THE 2009 REVISED BUDGET FISCAL STIMULUS PROGRAMME: MITIGATING THE IMPACT FROM THE GLOBAL CRISIS

I. INTRODUCTION

The global financial crisis that dealt drastic blows to the world economy in 2008 is predicted to continue, taking on even greater intensity in 2009. The world economic slowdown not only portends a steep decline in global trade volume, but also threatens widespread bankruptcies in major manufacturing industries, loss of production capacity and soaring unemployment worldwide. In developing and emerging market countries, this situation may harm the fundamentals of the economy and trigger economic crisis.

Alarm over the negative impact of the global economic downturn on emerging market countries and the flight-to-quality by global investors in the midst of the current world financial crisis has led to pressure bearing down on currencies worldwide, including the Indonesian currency. At the same time, United States dollar liquidity has dried up on many domestic markets. As a result, turbulence has broken out on forex markets not only in developed but also developing countries amid the mounting uncertainties.

As an open economy, Indonesia will not escape the negative impact of the world economic malaise, despite having developed considerable growth momentum. The global financial crisis that began to show significant impact in the third quarter of 2008 and the second round effects of this crisis that will intensify in 2009 are forecasted to impact negatively on Indonesia’s macroeconomic performance in 2009, with the balance of payments, real sector and budget all affected.

The most immediate negative impact of the global economic crisis has taken hold in the financial sector through psychological sentiment and as a result of the global liquidity crunch. The stock index in Indonesia has plunged about 50 percent, while the rupiah has tumbled in increasingly volatile movement. During 2008, the rupiah underwent 17.5 percent depreciation. With the ongoing deleveraging of global financial institutions, the volatile trend in the rupiah is set to last well into 2009.

These conditions are predicted to bring significant changes in slowed economic growth, employment and poverty reduction. The trend in downward revision of economic growth is in the 4.0 - 5.0 percent range, with the most optimistic forecast at 4.7 percent (below the original 5.0 percent estimate), mainly because of (1) investment growth predicted to slow to 5.9 percent from the earlier projected 7.5 percent, with sluggish performance in foreign direct investment and portfolio investments; and (2) export growth slipping from the previous 7.8 percent forecast to no more than 5.1 percent. Data for the past three months points to rapid weakening in exports with growth forecasted to stagnate (zero percent) or even dip into negative territory (-3.0 percent). The falling exports will also be followed by declining production, so that rationalisation of labour will ultimately be all but inevitable.

In response to these developments, increases in unemployment and poverty will become the next round of impact soon to buffet the national economy due to the effects of the global economic crisis. So far, mass dismissals have taken place in export-oriented industries. This will be followed by planned dismissals in the textile and textile product and paper manufacturing, alongside plans for temporary layoffs in wood-based and estates industries. The global economic recession will also lead to loss of employment for some of the many Indonesians employed overseas, forcing them to return to Indonesia. This will not only put added pressure on the Indonesian labour market, but also reduce foreign exchange receipts from remittances.

To mitigate this particular negative impact from the global financial crisis, it is essential for the Government to institute emergency fiscal adjustments to save the national economy. These measures include an enlarged economic stimulus programme in the 2009 Budget, revision to macroeconomic assumptions seen to be no longer realistic and adjustment in the various aggregates of state revenues, state expenditures, the fiscal deficit and budget financing.

The fiscal stimulus will operate in three ways in simultaneous pursuit of three objectives: (a) maintain and/or increase public purchasing power in order to sustain consumption growth at above 4 percent, or close to 4.7 percent; (b) prevent worker layoffs and improve business resilience and competitiveness in the face of the world economic crisis; and (c) mitigate the impact of job losses and reduce unemployment through expenditures on labour-intensive infrastructure development. Public purchasing power will be strengthened through reductions in personal income tax rates and an increase in the tax-free income band, provision of subsidies for generic medicines and cooking oil, subsidised VAT on end-products, cuts in fuel prices, pay increases for civil servants, military, police, retired government personnel and teachers/lecturers and provision of Direct Cash Transfers. The improvement in business resilience and export competitiveness will involve reductions in corporate and publicly listed company tax rates, import duty subsidies, personal and corporate income tax subsidies, VAT subsidies, reduced electricity billing rates for industrial users, lower prices for automotive diesel and government equity injections for grassroots business credit and export guarantees. Jobs will be created and impact of worker dismissals prevented or mitigated through added budget allocations for infrastructure for control of natural disasters, multi-year projects, rail networks, water treatment plants, housing, power generation and transmission, rehabilitation of farming community roads, market ports and construction of foodstuff warehouses.

These emergency fiscal adjustments are designed not only to mitigate the impact of the global crisis, but also to lay down stronger foundations for more rapid sustainable economic growth and reinforce the pillars of the national economy. This will be accomplished by taking forward reforms in all line ministry agencies.

These fiscal emergency measures have been tabled with the Budget Committee of the Indonesian Parliament for discussion and approval in compliance with the provisions of Article 23 of Act Number 41 of 2008 concerning the 2009 Budget, which read as follows:

“In an emergency, if the following events occur:

“a. deterioration in economic growth below the assumed level and deviation in other macroeconomic assumptions leading to significant reduction in state revenues and/or increase in state expenditures;

“b. significantly increased cost of borrowing, specifically in regard to yield on Government Securities; and/or

“c. systemic crisis in the national financial system and banking system requiring added guarantee funding for the banking system and Non-Bank Financial Institutions (NBFIs).

“The Government, with approval of the Indonesian Parliament, may take the following measures:

“1. expenditures for which funds are not budgeted and/or expenditures beyond the ceilings established in the Budget for Fiscal 2009;

“2. reallocation of expenditure budgets between programmes, between activities and/or between similar categories of expenditure within a single line ministry/agency and/or between line ministries/agencies;

“3. expenditure reductions for improvement of efficiency, without sacrificing the targets of priority programmes/activities that must nevertheless be achieved;

“4. draw-down of standby loans from bilateral and multilateral creditors; and

“5. issuance of Government Securities beyond the ceiling established in the Budget for the current year.”

In the elucidation to Article 23 paragraph (1) of Act Number 41 of 2008 concerning the 2009 Budget, an emergency exists if:

1. The prognosis of economic growth is at least 1% (one percent) below the assumed level, while the prognosis for other macroeconomic indicators deviates by at least 10% (ten percent) of assumed levels. The prognosis shall be calculated on the basis of macroeconomic indicator outcomes for 2008.
2. The nominal position of depositor funds in the national banking plunges dramatically.
3. Increased yield on Government Securities results in significant added costs for issuance of Government Securities, reflected in (a) no yield bids awarded within the Government benchmark during 2 (two) consecutive auctions; and/or (b) an upward trend in yield of at least 300 basis points (bps) in 1 (one) month.

From the assessment and intensive monitoring of the impact of the global financial crisis on the national economy and the 2009 Budget projections set out in Act Number 41 of 2008, some macroeconomic assumptions and the various aggregates, targets and budget allocation ceilings adopted in the 2009 Budget can no longer be deemed realistic. *First*, the economic growth assumption is forecasted at least 1.3 percent below the 6.0 percent envisaged in the 2009 Budget, or a maximum of 4.7 percent. *Second*, the deviation in the rupiah against the United States dollar is expected to surpass 17.0 percent, with the assumed rate of Rp 9,400 to the dollar in the 2009 Budget revised downward to Rp 11,000 to the United States dollar. *Third*, the assumed Indonesian Crude Price (ICP) is predicted to deviate over 43.8 percent from the originally predicted US$80 per barrel in the 2009 Budget to about US$45 per barrel.

Flagging economic growth will be transmitted into reduced taxation revenues and SOE dividends in the Budget. On the other hand, the drastic plunge in oil prices will impact state revenues through falling oil and natural gas revenues, while also reducing state expenditures on energy subsidies and make less funds available for oil and natural gas profit sharing funds. At the same time, the weakening of the rupiah against foreign currencies will affect all Budget revenue, expenditure and financing components with foreign currency content, such as funds received from external borrowings and interest and principal repayments on foreign debt.

Similarly, significant changes are expected in state expenditures, encompassing energy subsidies and debt interest in central government expenditures and the Profit Sharing Funds from oil and natural gas (DBH migas) component in transfers to the regions. While partly representing the impact of these changes in macro assumptions, and especially the drop in the Indonesian Crude Price and rupiah depreciation, these changes in state expenditures are also explained by expansion of the fiscal stimulus programme.

These changes in state revenues and expenditures augur for a significantly increased fiscal deficit. Therefore, to provide the added financing necessitated by the higher deficit, changes in financing are essential to cover the increased fiscal deficit in 2009.

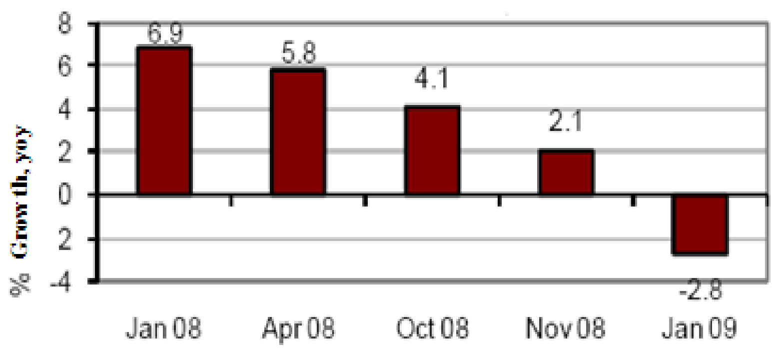
Furthermore, in reference to the provisions of paragraph (2) of Article 23 of Act Number 41 of 2008 concerning the 2009 Budget, the implementation of the 2009 Budget adjustments will be presented by the Government to the Indonesian Parliament in the Semi-Annual Budget Progress Report and/or the Central Government Financial Report for 2009.

II. IMPACT OF THE GLOBAL CRISIS ON THE ECONOMY AND STATE REVENUES IN 2009

Since mid-2007, the economic situation has been fraught with uncertainty and unpredictability in external factors. The crumbling of global financial markets has impacted the real sector, with many large manufacturing enterprises threatened with bankruptcy or at least suffering loss of production capacity. As a result, a surge in world unemployment will be almost unavoidable. In developing and emerging market countries, this situation may wreck economic fundamentals and trigger economic crisis. Many countries, such as Turkey, Pakistan, Iceland and east European nations, have been forced to turn to international financial institutions for liquidity assistance to save their economies from collapse.

