holistic framework of four interdependent components:

1. Building broad-based consensus in the country for medium-term revenue goals to finance public expenditures.
2. Designing a comprehensive tax system reform covering policy, administration, and the tax legal framework to achieve these goals.
3. Committing to steady and sustained political support (government-led and whole-of-government approach) of implementation of the strategy over multiple years.
4. Securing adequate resourcing—domestically and from capacity development partners and donors—to support implementation of the MTRS.

To achieve the MTRS's revenue target, tax policy, tax administration, and legal measures are needed. These reforms will work in tandem, and there will be important interactions between them. For example, improvements in value-added tax (VAT) compliance (tax administration) will be supported by a faster refund system, elimination of VAT exemptions, and simplification of the law (tax policy). Good-quality legal tax provisions—comprising tax laws, regulations, decrees, and circulars—are essential to provide certainty to taxpayers and to minimize the costs of compliance. The next two sections develop a set of concrete reforms in the areas of tax policy and tax administration. The revenue implications of these measures are quantified using historical data, international comparative evidence, or empirically validated model simulations—although some of these calculations might need further refinement when the government's own MTRS is formulated.

IV.2 Village Fund (Dana Desa)

Village Act has been assessed and it encourages village to be priority in National Development. On the other hand, by implementing Village Act, it has become trigger to improve the quality of welfare in village. Villages have had authority and source of fund to explore some potency in order to increase value added in village. Every year, Ministry of Finance has budgeted Village Fund gradually. In 2015, Village Fund has been budgeted IDR 20.7 trillion. In 2016, the sum of village fund has become IDR 46.98 trillion. In 2017, Ministry of Finance has approved IDR 60 trillion village fund.

It is still needed some improvements in implementing Village Fund. Some Subordinate regulations, Human Resource in Village and Control System are some instruments that influence quality of village fund utilizing. The most importance thing in implementing Village Fund is how central government provides Technical Assistant for village apparatus. It is related with village apparatus to manage fund well and utilize it appropriately. It will not impossible that village could have its own corporation like "Village Owned Enterprises". Moreover, by implementing Village fund, Indonesia could reduce economy inequality between rural and urban area gradually.

IV.3 E-Commerce Taxation

Digital economy has been the most-discussed issue in the taxation field for years. Several countries have taken various approaches regarding such issue. Firstly, EU Commission Report on its assessment on indirect tax regime has shown proof that voluntary compliance and cooperation among tax jurisdictions and the business could be regarded as most feasible approach since 2002. Also, The United States has taken serious approach towards digitalization and tax as depicted in the form of Foreign Account Tax Compliance Act (FATCA) to combat tax avoidance and tax evasion conducted through offshore financial center involvement. Indonesia has agreed to take participate in FATCA since financial technology-related issue should be grasp by all tax authorities as one of measures for taxing digital transactions – Indonesia has already been categorized as a so-called “qualified country” to implement AEOI.

Previously in 2013, DGT released a circular letter explaining taxation perspective on e-commerce which explains that classified ads, market places, retail online, and daily deals shall be interpreted into conventional transaction models; hence, tax can be imposed accordingly. Meanwhile, it is not an easy task for DGT to monitor as well as to control e-commerce transactions so that tax compliance is relatively low. On one hand, e-commerce has been growing in a rapid pace along with its complexities. Several issues such as cross border transaction (territorial-related issue), new model transaction, new models of payment, digital transaction record, and other digital innovation as well have become attention to pay to, especially tax authority.

Furthermore, although a lot of developed countries as well as developing countries have taken either measures or interim-measures, Indonesia is seemingly in the stance of “waiting for the best measure” which could harmonize with Indonesian tax system” while performing internal further analysis concerning digital economy in the form of enactment of The President Regulation Number 74 of 2017 concerning e-Commerce Road Map, dated on 21 July 2017 to boost economic potential while providing the relevant regulation platform for imposing the tax along the way.

