



PRESS RELEASE

2008 DRAFT STATE BUDGET: Maintaining the Momentum of Accelerated Economic Growth for the Job Creation and Poverty Reduction

The Government reoriented its Priorities, Efficiency and Effectiveness of Spending to Achieve Growth Target of 6.8 Percent, Improve Infrastructure, Education and Health Programs

Jakarta, August 16, 2007 – The 2008 DRAFT STATE BUDGET represents systematic follow-up of the implementation of the vision and mission of United Indonesia Cabinet as prescribed in 2004-2009 Medium-Term National Development Plan. The plan provides for three important agendas, namely (i) Creation of Secure and Peaceful Indonesia, (ii) Creation of Just and Democratic Indonesia; (iii) Improvement of People's Welfare. Efforts to achieve the three objectives are set forth every year in Government Work Plan, which is further elaborated in government's policy and State Budget.

The 2008 development theme is "Accelerated Economic Growth for the Job Creation and Poverty Reduction". The 2008 Government Work Plan specifies eight national development priorities, namely: (1) increase of investment, export and job opportunities; (2) revitalization of agriculture, fishery, forestry and rural development; (3) accelerated development of infrastructure and improvement of energy management; (4) improvement of accessibility and quality of education and health services; (5) improvement of the effectiveness of poverty reduction measures; (6) corruption eradication and accelerated bureaucracy reform; (7) strengthening of defense capability and improvement of domestic security; and (8) disaster response, disaster risk reduction, and improvement of avian influenza control.

The President of the Republic of Indonesia in his messages introducing Bill on 2008 State Budget stated: "The improvement of people's welfare is the highest priority and essential to the nation's future... With regard to the efforts to improve the welfare of our people, the government's budget and spending play important role."

To that end, the design of 2008 Draft State Budget incorporates basic changes in budget management, namely improvement of efficiency and savings through reduction of unproductive and non-priority spending coupled with the improvement of efficiency and effectiveness of capital spending. The fruits of efficiency and saving measures are used for capital spending and for social purposes covering three main components as follows:

- Human development and poverty reduction efforts for faster achievement of 2015 Millennium Development Goals (MDGs).

- Efforts to achieve economic growth rate of 6.8% by 2008 – from initial projection of 6.3% during 2007 - followed with the creation of job opportunities and poverty reduction by increasing the spending on development and repair of infrastructure.
- Continuous efforts to improve the quality of bureaucracy, law enforcement, security and national defense.

As stated by the President, the structure of 2008 Draft State Budget is expected to increase economic growth with equity. This reflection is manifested in the decision to set a target to reduce unemployment rate by the end of 2008 to 8-9% compared to 9.7% in February 2007, and poverty rate to 15-16% in 2008 from 16.7% (in March 2007).

MACRO ECONOMIC ASSUMPTIONS 2006 – 2008

Description	2006 Real			2008 Draft State Budget
		State Budget	Draft State Budget	
Growth of Gross Domestic Product				
Growth (%)	5.48	6.3	6.3	6.8
Nominal (IDR Trillion)	3,338.2	3,531.1	3,804.2	4,306.6
GDP per capita (in US\$)	1,643	1,704	1,858	2,077
Inflation	6.6	6.5	6.5	6.0
Exchange Rate	9,164	9,300	9,100	9,100
Average SBI Interest Rate (%)	11.74	12.0	8.0	7.5
ICP Oil Price (US\$/barrel)	63.8	64.0	60	60
Lifting (MBCD)	0.959	10	0.95	1,034
Unemployment	10.31 ¹			8 – 9
Poverty	17.8 ²			15 16.8

Source: Ministry of Finance, BPS, RKP 2008

1. August 2006
2. March 2006

2008 Draft State Budget – the initial milestone in the improvement of transparency of government budget

The 2008 Draft State Budget is presented in more details, comprehensively and transparently. The economic conditions and projections underlying the drafting of State Budget and the making of Government's policies that have effect on the details of state budget and financing are set forth in more details.

This is in line with the demand of the stakeholders including the House of Representatives, private sector, rating agency, international institutions, and the public, for complete and accurate information, and the government's wish for improved accountability and transparency in the management of state's finance.