The ongoing global financial crisis has gridlocked the world financial system and brought on declining economic activity and world trade. The slowdown in world economic growth in tandem with reduced growth in volume of world trade has been under way since mid-2007. World trade volume is set for deteriorate further in 2009, as indicated by the multiple revisions to the IMF projections, with the 6.9 percent growth projection in January 2008 lowered to 2.1 percent in November 2008 and revised further downward in the January 2009 projection to minus 2.8 percent (see **Graph 1**). This will inevitably have significant and direct impact on the export-led economies of China, Japan, Korea and the ASEAN nations, including Indonesia.

Graph 1
Forecasted Growth in World Trade Volume, 2009



In view of the accelerated deterioration of the past quarter, financial institutions across the board, such as the IMF, OECD, World Bank and ADB are revising downwards their predictions for world economic growth. The IMF, for example, has announced that world economic growth in 2009 will come under further pressure, with the previous 3.0 percent October 2008 forecast revised downwards in November 2008 to 2.2 percent. In January 2009, however, the IMF again revised its world economic growth forecast downward to 0.5 percent (see **Table 1**).

Table 1
GDP Growth Forecast, 2009

	Jan-08	Apr-08	Oct-08	Nov-08	Jan-09
World	4.4	3.8	3.0	2.2	0.5
USA	1.8	0.6	0.1	-0.7	-1.6
Europe	1.9	1.2	0.2	-0.7	-2.0
Japan	1.7	1.5	0.5	-0.2	-2.6
China	10.0	9.5	9.3	8.5	6.7
India	8.2	8.0	6.9	6.3	5.1
ASEAN-5	6.2	6.0	4.9	4.2	2.7

The world economic downturn will inevitably have a major bearing on the Indonesian economy. To prepare itself for this, the Government has responded in a series of adjustments to macro assumptions, as presented in **Table 2**.

Table 2
Macroeconomic Indicators

Macroeconomic Indicator	2007	2008		2009	
		Target	Outcome	Budget	Projection
Economic Growth (%)	6.3	6.4	6.2*	6.0	4.5
Inflation (%)	6.6	6.5	11.1	6.2	6.0
3-Month SBI Rate (%)	8.0	7.5	9.3	7.5	7.5
Exchange Rate (Rp/US$)	9,140	9,100	9,692	9,400	11,000
ICP Oil Price (US$/barrel)	72.3	95.0	96.8	80.0	45.0
Crude Lifting (MBCD)	0.899	0.927	0.931	0.960	0.960

*) Estimated Outcome

II.1 Economic Impact of Slowing Growth and Exchange Rate Depreciation

II.1.1 Economic Growth Down from 6.0 Percent to 4.5 Percent

The sudden plunge by developed countries into deep recession will have a negative impact on the macroeconomic performance that forms the basis for the 2009 Budget calculations. The Government has and will continue to take policy actions in anticipation of these developments. The economic growth projection has been revised downwards from 6.0 percent to maximum 4.7 percent. This is consistent with downward revision by international financial institutions of their growth projections for the Indonesian economy from an average of 5.9 percent in May 2008 to 4.5 percent in January 2009 (see **Table 3**). These downward revisions have been made in view of the continued deterioration visible in the crisis situation in January 2009, marked by the ongoing steep decline in world trade volume and the rapid, drastic economic contraction under way in all developed countries. The developed economies of the United States, Europe and Japan are even showing signs of economic depression, no longer just economic recession.

Table 3
Growth Projection (%)

Financial Institution	May 08	Sept 08	Dec 08	Jan 09
Danareksa Securities	5.9	5.9	5.6	4.8
HSBC Economics	5.3	4.9	4.9	3.8
Bank Danamon	6.3	6.3	4.3	4.3
JP Morgan Chase	5.2	4.7	4.2	4.2
Nomura	4.8	4.5	4.5	3.6
Global Insight	6.0	5.7	4.3	4.3
Citigroup	6.3	5.8	3.8	3.8
Standard Chartered	6.2	6.2	4.5	4.5
Bahana Securities	6.2	6.2	5.4	4.8
Asian Development Bank	6.2	6.2	5.5	5.5
World Bank	6.4	6.2	4.4	4.4
IMF	6.3	6.3	5.5	3.5
Average Consensus	5.9	5.7	4.7	4.3

Table 4
Economic Growth, Demand Side (%)

	Estimated 2008 Outcome	2009	
		Budget	Projection
Private Consumption	5.4	5.2	4.0 - 4.7
Government Consumption	10.7	8.5	10.0
Investment	12.6	7.5	5.0 - 5.9
Exports	13.7	7.8	-1.0 - 5.1
Imports	13.6	8.1	-1.0 - 5.4
GDP	6.2	6.0	4.0 - 4.7

The more modest projections for the Indonesian economy are explained by the downward revision of export and investment growth in response to the impact of flagging world economic growth. Alongside this, private consumption growth is forecasted in the range of 4 percent to 4.7 percent (see **Table** 4). Total consumption is forecasted to maintain moderate growth at 5.4 percent, due to the effect of cuts in Personal Income Tax and more rapid expansion in Government consumption indicated by rising expenditures for line ministries/statutory agencies, pay increases for civil servants and retired bearers of office, capital expenditures for infrastructure development and expenditures for community block grants (PNPM). The increased growth in Government Consumption in 2009 will also be bolstered by the carrying forward of activities from fiscal 2008.

On the production side, downturn is predicted in all sectors as a result of slowing world and domestic demand. Growth in the three dominant sectors in GDP formation – manufacturing, the trade, hotels and restaurants sector and agriculture, livestock, forestry and fisheries – is forecasted to slip from 3.8 percent to 2.6 percent, 7.8 percent to 6.0 percent and from 4.9 percent to 2.9 percent respectively. Other sectors with outlook for slowing growth include the financial sector and construction sector, where growth in 2009 is forecasted to reach 5.2 percent and 6.2 percent (see **Table 5**).

Table 5
Economic Growth by Sector (%)

Sector	Estimated 2008 Outcome	2009	
		Budget	Projection
- Agriculture, Livestock, Forestry and Fisheries	4.4	4.9	2.6 - 2.9
- Mining and Quarrying	0.4	0.6	0.9 - 1.3
- Manufacturing	4.1	3.8	2.0 - 2.6
- Electricity, Gas and Water	11.4	9.6	6.6 - 7.1
- Construction	7.5	6.8	5.4 - 6.2
- Trade, Hotels and Restaurants	7.5	7.8	5.3 - 6.0
- Transport and Communications	17.7	15.3	11.3 - 13.0
- Finance, Leading and Corporate Services	8.0	5.7	4.5 - 5.2
- General Services	6.0	6.7	4.6 - 5.6
GDP	**6.2**	**6.0**	**4.0 - 4.7**

II.1.1.1 Impact on Exports and Investment

The flagging pace of economic growth is predicted to have significant impact on exports and investment. The impact on Indonesia's exports, for example, comes from the economic slowdown in the United States and other trading partner countries that will bear down on international trade and economic activity. In the analysis of aggregate demand, the export growth forecast for 2009 has been lowered from the previous 7.8 percent to between minus 1 percent and an optimistic 5.1 percent. Due to the ongoing deterioration in export destination countries, it is no longer wise to downplay the possibility of stagnation or even contraction in exports.

This slowed growth is not only the result of falling world demand, but also plunging international commodity prices. Crude oil, for example, is now selling for only about $40 per barrel, or one third of the approximately US$145 high last year. Similarly, prices for mining products such as copper, nickel, tin, aluminium and coal as well as of agricultural products such as palm oil and rubber are now at only one fifth of the highs posted one or two years ago. The economic slowdown in Indonesia's main export destinations will have major impact on Indonesia's non-oil and gas exports, with the worst effects felt in demand from Singapore, the United States, Japan and China (see **Table 6**).

Table 6
GDP in Export Destination Countries (%)

Country	GDP (y-o-y)	
	2008	2009
USA	1.4	-1.6
Eurozone	1.2	-2.0
Japan	0.5	-2.6
China	9.7	6.7
Singapore	2.7	-5.0

The economic recession and soaring global unemployment will also affect export demand for manufactured goods and handicrafts. In the next phase, falling exports will be followed by diminished production, eventually making rationalisation of labour almost inevitable.

Another factor besides exports that is now slowing is investment. The liquidity crunch on the global market will intensify competition for foreign funds. The crisis of confidence triggered by world stock market indices has encouraged members of the public to engage in flight to quality by investing in safer instruments. This will in turn discourage investors from investing in emerging markets, including Indonesia, where risk is deemed higher than in developed countries. Accordingly, investment in 2009 is predicted to narrow in the range of 5.0-5.9 percent, less than the earlier predication of 7.5 percent. The investment sources expected to be affected by the slowdown include foreign direct investment (PMA) and portfolio investment. Nevertheless, this decline will be offset by rising Government investment marked by increased spending on capital goods under the Government policy designed to deliver an economic stimulus. The downward trend in interest rates will also help prevent further decline in investment.

II.1.1.2 Impact on Job Losses and Poverty

Increased unemployment and poverty will represent the third impact soon to hit our economy. Like in other countries, the fisheries, mining, manufacturing and construction sector and service industries in Indonesia, including non-bank financial institutions, have begun to cut back on their activities and workforce. As of January 2009, for example, 24,790 jobs were lost in export-oriented manufacturing, while a further 11,703 workers were temporarily laid off. Looming ahead are plans for dismissals of more than 25 thousand workers with more than 19 thousand others to be sent home. The bulk of the dismissals have taken place in the textiles and textile products industry, while the largest numbers of workers sent home are found in wood-based industries. The largest planned dismissals are set to take place in the textile and textile products industry and paper industry. The highest number of temporary layoffs is planned for the estates industry.