In terms of step that has been taken by Indonesia was collecting tax from Google as one of world biggest e-commerce entity in 2017 for their corresponding transaction in accordance with Indonesian tax rules. Google paid its tax owed to Indonesia since 2015 making Indonesia as the fourth country after Britain. India and Australia that has managed Google to pay tax. Google has been regarded to have permanent establishment in Indonesia by DGT, therefore Google would continue to pay income tax as well as VAT to Indonesia. Indonesia has started to take measures to other digital multinational giants since then.

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

V.1 Global Environment

In 2017, Indonesia's Macroeconomic was stable. Bank of Indonesia has implemented some policies to keep Economic Growth, Inflation Rate, Currency Rate and Interest Rate smoothly. Monetary Policy also has been formulated to reduce impacts from international economic pressure. Indonesia has obtained some lessons from Asia Financial Crisis in 2017 and Global Financial Crisis in 2008. This crisis insists Indonesia to care with some bad impacts and carry out preventive steps in the future. Therefore, Financial System Stability Committee (KSSK) has important role to keep Indonesia's economy to run on the right track.

Indonesia also had some challenges in International Trade in 2017. Indonesia Current Account in 2017 was still negative. It was caused oil import was still bigger that oil export so that it burdens Indonesia's Balance on Payment. On the other hand, Primary Income also recorded negative value. Besides, Indonesia also recorded positive trend in Investment Account in 2017. Portfolio investment still contributed the biggest portion from total investment. One of factors that caused the value of Portfolio investment increased significantly is Indonesia Government Bond got Investment Grade from International Credit Rating. The appraisal from international credit rating certainly makes investor more interesting to buy Indonesia Government Bond.

In the future, Indonesia will face global economy pressure. The trade war between China and United State absolutely is going to bring impact in Indonesia International Trade. China still becomes the main destination for Indonesia's export. By this condition, it will make distortion in Indonesia supply chain especially for commodities that exported to China. For not being China oriented export, Indonesia should diversify other export market so that Indonesia's export volume will not be influenced by geopolitical tension. Instead of, Indonesia also has chance to increase the quota of export if Indonesia could find new markets.

Indonesia is net oil importer country because the value of oil import is higher than oil export. It is seemed from the value of oil import that still becomes burden for Indonesia Balance on Payment. This certainly demands Indonesia government to formulate some policies. For short term, increasing the volume of oil lifting per day is a solution to increase oil export but it needs big investment to launch new oil exploration projects. On the other side, restricting the consumption of oil in society will be a trigger in social problem if government is not careful in implementing policy.

One thing that should be government's attention is US interest rate policy. Lately, US often increase the interest rate that cause capital outflows from emerging countries including Indonesia. By increasing of US interest rate, it makes Indonesia Currency (IDR) depreciated. In 2018, Bank Indonesia has carried out market intervention to keep Indonesia Currency (IDR). One of intervention steps that carried out by Bank Indonesia is increasing the Bank Indonesia interest rate so that the IDR pressure is not too significant. Bank Indonesia also has acted to keep trade-off between IDR and interest in order to not make distortion in Real Sector in Indonesia. In 2019, the possibility in US interest rate might continue. Therefore, Indonesia government should have provided anticipation steps to tackle the Fed Rate higher.

V.2 Fiscal Policy

In recent years, state revenue of Indonesia heavily relies on taxes of non-oil and gas sector, hence, government still put high effort on MTRS to boost tax revenue – such approach had not been done before 2016. However, there are several important issues related to MTRS. First, MTRS should designate a proper tax policy in accordance with long-term objectives. Second, MTRS should also generate stakeholder-friendly tax administration system so that vision and mission of DGT as the responsible tax authority in accordance with short-term objectives.

Meanwhile, from the state expenditure perspective, the main focus is on the quality of the expenditure i.e. expenditure on education, infrastructure, and health. First, government has launched several subsidy in education, among others are: *Kartu Indonesia Pintar (KIP)* which has been launched in 2014 to finance less fortunate yet smart high school students and below, *BIDIKMISI* which is intended to finance university undergraduate candidates who is less fortunate but possesses high-school outstanding passing grades, as well as Indonesia Endowment Scholarship *(LPDP)* for students who would like to pursue higher education in Indonesia universities or abroad. Overall, those three types of scholarship are provided for roughly 40% people who live under poverty line in accordance with Public Finance Act that regulates the total expenditure for education is accounted for 20% of the total state budget.