Main transformations presented in the Financial Note and 2008 Draft State Budget covers: (i) The economic conditions and projections underlying the formulation of Draft State Budget are given in details; (ii) various policy directions to be implemented by the government are given in details including their effect on the state budget and financing; and (iii) uncertainty Element and fiscal risk facing current and future State Budgets, in particular with regard to changes in macro economic assumptions and indicators, implementation of infrastructure guaranteeing program, public service obligation program, health of State-Owned Enterprises, and occurrence of natural disaster, and pension and social security policy plan, will be presented.

It is expected that the transformations will give full and proportional picture to the public at large and the decision makers when studying, analyzing, and keeping track of the implementation of State Budget. The government believes that more transparent and accurate information that is easily understandable to all people and decision makers will reduce uncertainty and improve the overall efficiency of economy.

Reallocation of government's budget towards more productive spending

The government through 2008 Draft State Budget seeks to consistently improve budget effectiveness and efficiency by drastically increasing capital spending from Rp 68.3 trillion (2007 Revised State Budget) to Rp 101.5 trillion (2008 Draft State Budget) or by 48.6%. At the same time, it has been proposed that spending on goods be reduced to Rp 52.4 trillion compared to that in 2007 Revised State Budget, which stood at Rp 62,5 trillion.

Significant Increase of Infrastructures Expenses

The Government pays its attention on the development of infrastructure to support economic growth and creation of job opportunities considering that economic growth will be boosted only if stock of infrastructures is increased and infrastructure quality improved. Therefore, biggest portion of capital expenses will be used for the development and repair of basic infrastructures including roads, bridges, sea ports and air ports, railway network, power plant and electricity transmission and distribution grid.

Increased allocation for infrastructure development is observable from increased budgets of two ministries in charge of infrastructures, namely Ministry of Public Works whose budget increased by 41.1% to Rp 35.6 trillion, and the Ministry of Transportation whose budget increased by 64.1% to Rp 16.2 trillion, from projected realizations in 2007 Revised Draft State Budget. A budget of Rp 5.6 trillion has been allocated to the Ministry of Energy and Mineral Resources.

Poverty Reduction and Protection of Poor Families Becomes Higher Priority.

Even though poverty rate in 2007 has decreased, there are a great number of poor families particularly in rural areas. Besides, some Indonesian families living around poverty line are vulnerable to economic turbulence.

Efforts to bring poor families out of poverty are reinforced with the expanded coverage of *Program Nasional Pemberdayaan Masyarakat (PNPM)* / National Community Empowerment Program, which was launched early 2007, from 2,831 sub-districts to 3,800 sub-districts. The efforts are carried out through consolidation of poverty programs run by various ministries, in particular three ministries, namely Ministry of Home Affairs, Ministries of Public Works, and State Ministry for the Development of Disadvantaged Area. The allocated funds increase from Rp 3.9 trillion (2007) to Rp 7.0 trillion. Increased budget has made possible for gradual allocation increase per sub-district from Rp 500 million to Rp 3 billion per sub-district in 2008-2009.

In addition to PNPM, the government's budget allocations for the protection of poor families and provision of health insurance for poor families are maintained and increased as well. The programs financed under the said allocations include:

- Continued provision of *Keluarga Harapan* program under which assistances in cash are given conditionally for use in the field of education, health and nutrition. The program was started this year and will be continued next year with pilot projects in 49 districts in 7 provinces covering 500 thousand poor families and requiring budget of Rp 1.1 trillion per year.
- Program on the Stabilization of Prices of Basic Necessities requiring budget of Rp.447 billion.
- Program on the provision of rice for poor families with 12.1 million target families, each of whom will get 10 kg of rice for 11 months, requiring budget of Rp 5.5 trillion.
- Health Insurance for 60 million poor people, provision of access to health services at Integrated Health Service Posts, Community Health Centers, and Third Class-Health Service at Government-Owned Hospitals and Government-Designated Private Hospitals;
- Grants for education purposes for 9-year education program and provision of subsidy to poor Senior-High School Students;
- Improvement of sanitary facilities and access to clean water;
- Interest Rate Subsidy in respect of Loan for the Purchase of Simple Houses including Rusunami requiring budget of Rp.800 billion.

The government also continues fuel and electricity subsidy in substantial amount. The 2008 Draft State Budget maintains fuel and LPG subsidies at Rp 46.7 trillion and Rp 2.4 trillion, respectively. Biggest portion of fuel subsidy is used to subsidize kerosene, which is used by poor families. In addition, the Government provides Rp 27.8 trillion for electricity subsidy. In order to reduce fuel and electricity subsidy, the government encourages the use of alternative energies other than fuel by, among others, accelerating the development of Non-fuel power plant and launching biofuel development program, which is supported with the provision of interest rate subsidy in respect of loan given for biofuel program, requiring a budget of Rp 449 billion.