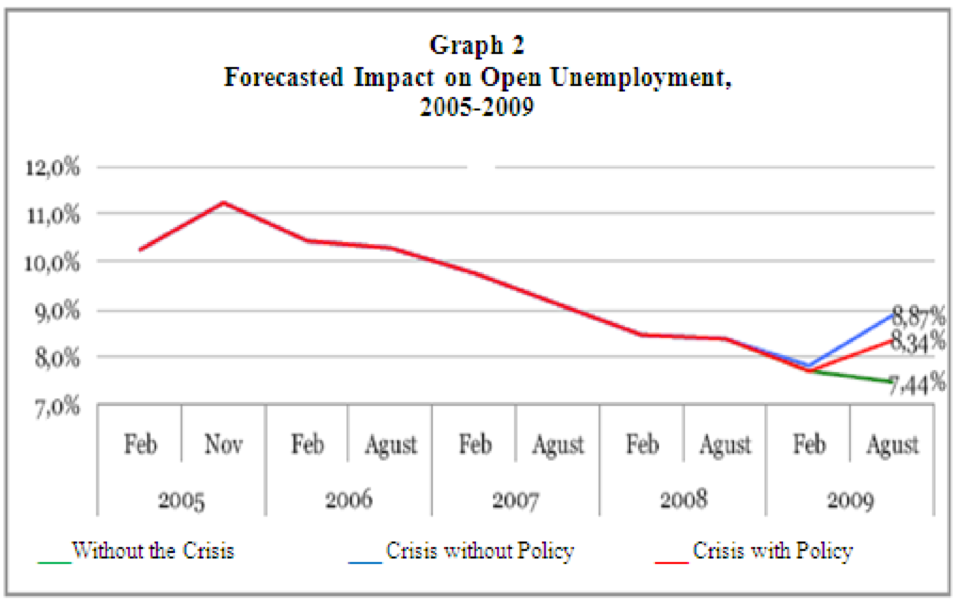
In an added blow, the global recession will lead to dismissals of Indonesians employed overseas and their return to Indonesia. These dismissals and returns will not only put added pressure on the Indonesian labour market, but also reduce foreign exchange receipts from worker remittances. In 2008, for example, 196,635 Indonesians were employed overseas around the world, including 105,166 in the Asia Pacific region and America, 91,407 in the Middle East and Africa and 62 in Europe. Among these workers, 66,816 were employed in Malaysia, 60,014 in Saudi Arabia, almost 18 thousand in Taiwan, while the United Arab Emirates and Kuwait were host to almost 11 thousand workers each. In addition, over 9 thousand were employed in Hong Kong and 8 thousand in Singapore.

Since 2005, unemployment in Indonesia has steadily declined, dropping from 11.2 percent in November 2005 to 8.39 percent in August 2008. This reduction in unemployment was closely tied to the high rate of quality economic growth supported by industrial growth that in turn created more jobs. In 2007-2008, each one percent increment in economic growth provided work for 450 thousand to 525 thousand workers.

Since 2008, the world economic downturn has impacted the creation of jobs, which has ultimately depressed demand for manpower on the domestic labour market. Exacerbating this condition is the falling international demand for labour, due to the deteriorating performance of the global economy. Analysis of elasticity of job creation to economic growth in the post-crisis period, with adjustments for the job losses that have taken place in some sectors and the added jobs created by the fiscal stimulus shows that in a normal, non-crisis situation, Indonesia's unemployment in 2009 is forecasted at 7.44 percent. However, in the steadily deteriorating situation of the world and domestic economy, it will become increasingly difficult during 2009 to keep unemployment in Indonesia from rising. If the Government does not quickly take anticipatory measures, mounting unemployment and poverty will be inevitable. Compared to the level reached in August 2008, unemployment is set to climb sharply in 2009, reaching an estimated 8.87 percent. However, the anticipatory measures prepared by the Government in a series of policy packages are expected to keep unemployment from rising further, with open unemployment in August 2009 predicted to ease to 8.34 percent. This is presented in **Graph 2**.

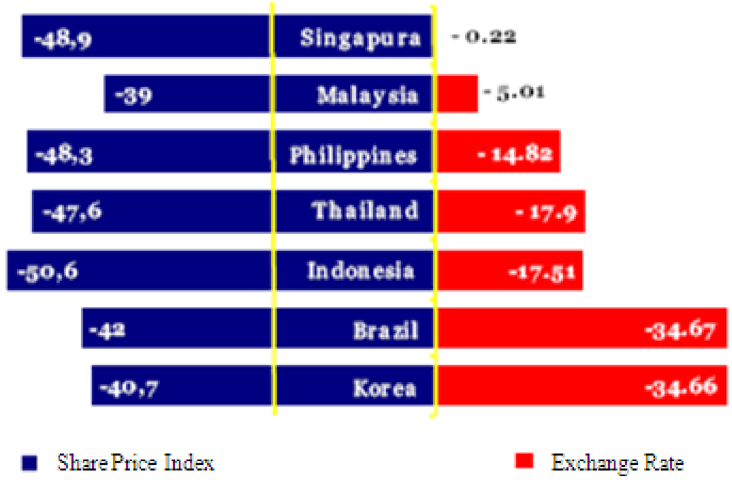
II.1.2 Rupiah Correction from Rp 9,400 to Rp 11,000 to the United States Dollar

The rupiah maintained a stable trend until August 2008, buoyed by the solid current account and consistent, prudent macroeconomic policy. However, since September 2008, the global financial crisis has intensified, producing steep depreciation in the rupiah accompanied by rising volatility. Alarm over the negative impact of the global economic downturn on emerging markets and the flight to quality by global investors in the midst of the current world financial crisis has put pressure on regional currencies, including Indonesia. The broad scale of this behaviour has dried up US dollar liquidity on domestic markets in numerous countries. Not only is liquidity tight, but forex markets in developed and developing countries are now undergoing fluctuating trends accompanied by rising levels of uncertainty



In 2008, the Korean won, for example, lost 34.66 percent of its value. Similarly, the Malaysian ringgit sustained 5.01 percent correction, the Singapore dollar eased 0.22 percent, the Thai baht plunged 17.09 percent and the Philippine peso lost 14.82 percent of its value. The rupiah itself recorded 17.5 percent depreciation throughout 2008 (see **Graph 3**). This depreciation is expected to carry forward in 2009. Therefore, the average rupiah exchange rate for 2009 is forecasted at Rp 11,000 to the US dollar, up from the Budget assumption at Rp 9,400 to the US dollar.

Graph 3
Correction in Currency Values and
Stock Indices in Emerging Markets, 2008



With no sign of recovery in the US economic and financial crisis, fiscal management will result in accumulation of debt from the massive costs of addressing the crisis. This, combined with the deteriorating condition of manufacturing that augurs for a trade deficit, will shift the natural equilibrium of the United States dollar against world currencies, in which theoretically, the dollar should follow a depreciating trend. This uncertainty over the value of the US dollar will continue to haunt the rupiah and other world currencies until 2010.

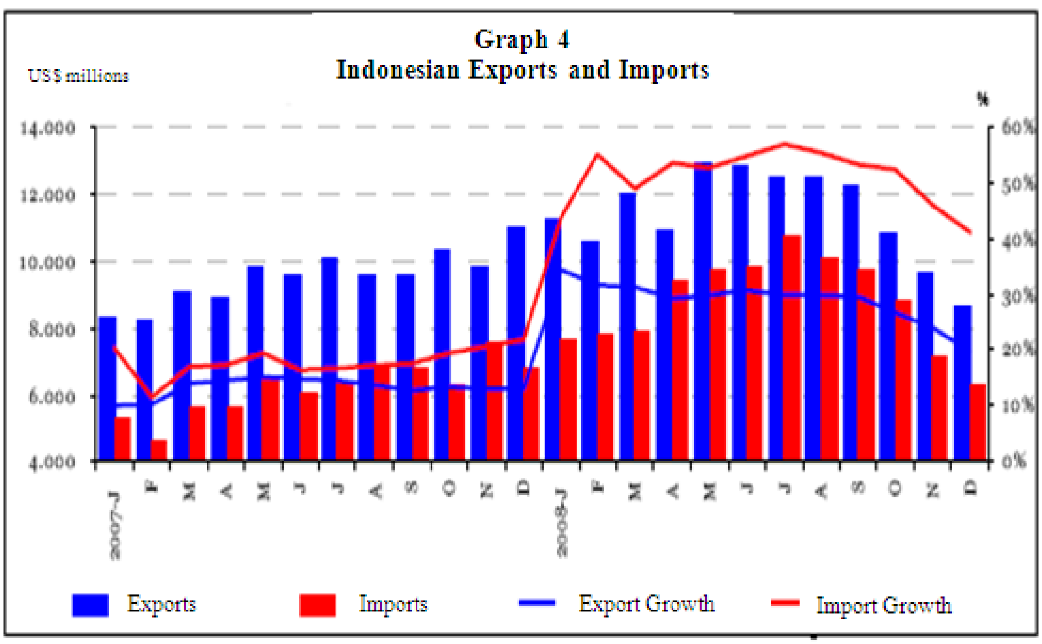
II.1.2.1 Impact on Balance of Trade and International Reserves

The most immediate negative impact of the global economic crisis is in the financial sector. The volume of world capital flowing into emerging market countries plunged from over US$600 billion in 2008 to no more than an estimated US$195 billion. The exodus of foreign capital from emerging markets both from deleveraging and resolution of financial difficulties at head offices in home countries led directly to a drop in the share price index on the Indonesian Stock Exchange (BEI). On the BEI, the steepest dive in share prices was recorded at 22.17 percent over a three-day period in 6-8 October 2008.

In keeping with this exodus of capital, the rupiah exchange rate against the United States dollar fell sharply, although ultimately charting correction at the end of 2008. International reserves dropped from US$56.9 billion at end-December 2007 to about US$51.6 billion at end-December 2008, sufficient for about 4 months of imports plus servicing of official external debt. The contraction in international reserves is explained partly by the heavy outflows of foreign capital, particularly on the Government Securities and Bank Indonesia Certificate (SBI) markets, in addition to intervention to stabilise the value of the rupiah. Even so, this still likely represents a safe level of international reserves, being greater than short-term repayment obligations on external debt. In 2009, further pressure on international reserves is expected due to the predicted downturn in Indonesia's exports, with the current account expected to chart a deficit. Given these conditions, international reserves at end-2009 are predicted at about USD50.9 billion, equivalent to 4.7 months of imports and servicing of government debt.

In regard to loan disbursements during October and November 2008, credit expansion was very thin. At end-October 2008, total lending stood at Rp 1,343.6 trillion, while at end-November 2008, the position reached Rp 1,371.9 trillion. In early 2009, credit expansion still faced a difficult outlook, despite the cut in the BI Rate. This was because liquidity flows were still largely dried up. Added to this, the banking sector was still concerned over mounting non-performing loans (NPLs), and was exercising extreme caution in lending. NPLs are forecasted to rise in 2009, reaching the level of 5.0 percent. This is up from the current position of 4.0 percent. The next issue is the tendency for banks to become depleted of capital as a result of funds allocated to offset steadily escalating market risk, credit risk and operational risk.

The second round impact of the financial crisis will be to weaken Indonesia's net exports due to loss of external purchasing power and the rising cost of imported raw materials brought on by depreciation in the rupiah. The weakening of the rupiah will drive up costs for importing raw materials, resulting in significantly increased production costs. If the rupiah maintains a downward trend against the dollar, the impact on industries with a high dependence on imported raw materials will escalate due to the loss of competitiveness of those industries. As shown in **Graph 4**, pressure from global economic conditions on Indonesia’s exports and imports began to have noticeable impact in the fourth quarter of 2008. Cumulative export growth (year-to-date), which had reached about 30.0 percent for the first three quarters of 2008, fell off significantly to only 19.9 percent in December 2008. This export downturn resulted mainly from slowing exports of manufactured and agricultural products, which account for about 80.0 percent and 5.0 percent of Indonesia's total non-oil and gas exports. In the statistics published by the Central Statistics Agency (BPS, data for December 2008), a key factor in the export decline is falling demand from Europe, Japan and the ASEAN nations. On the other hand, Indonesia’s exports to the United States continue to rise, although at a more moderate rate.



