

# FISCAL SUSTAINABILITY AND FINANCIAL REFORMS

By

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Mr. Chairman,  
Ministers,  
Excellencies,  
Distinguished Delegates,  
Ladies and Gentlemen,

I would like to join in the remarks of the Coordinating Minister on the tsunami tragedy and the untold human sufferings in the affected areas in Indonesia and in the other affected countries.

I am particularly grateful for the prompt and unconditional response of many of you, CGI and non-CGI member countries, United Nations and its agencies, multilateral institutions, other governmental and non-governmental organizations, corporate and individual volunteers. We will never be able to fully quantify the cost of the selfless efforts of people, equipment and manpower made available by governments, institutions and organizations around the world. This is unprecedented in post-war history. And we are very grateful indeed for your support.

As Minister of Finance, I would like to express our appreciation at this CGI meeting on the grants and other contributions pledged to us at the recent tsunami Summit. We estimated that about US\$1 billion of such grant pledges and soft loans should be made available this year to complement our resources for Aceh and Nias Island reconstruction. We have included this

amount in our FY 2005 Budget review. I ask for your support to make these funds available in a timely manner so as to enhance our efforts.

I would also like to thank the Paris Club creditor countries. Their offer of debt relief at the tsunami Summit and at the January 12<sup>th</sup> meeting in Paris for affected countries shows their understanding of the impact of such a tragic event.

Ladies and Gentlemen,

All our collective relief efforts will never compensate for the physical and emotional losses of those who were living in the affected areas. We can only play our part in the speedy reconstruction and rehabilitation of Aceh to contribute in a small way to restoring some order in their lives. I look for your continued support on this and allow me to add that further grants are very much welcome.

I would like to turn to our fiscal performance in 2004 and outlook for 2005. We are preparing a revised draft FY 2005 Budget to be discussed in Parliament. The previous administration had submitted a FY 2005 Budget in August 2004 in accordance with our Law on State Finance 17/2003. This was provisionally approved by the former Parliament in September 2004 so as to ensure fiscal continuity.

### **First, on the 2004 Budget performance and Outlook for 2005**

The Budget deficit for 2004 is estimated at Rp. 29.6 trillion equivalent to 1.48 per cent of GDP, higher than the revised Budget deficit of Rp.26.3 trillion representing 1.3 per cent of GDP. The high international oil prices and postponed implementation of the fuel price increase in 2004 resulted in a substantial increase in the cost of fuel subsidy contributing to higher expenditures.

This increase in expenditures was mostly offset by higher revenues from oil and gas. The remaining financing gap was bridged by the proceeds from the sale of Government minority shares in private recap banks and by disbursements from World Bank and ADB program loans.

We remain cautious on the outlook for 2005 given the anticipated slow down in global economic growth, higher US interest rates and

continued high level of oil prices. In addition, recognizing the additional expenditures on tsunami-related recovery efforts, we had to review our earlier plan for an additional reduction in the fiscal deficit and instead, we target a fiscal deficit for 2005 equal to one per cent of GDP up from 0.7 per cent in the original Budget. .

## **Second, Fiscal Consolidation Program**

In line with our prudent fiscal policy, we are re-doubling our efforts to contain Budget deficit to a manageable level despite the requests for additional resources for the reconstruction efforts for tsunami-affected areas. We are also considering cutting back on fuel subsidy. The grant support pledged by donor agencies, 'temporarily debt moratorium' by Paris Club creditor countries pending the World Bank/IMF assessment report and additional funds from CGI member countries would provide some relief for our fiscal management.

We will also focus on improving the effectiveness on the use of our resources and on ensuring better accountability. The recently concluded Infrastructure Summit provides scope for an increased private sector participation in developing the numerous infrastructure programs that will provide stimulus for economic growth and job creation. Our Government's commitment to provide an improved investment climate will accompany efforts to ensure greater certainty in the legal and regulatory environment in order to encourage private participation in our development.

### **Let me outline the major features of our fiscal policy**

- o We have concluded an agreement with Parliament to put in place responsible measures to reduce Budget deficit and help contain public debt at fiscally sustainable levels.
- o We will modernize the tax and customs administration and introduce structural reforms. We will amend the Tax and Customs Law to provide a more competitive tax system.
- o We will continue to rationalize Government expenditures with the view to redirecting them to priority areas including targeted compensation measures for fuel subsidy reduction and Aceh reconstruction and recovery.

- o We will improve the implementation of related fiscal decentralization measures under the revised Law 33/2004 on Fiscal Balance with the aim to improving the on-lending mechanism under KMK 35/2003 and the on-granting facility to local governments in relatively poor regions. We will amend Law 34/2000 on local taxes and levies to provide a more conducive environment for investment in the regions..

### **Third, on Financial Sector Reforms**

Let me just highlight a few reforms measures which have been and which will be taken in the financial sector:

- The Ministry of Finance and the Central Bank have signed an MOU on bank closing procedures and lender of last resort.
- The Law on Financial Safety Nets is now being drafted.
- The Deposit Insurance Agency Law has been passed in Parliament last year and the Deposit Insurance System is now being implemented.
- A blue print is being prepared to create an Integrated Financial Sector Authority.
- Bapepam is being merged with the Directorate for financial institutions at the Ministry of Finance to better supervise and regulate capital markets and financial institutions' activity.

### **Fourth on Public Sector Management**

We will coordinate our efforts with other ministries and agencies on the following key areas: public expenditure management, debt management, procurement and accounting, auditing and control for all levels of Government.

Within the Ministry of Finance, we are receiving assistance from the World Bank, the ADB and Australia to:

- o improve financial management, strengthen revenue collection and public financial management and accountability;

- o strengthen the national audit functions including for local governments and harmonize their financial systems with the center and improve the on-lending/on- granting mechanism;
- o introduce a performance based budgeting system;
- o design a debt management strategy and its capacity building, and
- o set up an advisory unit to provide policy guidance on overall public expenditure management.

Ladies and Gentlemen,

We remain committed to a prudent fiscal policy aimed at a gradual reduction of Budget deficit under our fiscal consolidation program. In spite of the extraordinary expenditures to be incurred for the Aceh reconstruction and rehabilitation and targeted compensation measures to mitigate for the poor the full impact of our proposed reduction in fuel subsidy, I believe our proposed fiscal deficit is at a sustainable level that will allow us to continue our macroeconomic growth with prospects of increasing new jobs.

Thank You

Minister of Finance,  
Jusuf Anwar