

2008 Annual Strategy Note for the Public Financial Management Multi Donor Trust Fund (PFM MDTF)¹

Introduction

1. Public financial management and revenue administration reforms continue to enjoy the highest political support and priority of our government. Their implementation is critical to overall development and to harvest the full gains of the favorable fiscal conditions in which we find ourselves after the past years of fiscal consolidation. Development success depends on the quality of public administration and good governance. The effectiveness and performance of the systems that we use to manage state finances are at the core of today's governance challenges.

2. Our reform agenda remains broad reaching from the administration of revenue collection to the budgeting, implementation, accounting and auditing of expenditures. These reforms are designed to improve how revenues are raised, how funds are allocated, used and accounted for. The trust fund is well positioned to support us in this regard and has been effectively utilized to mobilize flexible and responsive support across the wide range of reforms over the past year. By bringing together key development partners - the European Commission, the Government of the Netherlands and the World Bank - the trust fund provides a vehicle for effective and coordinated engagement that is reinforcing our agenda and is helping us achieve progress towards our goals.

Reform Progress in 2007

3. In the annual strategy note 2007 we identified three priority areas, (1) Reforms of the budget preparation and execution processes, and the implementation (2) Modernization and reform of revenue administration including improved services to the business community and good governance, and (3) Strategic management of the government's public financial management and revenue administration reform agenda. During 2007 we have made progress across these three areas.

4. State expenditures are gradually adopting an integrated budgetary system, which is performance-oriented and has a medium term dimension. Underpinning our commitment to the implementation of a modernized budget system, we have established a structural unit in the DG budget that is charged with developing improved procedures and systems and driving further change in the years ahead. With the 2008 budget we have introduced forward estimates for aggregate revenue and expenditure categories as a first step to develop a Medium Term Expenditure Framework (MTEF). The 2008 budget also elaborates on expenditure policies and specified expected outputs of our most critical spending programs. Treasury modernization has made headway with the pilot

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introduction of simplified and accelerated business process for the settlement of payment orders in selected treasury offices (KPPN Percontohan). This year we also saw the enactment of the Cash Management Regulation that provides the needed legal underpinning for the Treasury Single Account and especially the ability to bring into compliance off-budget accounts (the legal right to close existing accounts and prior MoF approval to open new ones). We have continued the expansion and extension of the Treasury Single Account, and in October the system was expanded to cover all expenditure accounts of all treasury offices in the country with the revenue side to follow soon.

5. At the same time the reform of revenue administration is gaining momentum. Reform of the tax administration is needed to sustain and expand the gains in revenue collection achieved in recent years and to mobilize the funds necessary for critical investments in infrastructure, social services and development. This year has seen the completion of the re-organization of our tax headquarters. We established structural reform units to implement re-engineering of business processes, modernization of IT systems and human resource reforms. We also implemented the roll out of modernized tax offices specialized on medium and small tax payers, and resolved the long standing issue of unpaid VAT refunds by settling the payment of claims from previous fiscal years. We are also moving forward on the design and implementation of a National Single Window that will provide a single electronic entry point for import and export clearances which will greatly reduce costs of trade transactions for businesses and boost foreign trade. This step is also critical to fulfilling our commitments in the ASEAN Single Window process.

6. With regard to overall reform management we have established a structural unit under the Secretary General's Office, the Center for Policy Analysis and Harmonization (PUSHAKA), which serves as the Minister's delivery unit in charge of monitoring Minister of Finance key policy implementation and the key performance indicators of all echelon I units within the Ministry. The Ministry has also spearheaded civil service reforms to create better performance incentives and institutional design in the civil service. We have already initiated the organizational transformation required for modernizing the Ministry of Finance in the years ahead, including further separation of policy and implementation functions. We are strongly committed to modernize the Ministry of Finance to further enhance our role in the formulation of economic and fiscal policies that allow our country to respond to the challenges and make use of the opportunities of this era of globalization.

7. A number of our reform achievements were supported by contributions from the trust fund. While reforms need to be driven by the political and technical leadership within the government, external inputs based on international best practice and tailored to the unique circumstances of Indonesia can lead to better reform outcomes. The trust fund provided key advisory services to support the development and piloting of a feasible approach to the implementation of the MTEF and performance oriented budgeting, as well as on the preparation of our statement of fiscal risks in the 2008 budget. We also successfully engaged in the area of overall reform management and the trust fund

supported a benchmarking study of the newly established PUSHAKA against ministerial delivery units in the United Kingdom. In the tax area, support was provided to install an optimized process for our VAT administration, and we engaged consulting services with regard to design of the national single window that we are planning to roll out in 2008.

8. Lastly, we appreciate the conclusion of the Public Expenditure and Financial Accountability Assessment 2007 (PEFA). The results of the assessment indicate progress and effectiveness of the on-going PFM reform program, but also point to areas where progress needs to be accelerated in the coming years. We see delivering such analytical products as a key strength of our development partners.

PFM MDTF priorities for 2008

9. Reforms of public financial management and revenue administration systems continue to be a key element in our overall development agenda. Their implementation is critical to yield the full potential of the favorable fiscal conditions which have resulted from the past years of fiscal consolidation and reform. We intend to deepen the reform measures initiated in the past year, and outline continued advisory services, technical assistance, training, workshops, surveys and benchmarking studies from the trust fund with particular emphasis on the following areas:

- a. Revenue Administration Reforms to increase tax revenue and enhance the business climate, with emphasis on the following:
 - i. preparations for the implementation of the Project for Indonesia Tax Administration Reform (PINTAR) which will be funded by an investment loan from the World Bank in support of structural reforms of the tax administration, to encompass:
 - a) the development of operational specifications;
 - b) formulation of an action plan; and
 - c) preparation of procurement documents for the implementation of PINTAR.
 - ii. continue to work on the realization of further quick wins that will complement the preparations for PINTAR, with emphasis in the following areas:
 - a) advisory services on tax gap analysis, study on expansion of tax bases, compliance cost survey, taxpayers benchmarking, profiling and mapping;
 - b) tax services, including call center comparative study;
 - c) re-engineering of business process and modernization of IT systems, including data processing center; and
 - d) tax compliance, including high-wealth individuals management, and VAT administration reform.
 - iii. implementation of the National Single Window (NSW) for importers and exporters.

- b. Modernization of the budget preparation, budget execution and treasury management processes and systems, including:
 - i. strengthening the linkage between budget allocations and policy priorities;
 - ii. continuing the move towards a more comprehensive implementation of the MTEF and a performance oriented budget;
 - iii. continue strengthening the capacity of the DPR Budget Committee on budget analysis and oversight of budget execution;
 - iv. strengthening internal controls as well as the timeliness and reliability of accounting data to meet international benchmarks;
 - v. expediting preparations for the implementation of the new budget and treasury system (SPAN/) and related changes in the budget and treasury business processes; and
 - vi. capacity-building for the Ministry of Finance and pilot agency personnel involved with the SPAN.
- c. Civil service reforms and organizational reforms of the Ministry of Finance, to encompass:
 - i. benchmarking against international best practices in terms of the organization and business process in other countries;
 - ii. Ministry-wide human resource management capacity building; and
 - iii. continued support for program governance and overall implementation of the PFM reform strategy.

10. We envision that our PFM-MDTF Donor's share our reform priorities and that we will be able to work together to translate these priorities into a tangible and result oriented work program funded by the trust fund. We would like to reiterate our sincere gratitude towards this program, in particular towards the European Commission, the Government of the Netherlands for their financial support and the World Bank for the administration of the trust fund, and we look forward to our continued cooperation and partnership.