The levelling off in growth is also visible in imports. Cumulative import growth (year-to-date) topped the 50 percent mark for the first three quarters of the year, but by end-2008 had dropped to 41.2 percent. This downturn is explained mainly by falling imports of consumption goods and raw materials, which make up about 85 percent of total imports. Under these conditions, export growth is predicted to fall off sharply, with even the possibility of stagnation or negative growth.

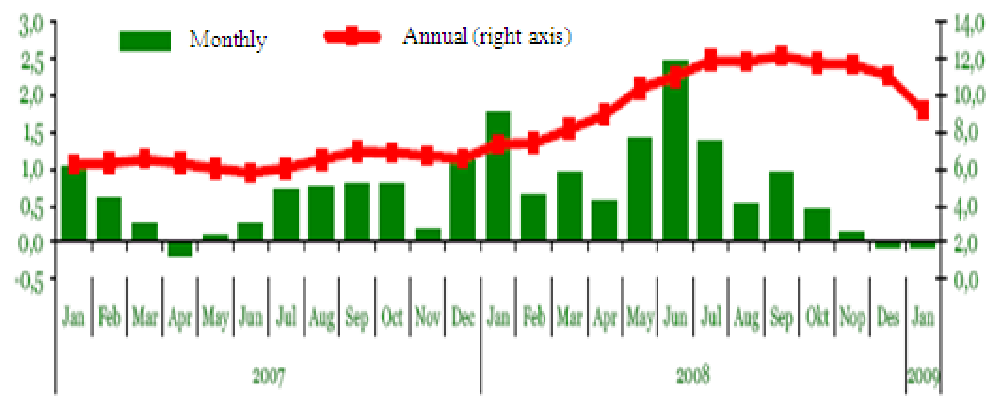
II.2 Other Macroeconomic Indicators

II.2.1 Inflation

Soaring crude oil and food commodity prices on global markets led to a rising inflationary trend in Indonesia beginning in early 2008. The mounting trend in oil prices, which climbed past US$135 per barrel, compelled the Government at end-May 2008 to raise subsidised fuel prices. This fuel price hike triggered an inflationary surge in June to 1.87 percent, the highest monthly rate of inflation for the past three years. Annual inflation in June 2008 thus mounted to 11.37 percent with cumulative inflation for January-June 2008 at 7.37 percent. In the subsequent months, inflation edged up further, reaching 12.14 percent in September 2008. This high rate of inflation came not only in response to price increases from the second round effect of the hike in subsidised fuel prices, but also escalating demand for staple goods in advance of the Ramadan fasting month and Eid-ul-Fitr festive season in early October 2008.

With world crude oil prices moving into decline and the Government and Bank Indonesia pursuing coordinated policy measures for inflation control, inflation progressively eased with Indonesia even recording 0.04 monthly deflation in December 2008. The deflation in December 2008 came in response to the reduction in the premium gasoline price from Rp 6,000/liter to Rp 5,500/litre on 1 December 2008 and again to Rp 5,000/litre on 15 December 2008. Similarly, automotive diesel was cut from Rp 5,500/litre to Rp 4,800/litre on 15 December 2008. During the month, prices also fell for other commodities, such as chicken, cooking oil and shallots. In response to these conditions, inflation at end-2008 came to 11.06 percent (see **Graph 5**).

Graph 5
Inflation, 2007-2009



In early 2009, global market prices for crude oil and other primary commodities continued to fall. Consistent with this trend, on 15 January 2009 the Government announced a renewed cut in prices for automotive diesel and premium gasoline to Rp 4,500/liter. This drop in fuel prices led to significant reductions in prices for goods and services. This contributed to another month of deflation in January at 0.07 percent. During 2009, inflation is predicted to ease to the 6.0 percent range. This is explained by reduced imported inflation in keeping with weakening world commodity prices and slowing domestic demand easing pressure from the output gap. Other factors are inflation expectations, minimum changes in administered prices and measures to safeguard supply and distribution of staple goods. Nevertheless, it is also important to keep a watch on potential inflationary pressure related to the holding of the 2009 National Elections.

II.2.2 3-Month SBI Rate

The high rate of inflation in 2008 compelled Bank Indonesia to hold the BI Rate at 9.50 percent in November 2008. As a result, the 3-month SBI rate remained at 11.49 percent. The relatively high 3-month SBI rate is a reflection of tight domestic liquidity from the knock-on effects of the global financial crisis. With inflation beginning to ease, Bank Indonesia lowered the BI Rate 25 bps to 9.25 percent in December 2008 in order to ease liquidity. This move was repeated in February 2009 in a further cut in the BI rate to 8.25 percent in keeping with inflation expectations for 2009.

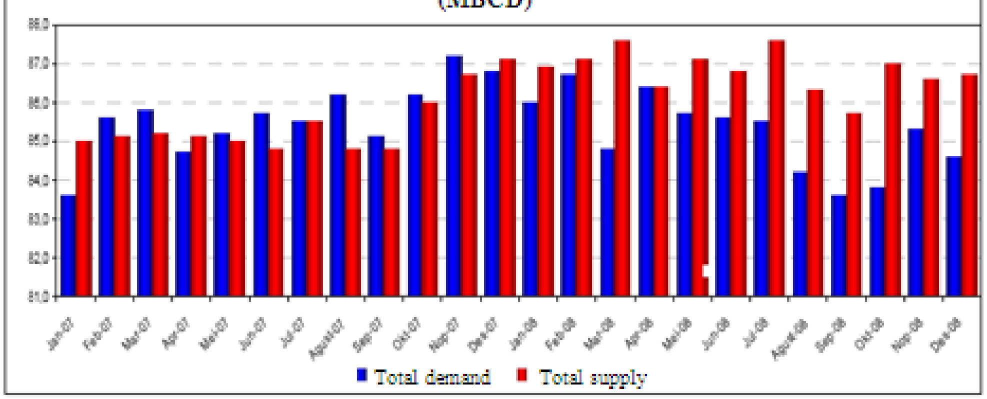
Following the cut in the BI Rate, reductions are expected in the 3-month SBI rate. In January 2009, the 3-month SBI rate averaged 10.31 percent. At end-2009, the average 3-month SBI rate is forecasted in the range of 6.5-7.5 percent, on track with the 2009 Budget estimate. The downward interest rate movement is expected to have a positive effect on investment activity and ultimately stimulate growth in the real sector.

II.2.3 Indonesian Crude Price and Lifting

Since December 2007, crude oil supply has exceeded demand. To illustrate, world crude oil supply in December 2008 stood at 86.7 million barrels, ahead of demand at only 84.6 million barrels. Even in spite of the oversupply, global market prices for oil persisted at high levels, touch as much as US$145 per barrel on 3 July 2008. This is widely believed to be linked to speculation.

In view of the ongoing decline in the world economy, oil demand is predicted to drop further, driving down world crude oil prices (see **Graph 6**). Near end-2008, the benchmark West Texas Intermediate (WTI) crude price plunged dramatically to a low of US$31.4 per barrel on 22 December 2008. Following this development, the average WTI price for 2008 came to US$99.2 per barrel.

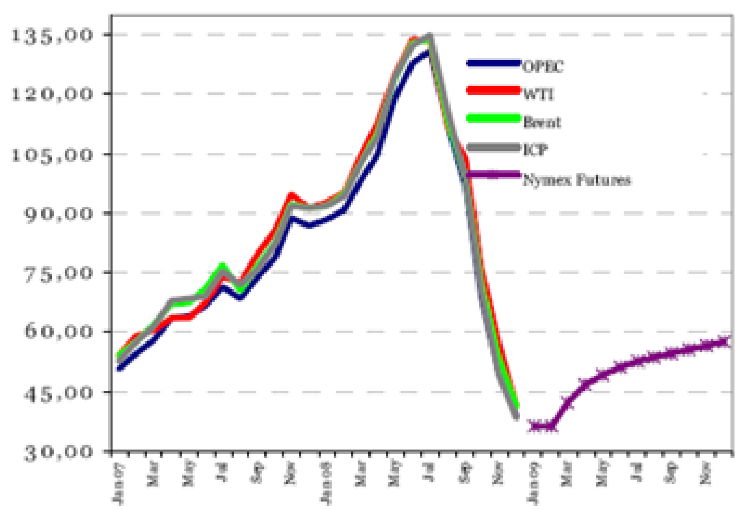
Graph 6
World Crude Oil Supply and Demand, 2007-2008
(MBCD)



With world crude prices on the rise, the Indonesian Crude Price (ICP) similarly mounted, peaking in July 2008 at an average of US$134.9 per barrel. After international oil prices began tumbling during the second half of 2008, the ICP also followed suit. During 2008, the ICP averaged US$96.8 per barrel. Given the potential for further global economic slowdown in 2009, demand for crude oil is also set to decline. WTI crude is forecasted to reach a new price equilibrium in 2009 in the range of US$40 to US$50 per barrel. In view of this, the Government has found it necessary to revise the ICP to an average US$45 per barrel (see **Graph 7**). Even so, conditions in 2006-2008 demonstrate the capability of world oil prices to surge to extremely high levels in a short time, underscoring the importance of Indonesia to be ready for all possible oil price scenarios, from high to low, and for Indonesia to build and strengthen energy resilience.

Volume of crude lifting in 2008 reached 0.931 million barrels per day, ahead of the assumed 0.927 million barrels per day in the Revised 2008 Budget. The high volume of lifting is related to the oil well revitalisation programme current in place, with production levels at end-2008 expected to contribute to increased domestic oil production during the coming year. Accordingly, crude oil lifting in 2009 is assumed at 0.960 million barrels per day.

Graph 7
International Oil Prices



II.3 significantly increased borrowing costs from escalating yield on government securities

The global financial crisis has led to the collapse of major companies and ushered in a period of slowing growth in the world economy. Stock markets have plummeted in various countries in keeping with deteriorating investor perceptions of the financial sector and global economic outlook. The crisis has triggered a loss of investor confidence in a wide range of financial instruments, leading to massive outflows of funds from capital markets. Bad debts have spiralled in keeping with loss of purchasing power caused by the steep downturn in economic activity. Enormous cash demand to finance transactions related to the subprime mortgage crisis and negative investor sentiment have brought on a global liquidity crunch. To avoid a further deterioration in the economic situation, many countries have bailed out their financial sector and have extended large-scale liquidity support to rescue the real sector. In consequence, liquidity on international money markets has steadily diminished and is increasingly difficult to obtain. Even if available, liquidity can only be obtained at very high cost.