The government is fully aware that the pockets of poverty are in rural areas in which most of poor families live as farmers. Increases in the allocations for rural and agricultural sectors are observable from increased budget allocation for agricultural sector, which stands at Rp 15.3 trillion (2008 Draft State Budget) consisting of Rp 8.9 trillion for the budget of Ministry of Agriculture, and Rp 6.4 trillion for the budget of irrigation sub-function. The farmers also enjoy various direct and specific subsidies in the form of fertilizer subsidy, interest rate subsidy, and seed subsidy, with total subsidy of Rp 10.1 trillion, an increase of 21.9% compared to the projected realization in 2007 Revised Draft State Budget. The protection given to the farmers is bigger if rice subsidy, which is part of rice price policy, is considered as indirect subsidy for farmers.

Development of People Becomes Highest Priority

As mandated by the Constitution, education rector receives the biggest budget allocation to reflect its priority in the efforts to improve the quality of Indonesian human resources. The increased allocation for this sector is intended to achieve poverty and gap reduction target through continued provision of free education and special education scholarship for poor families. In 2008, education will get 10.9% of central government's total spending. Central government's total spending on education increases to Rp 61.4 trillion from Rp 52.4 trillion (Revised Draft State Budget 2007).

This allocation represents 12.3% of State Budget pursuant to the definition established by the Constitutional Court. However, this figure will be greater if allocations in Specific Allocation Fund and General Allocation Fund, which are intended for payment of salaries,

restoration of elementary school buildings and procurement of school equipment and devices that have been agreed upon by Regional government, are taken into account.

Please note that pursuant to the definition of spending on education in the broad sense – which is internationally accepted – total spending on education reached 4.1% of GDP in 2007, which is close to international norm of 5% of GDP. For 2008, the amount of total spending pursuant to broad definition will only be known after all regions prepare their Draft Budget.

Health program also receives significant increased allocation, which is 4.3% higher than the figure in 2007 Revised Draft State Budget, from Rp 16.1 trillion to Rp 16.8 trillion. Budget allocation for health sector will be used to continue the provision of health insurance program for poor families as mandated by the Act on National Social Security System, and to improve the health of mothers and children so that next healthier and smarter generations can be expected.

Improved Governance through bureaucratic reform and increased budget for law enforcement

The allocations in 2008 Draft State Budget reflect the government's desire to improve governance for the purpose of law enforcement, corruption eradication and bureaucratic reformation. The government's desire is also reflected in some other things, including the government's proposals on 20% civil servant salary increase, payment of 13th salary, and increased meal allowance to Rp 15 thousand per business day/person. This salary adjustment is expected to increase the Take-Home Pay of lowest ranking civil servants (civil servants of rank I/a with service period of 10 years and of single status) to Rp 1.6 million/month in 2008 or almost threefold increase compared to the figure in 2005.

Significant increase in the government's budget allocations also occurs to almost all law enforcement institutions (State Audit Board, Supreme Court, Ministry of Law and Human Rights and Attorney General Office). Significant budget increases for law enforcement agencies in 2008 are expected to make them stronger in the efforts to eradicate corruption.

Defense and Security Budget towards ideal level

The spending allocations in 2008 Draft State Budget reflects the desire to make Indonesia peaceful. This is reflected from the increased budget for defense and security that are left to TNI and POLRI. Biggest portion of the increased budget will be used to pay meal allowance increase from Rp 30 thousand to Rp 35 thousand per day and the restoration of the boarding houses of TNI and POLRI members across Indonesia, and some other portion will be used to improve defense capacity. Efforts will be made to procure military equipments, to the greatest extent, from domestic industries such as PT DI, PT PAL and PT PINDAD. In order to support the development of defense industry, the government is making efforts to seek for additional financing for defense industry from domestic banking sector by drafting Government Regulation governing financing of budget from domestic banking sector.

Spending for Regional Governments also Increases

The budget for spending for regional governments also increases. The spending for regional government increases from Rp 252.5 trillion to Rp 271.8 trillion. The increase reflects the desire to bring about real decentralization and local autonomy.

Significant increase occurs in the special autonomy fund allocations for Papua and NAD provinces, at 2% of General Allocation Fund so that total Special Autonomy Fund sharply increases by 100% compared to the figure recorded in 2007 Revised Draft State Budget.