Second, infrastructures are massively built, particularly; new highway, airports, ports, and bridges construction projects are concentrated in the east part of Indonesia area to ease access for the population. The budget for infrastructure comprises roughly 25% of total state budget. Third, *Kartu Indonesia Sehat (KIS)* was launched in 2015 is intended to guarantee that under-poverty-line society have sufficient access to health insurance – the government allocates roughly 5% of the total state budget for such health expenditure.

Moreover, *Dana Desa* as a form of so-called Village Fund has been established in 2015. As already been previously discussed, the increasing amount of *Dana Desa* saw that the objective of Village Fund is merely to increase economic potential within villages as well as to enhance standard of living of villagers. Besides, Village Fund may also be used as a source of funding not only infrastructure but also for village empowerment under the administration of the responsible village authority. In principle, such expenditures are allocated in order to lower poverty rate and inequality between urban sector and rural sector.

Further, due to the fact that government of Indonesia is still in the stance of budget deficit, the issuance of government bond is regarded as an instrument to finance such deficit with the condition that the government shall implement a budget discipline by ruling budget expenditure by not more than 3% of GDP and maintaining the level of the debt to be less than 60% of GDP.

Nevertheless, fiscal policy should be practically supported by stable macroeconomics condition, for instance, fiscal authority should consider economic indicators such as GDP growth, inflation rate, oil-lifting, currency rate, employment rate, and so forth in the process of budget planning to mitigate a severe budget deficit. Thus, endurance, credibility, and sustainability of the ideal state budget design will seem to be feasible.

V.3 Challenge on Tax Administration

Based on Director General of Taxes Decree Number 95 of 2015, Five DGT Policy Objectives have been set as follows:

1. Year 2015:Guidance Year of Taxpayer’s Compliance;
2. Year 2016: Law Enforcement;
3. Year 2017: Reconciliation;
4. Year 2018: Synergy With Government Institutions,Agency, Association, and other parties;
5. Year 2019:Self-Reliance of State Budget.

In order to meet its policy objectives, DGT Strategic Map consists of 17 strategic objectives with the framework based upon the perspective of learning and growth, internal processes, customers, and stakeholders. By having strong basic foundations as competitive human capital, conducive organization, reliable management of information system, and optimal management of budget,DGT would be able to address its internal processes strategies which includes strategies in the function of services and dissemination, supervision, and law enforcement supported by the improvement in data reliability and maximum quality control. Consequently, on the customers ‘perspective, public service fulfilment as well as high level of tax compliance would be achieved, moreover, such achievements would then contribute tothe optimal tax revenue – the ultimate goal aimed by the government and, most importantly, the public.

On one hand, DGT has done several historical accomplishment. First, Tax Amnesty Program which was participated by 973,426 taxpayers has contributed to a total of IDR 4,884.26 trillion of assets declared. Besides,Voluntary Asset Disclosure – Final Tax Rate policy has been enacted as a result of Tax Amnesty success. On the other hand, in addressing “Transparency in Building The Nation” issue, Indonesia along with other G20 countries have stated the commitment to adhere international taxation agreements as well to implement AEOI as stated in Common ReportingStandard (CRS) starting in 2017. Such initiative serves as one of global community’s endeavors to combat tax avoidance and tax evasion resulting fromlimited access to financial information ofrespective countries which then called as the end of the banking secrecy for tax purposes.

Thus, having been effortlessly implementing Guidance Year of Taxpayer Compliance, Law Enforcement, Reconciliation, and Synergy with other parties since 2015, DGT is now seeking to meet itsultimate policy objective: Self-Reliance of State Budget.Any effort for achieving optimal tax revenue such as increasing tax ratio, broadening tax base, introducing new taxese.g. inheritance, gift, and net

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