The effect of this is to drive up borrowing rates, including interest rates on Government bonds. Although many central banks in developed countries have lowered their policy rates, bonds sold on international markets have still seen significant increases in rates.

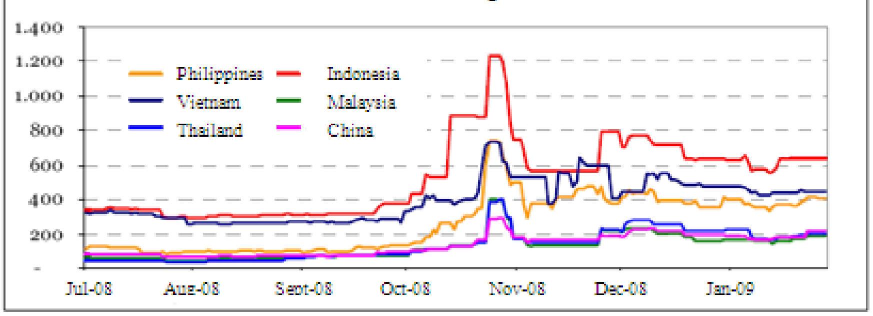
The exodus of foreign funds from Indonesia in response to the global financial crisis has spurred demand for US dollars, putting pressure on the rupiah. The declining growth in depositor funds and outflows of foreign funds has brought about a liquidity crunch on the domestic market that has driven up loan interest rates. In overall terms, yield on Government Securities mounted considerably in comparison to end-2007 (see **Table 7**). For example, yield on 10-year Government Securities widened to 11.97 percent on 27 January 2009, above the end-December 2007 yield at 10.02 percent. Similar movement was reported for US dollar denominated Indonesian Government international bonds. Yield on Government international bonds, still at only 6.27 percent at end-2007, soared to 11.14 percent by 27 January 2009. The consequence of the higher yield on Government bonds is the increased interest payable on these loans.

Table 7
Government Securities Yield (%)

Period		**31 Dec 07**	**31 Dec 08**	**27 Jan 09**
Government Securities Yield (%)	5 Y	9.21	11.80	11.50
	10 Y	10.02	11.89	11.97
	30 Y	10.64	12.19	12.43
	INDO-18	6.27	9.42	11.14

Negative investor sentiment led to significant increases in credit default swaps (CDS) for emerging market countries, including Indonesia (see **Graph 8**). On 24 October 2008, 10-year CDS on Indonesian Government Bonds was priced at 1236.38 bps above LIBOR. This has contributed to the increased yields demanded by investors in Government bonds. Investors expect higher yields on Government bonds to cover the cost of CDS.

Graph 8
10-Year CDS Spread



Yield on US dollar denominated 10-year international Government bonds has climbed sharply, reaching 14.81 percent on 27 October 2008. Following this, yield on domestic Government Securities also soared to 20.96 percent. Bolstered by rising investor confidence, 10-year CDS on

Government bonds gradually eased to 638.57 bps above LIBOR on 27 January 2009. This has had a positive impact on Government bond yield, which also showed similar downward movement.

In early 2009, government securities showed a positive trend. The 13 January 2009 auction, for example, raised a total of Rp 5.95 trillion, or 65.1 percent of the total Rp 9.137 trillion in incoming bids. The results of that auction exceeded the indicative amount set at Rp 3.0 trillion, producing an overall bid to cover ratio of 1.54. This attests to the continued availability of liquidity for placement in Government bonds.

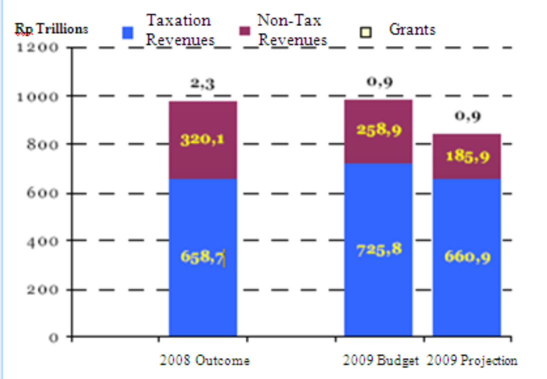
Despite this, the global bond market will become increasingly difficult and expensive to tap due to the many developed nations that have embarked on primarily debt-financed stimulus programmes to keep wheels turning in the real sector. The already keen competition for liquidity will become tighter still. As a result, the cost of funds that must be borne in issuing bonds will mount all the higher. The Government will maintain a prudent, wise debt management strategy. The existing policies of diversification of instruments and tapping of the lowest cost, lowest risk sources of debt without political ties will be retained.

II.4 Impact of Changes in Macroeconomic Indicators on State Revenues

The changes in macroeconomic indicators brought about by the global financial crisis have necessitated changes in the targeted state revenues formulated in the 2009 Budget. In response to the changed aggregates, 2009 tax and non-tax revenues are projected significantly lower than before. The reduced taxation revenue projection for 2009 is explained by the smaller tax base suggested by the nationwide drop in income levels brought about by slowing economic activity. Alongside this, the projected reduction in non-tax revenues is largely the result of the changed crude oil price (ICP) assumption from US$80 per barrel to US$45 per barrel.

In the adjustments to the 2009 Budget, taxation revenues were calculated on the assumption of 4.5 percent economic growth, taking into account the effective implementation of the fiscal stimulus. However, if the fiscal stimulus does not proceed according to plan and economic growth drops below 4.5 percent, taxation revenues may fall short of the targeted level in the adjusted 2009 Budget. Tax revenues are targeted at Rp 660.9 trillion, down Rp 65.0 trillion from the 2009 Budget target. This adjustment to taxation receipts also takes into account the fiscal stimulus already envisaged in the 2009 Budget and the added new fiscal stimulus, such as concerning payroll tax. Alongside this, non-tax revenues are targeted lower at Rp 185.9 trillion, or down Rp 73.1 trillion from the 2009 Budget level (see **Graph 9**).

Graph 9
Revenues and Grants



At a more detailed level, changes in individual macroeconomic indicators have varying impact on tax and non-tax revenues. A one percent downturn in economic growth produces a Rp 12.7 trillion drop in domestic revenues with taxes down in all areas other than oil and natural gas income tax. The oil and natural gas tax, however, remains unchanged. This fall in economic growth also has no effect on the targeted non-tax revenues for 2009.

At the same time, each decline of US$10 per barrel in the ICP reduces domestic revenues by Rp 33.9 trillion, with oil and natural gas income tax revenue down Rp 7.2 trillion and resource-based non-tax revenues on oil and gas down Rp 26.7 trillion. Each Rp 1,000/US$ depreciation in the rupiah exchange rate produces an increase in domestic revenues of Rp 24. trillion, divided into Rp 6.6 trillion in tax revenues and Rp 18.1 trillion in non-tax revenues. These added tax revenues consists of Rp 0.6 trillion in non-oil and gas tax receipts and Rp 6.0 trillion in oil and natural tax income tax (see **Table 8**).

Table 8
Sensitivity of Domestic Revenues
(Trillions of rupiahs)

	Economic Growth Down 1%	**Exchange Rate Up Rp 1,000**	**ICP Down US$10**
1. Taxation Revenues	(12.7)	6.6	(7.2)
2. Non-Tax Revenues	-	18.1	(26.7)
Domestic Revenues (1 + 2)	(12.7)	24.7	(33.9)

Taxation Revenues

Depressed economic growth in 2009 will also have a downward impact on national revenues, due to the slowdown in economic activity. One direct impact will be lower income tax revenues on non-oil and gas sources, payable by personal and corporate taxpayers. Income tax revenues are forecasted at Rp 318.7 trillion in 2009, down Rp 38.7 million from the planned level in the 2009 Budget. This decline will not only result from diminished non-oil and gas income tax receipts caused by the slowing pace of economic growth, but also the reduced forecast for oil and natural gas income tax revenues. Income tax revenues from oil and natural gas are forecasted at Rp 38.7 trillion in 2009, Rp 18.0 million below the planned level in the 2009 Budget. This is explained by the lower estimated Indonesian Crude Price, down from US$80 per barrel in the 2009 Budget to US$45 per barrel.

Lower levels of national income also augur for more modest domestic consumption, affecting Government consumption, private consumption and household consumption. A direct impact of this will be reduced VAT receipts, as these are tied very closely to national consumption levels. With national consumption levels expected to decline in 2009, VAT receipts are forecasted at Rp 233.6 trillion, or Rp 15.9 trillion below the planned level in the 2009 Budget.

Targeted taxation revenues are also down in receipts from land and building tax and property transfer tax, now projected at Rp 31.0 trillion. This is Rp 5.6 trillion less compared to the 2009 Budget. This downward revision is explained primarily by the forecasted reduction in land and building tax from oil and natural gas operations related to the lower assumed Indonesian Crude Price.

On the other hand, flagging economic growth will have little bearing on achievement of the excise revenue target in 2009. Following the decision to raise excise rates by an average 7 percent early in

2009, excise receipts are in fact predicted to reach Rp 54.4 trillion. This forecast is significant, as it marks a Rp 4.9 trillion increase over the level set in the 2009 Budget.

In further developments, the global financial crisis that has unfolded into a global economic crisis will bear down on international trade. Exports and imports are forecasted to decline in both volume and value. This will affect revenues from import duties and export taxes. For this reason, the targeted import duty receipts for 2009 have been adjusted down to Rp 17.2 trillion, a reduction of Rp 2.0 trillion from the level envisaged in the 2009 Budget. Similarly, export tax revenues in 2009 are forecasted at Rp 2.4 trillion, a reduction of Rp 7.0 trillion from the 2009 Budget.

The projected fall in import duty revenues is not only the result of forecasted decline in volume and value of imports, but also takes account of international trade agreements necessitating reductions (harmonisation) in import tariffs for certain goods and in specified areas. At the same time, the lower planned receipts from export taxes in 2009 are related primarily to the decision to reduce the export tax on Crude Palm Oil to 0 (zero) percent with effect from October 2008. This rate for CPO export tax is unlikely to see significant change during 2009.

Non-Tax Revenues

In addition to the decline in taxation revenues, non-tax revenues are also revised downwards to Rp 185.9 trillion, representing a drop of Rp 73.1 trillion from the 2009 Budget target. This steep reduction is primarily explained by the dramatic drop in the ICP from US$80/barrel in the 2009 Budget to US$45/barrel. The steepest decline in non-tax revenues is expected resource-based receipts from oil and natural gas and dividend payments from SOEs.