The government also reallocates de-concentration and support fund at Rp 4 trillion to Special Allocation Fund so that total Special Allocation Fund for 2008 will be Rp 21.2 trillion.

With more money to be earmarked for regional and local governments, it is expected that Provincial, City and District governments will reduce levies, which have been burdensome to business world and the community and caused uncertainty and high-cost economy.

Budget Financing Increasingly Relies on Domestic Sources in Particular Tax

The financing of Draft State Budget will come from the increased domestic tax and non-tax revenues. Tax revenue ratio in 2008 Draft State Budget increases from 12.9% of GDP in 2007 Revised Draft State Budget, to 13.6% of GDP (2008 Draft State Budget). The non-oil tax revenue ratio increases to 12.6% of GDP (2008 Draft State Budget) from 11.9% of GDP in 2007 Revised Draft State Budget.

Projected total state income and grants is Rp.761.4 trillion or increase by 11.2% compared to the projected realization in 2007 Revised Draft State Budget.

With the said additional revenues, budget deficit in 2008 Draft State Budget can be maintained at 1.7% of GDP. This deficit coupled with increased economic growth and increased repayment of the government loans will enable debt ratio to drop to 33% of GDP at the end of 2008 compared to projected 35.6% in 2007.

In 2008 Draft State Budget, net financing of budget from domestic sources is projected to reach Rp 91.7 trillion. It has been projected that the domestic source-funded financing will come from (i) the issuance of Government Securities or SBN taking into account fiscal and monetary policies in integrated manner; (ii) optimal sale of bank restructuring program assets; (iii) government's savings with Bank Indonesia; and (iv) privatization. Financing from privatization source is set at relatively low level because the government is fully aware that privatization should not be intended only to finance the deficits in State Budget, but more to restructure and improve the performance of State Enterprises as mandated by Act Number 19 of 2003 on State Enterprises.

Meanwhile, net financing of budget from overseas loan sources has been projected at negative Rp 16.7 trillion. The said figure consists of program loans and project loans at Rp 43.0 trillion, less the payment of principal amount installment of overseas loan at Rp 59.7 trillion.

SUMMARY OF 2007 REVISED DRAFT STATE BUDGET AND 2008 DRAFT STATE BUDGET			
(in trillion rupiah)			
	2007		2008
	State Budget	Revised Draft State Budget	Draft State Budget
A. State Revenue and Grant	723.1	684.5	761.4
I. Domestic Revenue	720.4	681.8	759.3
1. Tax Revenue	509.5	489.9	583.7
Tax Ratio (% of GDP)	13.5	12.9	13.6
2. Non-Tax Revenue	210.9	191.9	175.6
II. Grant	2.7	2.7	2.1
B. State Spending	763.6	746.4	836.4
I. Central Government's Spending	504.8	493.9	564.6
II. Spending for Regional Governments	258.8	252.5	271.8
C. Budget Surplus/Deficit (A- B)	(40.5)	(62.0)	(75.0)

% of GDP	(1.1)	(1.6)	(1.7)
D. Financing (I + II)	40.5	62.0	75.0
I. Domestic Financing	55.1	74.6	91.7
II. Overseas Financing (net)	(14.6)	(12.6)	(16.7)

Budget Function covers only part of Economic Reform Program

In addition to the fiscal stimulus, efforts to encourage the creation of job opportunities through increases in investment and export will be directed more towards reformation of micro economy as set forth in Presidential Instruction Number 6 of 2007.

The reform of micro economy is focused on four main groups, namely (i) improved investment and business climate, (ii) accelerated development of infrastructure across Indonesia, (iii) financial sector reformation and (iv) empowerment of micro, small and medium-size enterprises.

Efforts to achieve the objectives will be possible only if macro economy stability is in place. It is expected that inflation surges in 2005 can be brought to stable level with the coordination of fiscal and monetary policies and the control of prices of basic necessities through, if necessary, the re-opening of rice import opportunity. The above measures are expected to bring inflation to stable level of around 6% during 2008 as stated in the 2008 Draft State Budget assumptions.

The 2008 Draft State Budget also poses a number of fiscal risks such as macro assumption variations, risks attributable to government debt position, infrastructure development project risk, state enterprise ownership risk, pension program risk, fiscal decentralization risk, and Bank Indonesia risks. Details of those risks are described in Chapter VI of Note to 2008 Draft State Budget.

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