As a result of the change in the ICP assumption from US$80 per barrel to US$45 per barrel and in the assumed exchange rate from Rp 9,400/US dollar to Rp 11,000/US dollar, resource-based revenues from oil and natural gas are projected at Rp 92.0 trillion, representing a Rp 70.1 trillion drop from the planned level in the 2009 Budget. Contributing to this reduction are diminished revenues from crude oil, representing a drop of Rp 60.7 trillion, and from natural gas, similarly down Rp 9.4 trillion.

The steep plunge in oil prices at the end of 2008 and the impact of the global economic crisis also impacted preliminary figures for SOE earnings in 2008, which are expected to come below forecasted levels. This is one factor in the downward revision of SOE dividend receipts in 2009 to Rp 26.1 trillion. At this level, the expected SOE dividends have been reduced Rp 4.7 trillion from the level planned in the 2009 Budget.

III. FISCAL STIMULUS PROGRAM FOR 2009

To prevent even worse deterioration in the economy due to the impact of the global crisis, the Government will launch a countercyclical policy during 2009. The countercyclical policy, consisting of a fiscal stimulus, is aimed primarily at (a) sustaining and/or strengthening public purchasing power to maintain growth in household consumption at 4.0 to 4.7 percent; (b) maintaining corporate/business resilience in the face of the global crisis; and (c) creating employment and mitigating the impact of job losses through the labour-intensive infrastructure construction policy. The total funds allocated for this fiscal stimulus programme amount to Rp 71.3 trillion (see **Table 9**).

Table 9
Fiscal Stimulus, 2009
(Trillions of rupiahs)

Description	Allocation
1. Tax Savings	43.0
- Reductions in Income Tax Rates:	32.0
- Lower Corporate Tax Rate	18.5
- Lower Personal Income Tax Rate	13.5
- Income tax-free band raised to Rp 15.8 million	11.0
2. Tax/Import Duty Subsidies for Business/Targeted Households	13.3
- VAT on oil/gas exploration, cooking oil	3.5
- Import duties on raw materials and capital goods	2.5
- Payroll tax	6.5
- Geothermal tax	0.8
3. Pro-Business/Jobs Subsidies + Budget Expenditures	15.0
- Reduced price for automotive diesel	2.8
- Discounted electricity billing rates for industrial users	1.4
- Additional infrastructure expenditures + subsidies + government equity injection	10.2
- Upscaling of Community Block Grants (PNPM)	0.6
Total Stimulus	**71.3**

III.1 Sustaining and/or Strengthening Public Purchasing Power

To achieve the targeted rate of economic growth, private consumption, which comprises the primary growth factor, must be sustained and if at all possible given added momentum. In this regard, the Government is delivering a fiscal stimulus to sustain and increase public purchasing power in an effort to keep growth in household consumption at 4.0 percent to 4.7 percent during 2009. This stimulus consists of cuts in personal income tax rates, an increase in the tax-free income band and provision of various subsidies, including price subsidies for generic medicines, price subsidies for cooking oil and VAT subsidies for cooking oil downstream products and biofuels.

Concerning taxation, the 2009 Budget includes reductions in personal income tax rates pursuant to the amendment to the Income Tax Law. This will strengthen real private incomes, which in turn is expected to boost purchasing power. The lower personal income tax rates offer a tax saving of Rp 24.5 trillion that will provide added liquidity to the economy and bolster household purchasing power (see **Table 10**).

Table 10
Public Purchasing Power Stimulus, 2009
(Billions of rupiahs)

Description	Allocation
A. Taxation	**24,500.0**
1. Reduction in Non-Oil and Gas Income Tax Rates	**13,500.0**
- *Reduction in personal income tax rates (35% --> 30%) and addition of tax brackets*	
2. Income tax-free band raised to Rp 15.8 million	**11,000.0**
B. Subsidies	**1,410.0**
1. Tax Subsidies	**1,000.0**
- VAT on Cooking Oil	800.0
- VAT on Biofuels	200.0
2. Non-Tax Subsidies	410.0
- Cooking Oil	210.0
- Generic Medicines	200.0
Total Stimulus	**25,910.0**

The amended Income Tax Law introduces fundamental changes in the tax rates and tax brackets for personal and corporate taxpayers. The fiscal stimulus for personal taxpayers will provide the public with tax savings of Rp 24.5 trillion. This stimulus, which involves a simplification and reduction in tax rates for each income bracket for personal taxpayers (top rate reduced from 35 percent to 30 percent), will deliver an impact of Rp 13.5 trillion, while rise in the tax-free income band from Rp 13.2 million per individual to Rp 15.8 million will have a further impact of Rp 11.0 trillion.

In actions involving 2009 Budget expenditures to sustain public purchasing power, the Government has announced a 15 percent basic salary increase for civil servants, military personnel, police and pensioners and the payment of a 13th month salary. Complementing this will be Direct Cash Transfers paid out to 18.2 million target households for 2 months at the rate of Rp 100,000 per household per month. The Government has also prepared a Rp 1,410.0 billion stimulus package aimed at mitigating the negative impact of the global economic crisis. This stimulus consists of Rp 800.0 billion in tax or VAT subsidies for cooking oil, Rp 200.0 billion in VAT subsidies for biofuels, Rp 210 billion in subsidies for cooking oil and Rp 200.0 billion in generic medicine subsidies.

The VAT subsidy for cooking oil is a continuation of a VAT facility extended in 2008. In 2009, the VAT subsidy will support sales of cooking oil in bulk and in simple packaging using the Government-owned generic brand name of “Minyakita.” In addition to the cooking oil VAT subsidy, the Government will also subsidise cooking oil prices in market operations at the rate of Rp 1,000/litre as means of reducing and stabilising cooking oil prices on the open market and easing the burden for low income earners. Under the present conditions (international CPO price at US$600/ton), “Minyakita” is selling for Rp 6,000/litre. The cooking oil market operations target all 18.2 million target households in the poverty alleviation programme, with sales at 1 litre per month for a duration of 10 months. This distribution will reach 100 percent of low income households, or 11.7 percent of the total bulk cooking oil market for households. The cooking oil will be distributed by means of the subsidised cooking oil mechanism with support from local government and private business (implemented in 2008).

Added to this, the biofuels VAT subsidy is aimed at ensuring the availability of biofuels at lower prices competitive with non-renewable oil-based fossil fuels. This subsidy is expected to enable future increases in biofuel production and thus reduce dependence on fossil fuels.

In a similar vein, the Government is operating the Rp 200.0 billion Subsidised Generic Medicines (OGS) scheme to ensure availability, affordability and equitable distribution of medicines to all regions in anticipation of economic recession. This subsidy is extended for fast-moving and life-saving medicines. The subsidy is also available for essential drugs, health programme drugs and drugs not economic viable, but essential for health care.

III.2 Corporate/Business Sector Resilience in the Face of Global Crisis

To bolster competitiveness, business resilience and exports, the Government is also providing a stimulus through taxation, provision of various subsidies and financing. The taxation stimulus involves the reduction of the single corporate tax rate, while the subsidies consist of import duty relief, VAT support, payroll tax incentive, reduced electricity billing rates for industrial users and lower prices for automotive diesel. The financing stimulus consists of state equity injection for grassroots business credit (KUR) and export guarantees.

In regard to taxation, the fiscal stimulus for strengthening business competitiveness and exports is already included in the formulation of the 2009 Budget. The fiscal stimulus consists, among others, of Rp 18.5 trillion in tax savings through amendment to the Income Tax Law (see **Table 11**).

Table 11
Stimulus for Improved Business Resilience and Export Competitiveness
(billions of rupiahs)

Description	Allocation
A. Taxation	**18,500.0**
1. Reduction in Non-Oil and Gas Income Tax Rates	**18,500.0**
- *Reduction in Corporate Tax rate (30% --> 28%) with further 5% relief for stock exchange listed companies*	
B. Subsidies	**16,432.8**
1. Tax Subsidies	**12,300.0**
- Import Duties for Industries	2,500.0
- VAT on Oil and Natural Gas Exploration	2,500.0
- Geothermal Tax	800.0
- Payroll Tax	6,500.0
2. Non-Tax Subsidies	**4,132.8**
- Automotive Diesel Reduced by Rp 300/litre	2,779.9
- Discounted electricity billing rates for industrial users	1,337.9
- Interest subsidy for water utilities	15.0
C. Financing	***2,000.0***
- State equity injection for Asuransi Ekspor Indonesia (ASEI)	*1,000.0*
- State equity injection for Askrindo and Jamkrindo	*1,000.0*
Total Stimulus	**36,932.8**

The amendment to the Income Tax law contains a fundamental change in the application of the single corporate tax rate, which is lowered to 28 percent for 2009, and offers 5 percent relief for stock exchange listed companies below the prevailing taxation rate. Corporate tax payers also benefit from the provision of tax incentives for companies operating in specified sectors and/or located in specified regions.

In the area of budget expenditures, the Government has prepared a Rp 16.4 trillion stimulus package aimed at mitigating negative impact from the global economic crisis on business and export competitiveness. This stimulus consists of Rp 2.5 trillion in import duty exemptions, Rp 2.5 trillion in VAT subsidies for oil and natural gas exploration, Rp 0.8 trillion in income tax relief for geothermal production, Rp 6.5 trillion in payroll tax incentives, Rp 1.4 trillion in reduced electricity billing rates for industrial users, Rp 2.8 trillion in price cuts for automotive diesel and Rp 15.0 billion interest subsidy for water utility companies.

In the 2009 Budget, the Government allocated Rp 2.5 trillion in subsidies for import duty relief in order to ensure the supply of goods and/or services in the public interest, support the real sector and boost the competitiveness of selected domestic industries. These import duty subsidies cover 14 sectors and include raw materials and components for heavy equipment manufacturing, raw materials and components for small capacity thermal power plant production, skim and full cream milk, automotive manufacturing raw materials and components, electronics components, shipbuilding raw materials and components and aircraft.

The VAT subsidy for imports is extended to companies engaged in oil and natural gas exploration. This subsidy for import-related taxes is expected to encourage more companies to invest in oil and natural gas and thus pave the way for future expansion in oil and natural gas production.

In a similar vein, the Government is extending a VAT incentive for geothermal energy to promote activity for power generation from geothermal sources in order to meet rising demand for electrical power.

The Payroll Tax Subsidy is provided by the Government in a measure to fend off the possibility of mass layoffs by companies. Taxes collected by companies for permanent employees will not need to be paid to the State Treasury. Instead, these taxes will be paid by the Government, so that the taxes withheld from payrolls can be used to reinforce working capital and finance company operations.

To lower production costs, the Government is reducing electricity billing rates for users in the I-3 industrial category with 20 KVA to 30 KVA supply capacity and in the I-4 category with above 30 KVA capacity. The maximum peak hour rate has been cut from four times to three times the normal electricity billing rate.

To ease the burden of transportation costs borne by the public, the Government decided to lower the price of subsidised automotive diesel by Rp 300/litre from Rp 4,800/litre to Rp 4,500/litre with effect from 15 January 2009. This brings the accumulated reduction in subsidised automotive diesel prices since mid-December 2008 to 18.2 percent (from Rp 5,500/litre to Rp 4,500/litre). The lower price for automotive diesel is expected to produce a reduction in transport fares of about 10 percent.

In addition, to bring clean water to an additional 10 million low income households, the Government is subsidising interest paid by water utilities on funds obtained from the banking system.

In addition to the activities described above, a fiscal stimulus will also be delivered through Rp 1.0 trillion added state equity participation in the Indonesian Export Insurance (ASEI) corporation in support of export guarantees and Rp 1.0 trillion in the Jamkrindo and Askrindo loan guarantee corporations to boost funding for grassroots business credit guarantees.

The grassroots business credit guarantees are provided to secure improved access to financing for micro, small and medium enterprises and cooperatives in order to boost national economic growth. In this way, the injection of state capital is expected to provide added capacity for guaranteeing grassroots business credit and thus enable more micro, small and medium enterprises to benefit from these loan funds.

III.3 Job Creation and Mitigation of Job Losses through Labour-Intensive Construction of Infrastructure

To create jobs and mitigate the effects of job losses, the Government will allocate a Rp 8,376.5 billion fiscal stimulus in 2009, divided into (1) Rp 7,775.0 billion in infrastructure spending, and (2) Rp 601.5 billion for the national community block grant (PNPM) programme (see **Table 12**).

The additional stimulus funding allocations for job creation and mitigation of job losses will be prioritised for labour-intensive construction of infrastructure in various fields. The areas to receive these funding allocations include public works, communications, energy and housing. The detailed activities to be funded by additional infrastructure expenditure allocations are as follows:

(1) Public works infrastructure development at Rp 3.385 trillion;
(2) Communications infrastructure development at Rp 1.325 trillion;
(3) Energy infrastructure development at Rp 1.0 trillion;
(4) Housing infrastructure development at Rp 680.0 billion;
(5) Market infrastructure development at Rp 315.0 billion;
(6) Construction and rehabilitation of farming community road and irrigation infrastructure at Rp 650.0 billion;
(7) Improvements to vocational training at Rp 300.0 billion; and
(8) Rehabilitation of warehouses for storage of staple goods at Rp 120.0 billion.

The budget allocations for public works infrastructure will be used to finance (1) flood control (including flooding by the Bengawan Solo); (2) rehabilitation of irrigation networks in support of food resilience (in South Sumatra, Banten, West Java, Central Java, Yogyakarta, East Java, Maluku, South Sulawesi and Papua); (3) expansion of water distribution networks and construction of water treatment plants; (4) accelerated completion of multi-year contracts; and (5) inspection routes and irrigation in aquaculture pond production centres.

Similarly, the budget allocations for communications infrastructure development will be used for (1) construction and rehabilitation of railway links; (2) additional funding for construction of the Kuala Namu airport; (3) runway extensions and airport rehabilitation; and (4) construction and rehabilitation of ferry ports and wharves.

Table 12 Fiscal Stimulus for Labour-Intensive Infrastructure Improvements (billions of rupiahs)	
PROGRAMME	**Allocation**
I. Infrastructure Expenditure	**7,775.0**
1 Public Works Infrastructure Development	**3,385.0**
a. Flood Control (including Bengawan Solo flooding)	1,000.0
b. Irrigation network rehabilitation for food resilience (South Sumatra, Banten, West Java, Central Java, Yogyakarta, East Java, Maluku, South Sulawesi and Papua)	600.0
c. Extension of water distribution networks and construction of water treatment plants	385.0
d. Accelerated completion of multi-year contracts	1,000.0
e. Inspection routes and irrigation in aquaculture pond production centres	400.0
2. Communications Infrastructure Development	**1,325.0**
a. Construction and rehabilitation of rail links	800.0
b. Additional funding for construction of Kuala Namu Airport	200.0
c. Runway extension and airport rehabilitation	145.2
d. Construction and rehabilitation of ferry ports and wharves	179.8
3. Energy Infrastructure Development	**1,000.0**
a. Power plant and transmission line construction	900.0
b. Energy Self-Sufficient Villages	75.0
c. Drilling for clean water in rural areas	25.0
4. Housing Infrastructure Development	**680.0**
a. Low-Rental Apartment Construction for Military/Police/Workers/Students (40 twin blocks)	480.0
b. Construction of special housing (fisherfolk, border areas and natural resources processing locations)	200.0
5. Construction of Market Infrastructure	**315.0**
a. Market construction for itinerant vendors/Micro and Small Enterprises	100.0
b. Construction of Sample Markets	120.0
c. Construction of synergy markets and supporting markets	15.0
d. Construction of economic corridor markets in Yogyakarta, Sragen, Sleman, Solo, Magelang and Bantul	80.0
6. Infrastructure spending for construction and rehabilitation of farming community road and irrigation infrastructure	**650.0**
a. Roads supporting cultivation in estate production centres	60.0
b. Roads and irrigation for farmers in livestock farming and horticultural centres	125.0
c. Roads and irrigation for farmers in food staple production centres	465.0
7. Improvements to vocational training	**300.0**
a. Skills training by Vocational Training Centres	136.0
b. Improvements to Vocational Training Centre facilities	164.0
8. Rehabilitation of warehouses for storage of staple goods (rice and corn)	**120.0**
II. National Community Block Grant Programme	**601.5**
TOTAL	**8,376.5**

Furthermore, budgeting under energy infrastructure construction programmes will be allocated for (1) construction of power plants and transmission lines; (2) establishment of energy self-sufficient villages; and (3) drilling for clean water in rural areas. Budget allocations for housing infrastructure construction will be used for the construction of 40 twin blocks of low-rent apartments for military/police/employees and students and the construction of dedicated housing for fisherfolk and communities in border regions and natural resource processing locations.

Budget funding for market infrastructure development will be used to (1) build markets in support of itinerant traders/micro and small enterprises; (2) construction of pilot markets; (3) construction of synergy and supporting markets; and (4) construction of economic corridor markets (in Yogyakarta, Sragen, Sleman, Solo, Magelang and Bantul).

Furthermore the budget for construction and rehabilitation of road and irrigation infrastructure for farmers will be allocated for (1) roads supporting cultivation in estate production centres; (2) farming community roads and irrigation in livestock farming and horticultural centres; and (3) farming community roads and irrigation in food staple production centres. Budget funds for improvements to vocational training programmes will be used to provide skills training at Vocational Training Centres and to improve the building facilities at these centres.

Budget allocations for national community empowerment programmes/activities carried forward will be used for the Community Block Grant programmes/activities envisaged in the Fiscal 2008 Budget Approvals that could not be completed before the end of Fiscal 2008, necessitating the carrying over of these activities into Fiscal 2009. The Community Block Grant programmes/activities carried forward consist of Direct Community Aid in programmes for sub-district development, urban poverty reduction, rural infrastructure development and accelerated development in disadvantaged and special regions. The Community Block Grant programme is formulated as a mechanism for poverty alleviation with community participation, ranging from planning to implementation, monitoring and evaluation. The objectives of the Community Block Grant programmes are (1) provision of quality, sustainable, and environmentally-friendly urban and rural infrastructure appropriate to local needs and capacity; and (2) construction of urban and rural infrastructure on a participatory, transparent and accountable basis.

IV. 2009 BUDGET POSTURE AND DEFICIT FINANCING

IV.1 Adjustments to 2009 Budget Posture

In view of the changes in various macroeconomic assumptions with significant bearing on Budget aggregates affecting both revenues and expenditures, the latter in response to the additional stimulus programmes described earlier, the following changes are proposed to the 2009 Budget adopted in Act Number 41 of 2008:

First, a Rp 138.1 trillion reduction is proposed in state revenues and grants from the Rp 985.7 trillion set in the 2009 Budget to Rp 847.7 trillion. This change in revenues and grants is explained by the drop in oil and natural gas revenues and the Pertamina dividend, mainly as a result of the cut in the assumed Indonesian Crude Price (ICP) from US$80 per barrel to US$45 per barrel.

Second, a Rp 52.5 trillion reduction is proposed in state expenditures from the original Rp 1,037.1 trillion adopted in the 2009 Budget to Rp 984.6 trillion. In this reduction, Central Government expenditures are cut Rp 34.8 trillion from Rp 716.4 trillion to Rp 681.5 trillion and transfers to regions by Rp 17.6 trillion from Rp 320.7 trillion to Rp 303.1 trillion.

Despite the substantial overall reductions in state expenditures, the budget expenditure allocations for line ministries/agencies and education are unchanged at Rp 322.3 trillion and Rp 207.4 trillion, as prescribed in the 2009 Budget. This is mainly to ensure that planned activities and programmes are able to proceed on schedule and to improve the rate of budget expenditure absorption, which in turn is expected to provide stimulation for economic activity. In a similar vein, the ratio of education expenditures to total Budget is increased from the 20.0 percent mandated by a Constitutional Court decision and the 1945 Constitution to 21.1 percent.

In regard to Central Government expenditures, the proposed change in the expenditure ceiling is derived from the following: *(i)* Rp 9.0 trillion increase in debt interest payments (8.8 percent) from Rp 101.7 trillion to Rp 110.6 trillion; *(ii)* Rp 43.1 trillion cut in subsidies, consisting of reductions of Rp 36.6 trillion in energy subsidies and Rp 6.6 trillion in non-energy subsidies; *(iii)* Rp 8.4 trillion reduction in other expenditures from Rp 65.1 trillion to Rp 56.8 trillion; and *(iv)* added stimulus funding for labour-intensive infrastructure works at Rp 7.7 trillion.

In the area of energy subsidies, the fuel subsidy will be slashed from Rp 57.6 trillion in the 2009 Budget to Rp 24.5 trillion, while the budget allocation for the electricity subsidy will be trimmed Rp 3.5 trillion from Rp 46.0 trillion to Rp 42.5 trillion. Non-energy subsidies are reduced Rp 6.6 trillion from the former Rp 63.1 trillion in the 2009 Budget to Rp 56.6 trillion. These subsidy reductions are obtained mainly from the lower VAT subsidy for domestic subsidised fuels in keeping with the fuel subsidy reduction gained from the drop in the ICP and lower subsidised fuel prices. Furthermore, concerning the non-energy subsidies, Rp 0.4 trillion in planned in budget allocations for the cooking oil subsidy, medicine subsidy and the interest subsidy for water utility companies.

Changes have been made to miscellaneous expenditures to accommodate an additional Rp 2.8 trillion carried over for election activities and Rp 0.6 trillion carried over from Community Block Grants in 2008. The additional budget for election activities carried forward covers the election preparations not completed by the end of 2008 to permit completion in 2009 to keep the elections on schedule. Similarly, the Community Block Grants carried over from 2008 are direct community aid funds for Community Block Grant programmes, consisting of the subdistrict development programme, urban poverty alleviation programme, rural infrastructure development programme and accelerated development of disadvantaged and special regions carried over from 2008 to 2009 in order to ensure continuity of these activities for accelerated poverty reduction.

Another change in miscellaneous expenditures is a Rp 11.7 trillion (73.9 percent) reduction in reserves for fiscal risk from Rp 15.8 trillion in the 2009 Budget to Rp 4.1 trillion. The change in the fiscal risk reserves is in response to the changes in macroeconomic assumptions for 2009 and reduction in taxation revenues.

At the same time, the budget for transfers to regions is reduced by Rp 17.6 trillion (5.5 percent) from the 2009 Budget allocations at Rp 320.7 trillion to Rp 303.1 trillion. This is to offset the effect of diminished oil and natural gas profit sharing funds (DBH) caused by the change in the ICP assumption from US$80 per barrel to US$45 per barrel. The change in the ICP assumption also has a bearing on the smaller budgeted transfers to regions from the resource-based profit sharing funds from oil and natural gas (DBH SDA migas) and the land and building tax profit sharing funds from oil and natural gas (DBH PBB migas), as these profit sharing funds are based on the outcome of non-tax revenues and land and building tax receipts from oil and natural gas. This change brings the estimated profit sharing funds allocation for 2009 to Rp 68.1 trillion, down Rp 17.6 trillion (20.6 percent) from Rp 85.7 trillion in the 2009 Budget. In contrast, profit sharing funds from tobacco excise have been increased to Rp 1,062.2 billion from the Rp 964.8 billion set in the 2009 Budget, with part of these funds earmarked as support for vocational training centres.

Despite the reduction in budget transfers to the regions, General Allocation Funds (DAU), Special Allocation Funds (DAK) and the Special Autonomy and Adjustment Funds are unchanged. This is because the calculation of these funds reflects the financial needs and fiscal capacity of the regions. The 2009 General Allocation Funds will remain at Rp 186.4 trillion, as these funds are generally allocated within Regional Budgets as payroll expenditures for regional civil servants. In addition, the 2009 General Allocation Funds are calculated by a formula consisting of basic allocation and fiscal gap without allocation of equalisation funds in the General Allocation Funds (Non-Hold Harmless Policy), and therefore reflect the financial needs and fiscal capacity of the regions. In a similar manner, the 2009 Special Allocation Funds are held at Rp 24.8 trillion and are earmarked to support pro poor, pro job creation and pro growth regional development.

In this vein, the Government is working to encourage regional governments to fast track the promulgation of regional regulations on the Regional Budget so that these budgets can be implemented effectively. The timely promulgation of the Regional Regulations concerning the Regional Budget will also accelerate regional expenditures, which in turn will make regional expenditures work more effectively in stimulating the economy at the regional level.

Given the importance of the regions in mitigating the effects of the global financial crisis and in economic development, the Government will maximise its efforts to keep the global economic turmoil from placing excessive burdens on the regions. Even so, regions must also ready themselves with appropriate strategies to deal with the knock-on effects from volatile oil prices and the global financial crisis. Regional budgets should reflect local capacity to finance local needs, so that the paradigm of constantly expanding regional budgets should be considered with great care and begin to take realistic account of regional fiscal capacity. For this reason, it may happen that a regional budget is smaller than for the preceding year, and that regional budget outcomes may fall short of the adopted budget for the current year.

Added to this, accelerated realisation of regional government expenditures must be matched by improved quality in regional budgeting. Measures taken to improve the quality of regional budgets include performance-based budgeting, budgeting within the medium-term development framework and accountable reporting systems. The formulation and appropriation of budgetary transfers to regions within Regional Government Budget must remain focused on achievement of regional development goals. The Central Government and regional governments have the responsibility to work in synergy to rectify and improve the quality of decentralised fiscal management.

Third, an increase is proposed in the 2009 Budget deficit beyond the previously approved Rp 51.3 trillion (1.0 percent of GDP) to Rp 136.9 trillion (2.6 percent of GDP). The increased deficit is not expected to disrupt fiscal sustainability in the long term, given that most of the added deficit will be financed from unused budget financing (SILPA) left over from 2008.

Fourth, with the increased deficit target in the 2009 Budget, the budget financing target has been adjusted upwards from the originally agreed Rp 51.3 trillion to Rp 136.9 trillion. This amended financing target for the 2009 budget is derived from *(a)* added Rp 49.2 trillion financing from the domestic banking system, taken from the additional appropriation of Rp 49.2 trillion in unused budget expenditures carried over from 2008; *(b)* Rp 4.4 trillion increase in drawdown of program loans, up from the originally agreed Rp 26.4 trillion to Rp 30.8 trillion; and *(c)* additional debt financing at Rp 44.5 trillion. Furthermore, the changes to the budget financing take into account the added Rp 2.0 trillion state equity injections for the Jamkrindo and Askrindo loan guarantee institutions and export guarantees and a Rp 10.5 trillion increase in external debt principal instalments.

Table 13 2009 BUDGET POSTURE (trillions of rupiahs)		
	Budget	**Projection**
A. REVENUES AND GRANTS	**985.7**	**847.7**
I. DOMESTIC REVENUES	**984.8**	**846.7**
1. Taxation Revenues	725.8	660.9
2. Non-Tax Revenues	258.9	185.9
II. GRANTS	**0.9**	**0.9**
B. STATE EXPENDITURES	**1,037.1**	**984.6**
I. CENTRAL GOVERNMENT EXPENDITURES	**716.4**	**681.5**
- Line Ministry/Agency Expenditures	322.3	322.3
- Non Line Ministry/Agency Expenditures	394.1	359.2
II. TRANSFERS TO REGIONS	**320.7**	**303.1**
C. BUDGET SURPLUS/DEFICIT (A - B)	**(51.3)**	**(136.9)**
% deficit to GDP	***(1.0)***	***(2.6)***
D. FINANCING (I + II)	**51.3**	**136.9**
I. Domestic Financing	**60.8**	**108.0**
II. External Financing (net)	**(9.4)**	**(15.6)**
III. Additional Debt Financing	**0.0**	**44.5**

IV.2 Adjustments to 2009 Financing Targets

In regard to financing, the change in the exchange rate assumption from Rp 9,400/US$ to Rp 11,000/US$ automatically brings changes in the external financing component. On one hand, more funds are received from drawing on program loans, but on the other, there is increased spending for principal instalments on external debt. In net terms, the change in the exchange rate assumption means that external financing is diminished by Rp 6.1 trillion. If the reduction in external financing is combined with the increased fiscal deficit, the additional required Budget financing comes to Rp 91.7 trillion. Due to the size of the added financing, adjustments have been made to the existing financing sources by utilising existing available financing and seeking new financing sources. After careful calculations, most of the additional required Rp 91.7 trillion financing will be covered by Rp 49.2 trillion increase in unused 2008 Budget expenditures from the originally projected Rp 2.1 trillion to Rp 51.3 trillion. The unused 2008 Budget expenditures are an added accumulation of unused cash funds in the Government account resulting from a substantial excess of state revenues and financing receipts over expenditures for the state and for financing. This leaves a Rp 42.5 trillion gap in financing for which additional debt will be sought beyond the originally planned borrowing level. However, because Rp 2.0 trillion of the fiscal stimulus programme will be used in Community Block Grants, the additional new borrowings come to Rp 44.5 trillion.

All efforts will be taken so that the added borrowings are raised through issuances of negotiable and non-negotiable government securities in rupiah and foreign currencies sold to both domestic and foreign investors, provided that market conditions remain conducive. In view of the current adverse conditions on world financial markets and at home, there are concerns that these issues of Government Securities may not deliver optimum results. This is explained by the increasingly limited buying demand from investors due to the economic slowdown that has led to diminished investing capacity and a liquidity crunch and the many countries in the world taking on added debt to rescue their economies and deliver a fiscal stimulus. Issues of Government Securities must also take account of the needs of the business/corporate world to refinance existing debt in order to prevent a crowding-out effect on financial markets that could lead to even greater difficulty in soliciting financing on the market and drive up the cost of funds.

To anticipate this, the Government has held intensive talks with conventional creditors from multilateral institutions and/or bilateral creditor nations to provide back up in the form of standby loans, should it not be possible to issue an optimum volume of Government Securities. So far, several creditors have committed themselves to supporting the financing needs for 2009 in order to deliver a fiscal stimulus by means of the standby loan mechanism. Creditors ready to extend standby loans with commitments reaching US$5.0 billion include the Asian Development Bank (ADB), World Bank (WB), Australia and Japan, via the Japan Bank for International Co-operation (JBIC). This represents the total commitment available for back up use over a period of 2 years, covering 2009 and 2010. If these funds are not fully drawn in 2009, the commitments may still be used as backup until 2010.

This standby loan support may comprise loans that may be draw only if debt financing from issuance of Government Securities cannot be raised as agreed in the quarterly plan and also guarantees for issuance of Government Securities on the international market and most importantly on the market in Japan. Concerning drawdown, at the end of each quarter, the Government will hold consultations with creditors on the amount of loan funds to be drawn. Drawing of funds from each lender will be adjusted pro rata according to individual commitments made.

Table 14
DEBT AND NON-DEBT BUDGET FINANCING, 2009
(Trillions of rupiahs)

Description	Budget	Projection
A. BUDGET SURPLUS/(DEFICIT)	**(51.3)**	**(136.9)**
B. FINANCING	**51.3**	**136.9**
1. Non-Debt	**6.1**	**53.2**
2. Debt	**45.3**	**83.7**
a. Government Securities (net)	54.7	54.7
- Issuance	99.6	99.6
- Matured Principal	(44.9)	(44.9)
b. Net External Borrowings	(9.4)	(15.6)
- Drawdown on Foreign Loans	52.2	56.5
- Program Loans	26.4	30.8
- Project Loans	25.7	25.7
- External Debt Principal Instalments	(61.6)	(72.1)
c. Additional Debt Financing	0.0	44.5

Source: Ministry of Finance